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What's Next in the U.S.-China Strategic Competition

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U.S. and Chinese officials are to meet again Thursday to continue trade negotiations. But, even if an agreement is reached on tariffs and market access to China, don't be deceived: Beneath the surface, there are greater forces pulling the countries further apart.

Beyond the "trade war," the U.S. and China are engaged in a broader strategic competition, including over technology, motivated by concerns that China is closing the gap with the U.S. in advanced technologies, such as 5G, that have significant national security as well as commercial implications. In the coming days and weeks, the Trump administration is set to respond to Congress — or otherwise take affirmative steps — on a variety of trade-related issues, all of which will impact the trajectory of the "trade war" and the broader strategic competition between the U.S. and China. Here are three developments to watch:

1. Hong Kong: The End of Preferential Trade Status?

For the first time (since the handover in 1997), Congress is actively considering whether Hong Kong should continue to receive preferential treatment for U.S. export-controlled products and technology that would otherwise require a license when destined for mainland China.

Legislation introduced in both chambers of Congress mandates that the U.S. Commerce Department report annually on China's efforts to use Hong Kong to evade U.S. export controls and economic sanctions. Additionally, a bipartisan group of Senators sent a letter to Secretary of Commerce Ross and Secretary of State Pompeo asking whether U.S. export controls in relation to Hong Kong "are sufficient to safeguard U.S. interests."

In 2017, the Commerce Department imposed a requirement that, before a U.S. export-controlled item could be reexported from Hong Kong, the party seeking to undertake that transaction had to obtain a license from the Hong Kong government if it were required, or obtain a written statement from the Hong Kong government that a license was not required. The agency's response to the letter, which is expected shortly, should indicate the degree to which the rule will be enforced vigorously by the Commerce Department to gather intelligence on such reexports and secure commitments from Hong Kong to prevent U.S. technology from being diverted to China.

2. Securing the U.S. Technology Supply Chain

In October, the Commerce Department is scheduled to publish regulations implementing the President's May 15, 2019, Executive Order on Securing the Information and Communications Technology Supply Chain, which may be effective immediately. On its face, these rules appear aimed at keeping products from Chinese companies like Huawei and ZTE out of the U.S. technology ecosystem. However, the Executive Order goes much further and will likely have a reach outside the U.S.

The Executive Order's authorizing statute, which also underpins most U.S. economic sanctions, permits the Executive Order to be applied extraterritorially and impact the conduct of companies worldwide, similar to how sanctions on Iran extend to subsidiaries of U.S. companies globally.

Secretary Ross has suggested that China itself might be designated a "foreign adversary" on the basis that Chinese communications and technology companies developing and implementing 5G networks poses an unacceptable risk to U.S. national security. That designation would make it possible for such Chinese companies to be targeted generally. Moreover, the Executive Order extends to parties subject to the jurisdiction of a foreign adversary, meaning any company operating in China may fall within its reach as a matter of U.S. law, even those based in other countries.

Notably, the Executive Order adopts as a grounds for control the fairly discretionary standard of what poses an "unacceptable risk" to U.S. national security, granting the U.S. government-wide latitude in choosing whom and what to act against.

3. Controlling Access to Emerging Technologies

Even if an interim trade deal resulted in the U.S. easing the current export ban on Huawei, there is a larger effort underway to restrict China's access to leading-edge technologies.

By the end of the year, the Commerce Department is scheduled to issue rules on the export of "emerging technologies," including artificial intelligence, robotics, and quantum computing, some of which will go into immediate effect. Though the restrictions are not directed at China only, their clear impetus is Congressional concern over China's targeting of such technologies through investment in and acquisition of U.S. companies, as part of its "Made in China 2025" program.

Imposing such restrictions could mean that sales and services provided to certain customers or markets, or the contracting with or employment of certain foreign entities or nationals, may be prohibited without prior authorization. They may also impact other types of transactions, including M&A, minority investments, joint ventures, licensing arrangements and collaboration with multinational enterprises.

The Great Decoupling

It seems increasingly difficult to imagine a trade agreement reached in the near-term that could resolve the profound differences between the U.S. and China sufficient to blunt the momentum of the larger forces pushing them apart.

What lies ahead for companies is an increasingly complex U.S.-China landscape to navigate, with regulatory headwinds blowing in the world's two most important markets. In addition to the obvious geopolitical dimensions of the current situation, these developments will complicate business planning, increase enterprise risk and make value chains more vulnerable.

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