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Containing China

The Chinese character for China depicts a place between heaven and earth, at the center of the universe, and, for 5,000 years, China has viewed itself as the leading power on earth in terms of the quality of its civilization. The United States and other countries must keep this worldview in mind as they seek to contain China's quest for global domination.

China continues to run a non-market-oriented economy. It provides heavy subsidies to its state-owned enterprises, dumps its exports unfairly, manipulates its currency, appropriates U.S. intellectual property, including patents, copyrights, and trademarks, and, most devastatingly, uses the Internet to seize an almost insurmountable advantage in the world of electronic commerce.

Most of the press coverage in the United States of U.S.-China trade issues has been about tariffs the United States has applied against China pursuant to Section 301 of the Trade Act of 1974, which allows the president to take all appropriate actions to counter the unfair acts, practices or policies of a foreign government. The containment of China, however, must be multi-dimensional, focused not only on tariffs, and played out by both Congress and the Executive Branch. Section 301 is but one tool in the U.S. arsenal of possible responses to China's quest for global influence as a rising power. The problem with the Trump Administration's Section 301 complaint against China is that, while its objective is correct - reducing our one-sided trade relationship with China - there is no well-defined overall policy of containment. Several steps have been taken thus far, but much more needs to be done. The purpose of this article is to outline an ongoing strategy of containment that the United States should use to counter China's behavior in the marketplace.

II. Promotion of U.S. foreign investment: The BUILD Act

China's Belt and Road Initiative has as its goal the creation of a new silk road for Chinese trade and investment throughout the developing world. Containing China requires a commitment to counter this initiative by supporting U.S. investment in infrastructure in emerging markets. A major step was taken in this direction on Oct. 5, 2018, when President Trump signed into law the Better Utilization of Investments Leading to Development (BUILD) Act of 2018, which creates a new foreign aid agency: the United States International Development Finance Corporation (IDFC). This largely overlooked legislation consolidates the Development Credit Agency (DCA) of the U.S. Agency for International Development with the Overseas Private Investment Corporation (OPIC) and triples the financing authority of OPIC from $22 billion annually to $60 billion. The IFDC has the authority to provide loans, loan guarantees and insurance to companies willing to do business in developing nations.

The drafters of the BUILD Act have made clear that its intent is to counter China's drive towards global dominance by providing an alternative to "state-directed investments by authoritarian governments," an obvious reference to China and its growing overseas aid. As Senator Bob Corker, the chairman of the Senate Foreign Relations Committee, stated, "We're seeing what China is doing throughout Africa and South America ..., and people are waking up and realizing we have to have involvement with the countries, not just for a return on investment, but to move them toward a market-based approach."

The BUILD Act provides the resources for the United States to launch an ambitious program of infrastructure and low-carbon technology across the emerging world, which will be an effective counter to China's Belt and Road Initiative.

III. Restrictions on inward foreign investment: CFIUS reforms

The second element of containment is to sharply limit, through U.S. government intervention, Chinese investment in the United States that is a threat to U.S. national security. It is appropriate to be skeptical of China's investments in the United States in light of its predatory, mercantilist behavior, and recently documented Chinese-government-directed hacking of U.S. government agencies and private industry. The challenge here is to maintain the balance between the desire for commercial engagement with China and the need to check China's quest for technological supremacy. As Assistant Attorney General John Demers has stated, "China wants the fruits of America's brainpower to harvest the seeds of its planned economic dominance."

Reviews of foreign investment in the United States are undertaken by the Committee on Foreign Investments in the United States (CFIUS), a federal inter-agency committee chaired by the Secretary of the Treasury. CFIUS national security reviews are usually conducted before foreign investment is undertaken, at the request of the foreign investor. However, the U.S. Government can undertake a CFIUS review after the foreign investment is made and unravel the transaction.

On Aug. 13, 2018, President Trump signed the Foreign U.S. Investment Risk Review Modernization Act (FIRRMA) to expand the U.S. government's power to review investments from foreign countries. This legislation is a direct response to China's efforts to obtain U.S. technology through mergers, acquisitions and takeovers.

There are three principal reforms under FIRRMA. First, the CFIUS inter-agency committee will now review proposed purchases of minority shareholding interests of U.S. companies. This is a significant shift in policy, which had permitted CFIUS reviews only of majority, or control, purchases. Second, the Committee's jurisdiction now specifically includes real estate transactions located in an area adjacent to ports or near military installations or other sensitive U.S. government facilities. This was implicit in prior CFIUS legislation but has now been made explicit. Third, the bill expands CFIUS's jurisdiction to include any investment by a foreign person in a U.S. business that (1) owns, operates, manufactures, supplies or services critical infrastructure; (2) produces, designs, tests, manufactures, fabricates or develops critical technologies; or (3) maintains or collects the sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security. Covered investments subject to CFIUS review include investments that afford a foreign person (1) access to material nonpublic technical information; (2) membership or observer rights on the board of directors of a U.S. business; or (3) involvement in decision-making regarding the sensitive personal data of U.S. citizens, critical technologies or critical infrastructure.

Investments in U.S. businesses by a foreign person through an investment fund as a limited partner are permissible, assuming the fund is managed by a general partner who is not a foreign person and the foreign person does not have the ability to control the fund or its investment decisions.

The net effect of FIRRMA is that investors from China, or any other foreign country, will have to thread a very narrow needle in order to invest in a critical U.S. technology or infrastructure. FIRRMA would appear to permit such investment only if the foreign investor is a minority, non-control, passive investor in a fund managed by a U.S. entity as the general partner.

IV. Tax reform

The third element of containment is international tax reform. America's economic power is diminished

and China's enhanced when U.S. companies invest in China instead of the United States. The trend of outsourcing with foreign subsidiaries in China has been encouraged, however, by the U.S. tax policy of deferral of foreign source income that is earned by foreign subsidiaries.

This issue was addressed with the passage of the Tax Cuts and Jobs Act of 2017, U.S. federal tax legislation that entered into force on Jan. 1, 2018. By reducing the corporate rate of taxation from 35 percent to 21 percent, the new U.S. international tax policy will discourage direct foreign investment by U.S. enterprises. This move should significantly increase investment in the United States, and reduce imports from China, as currently an estimated 30 percent of all imports from China are imports from Chinese affiliate companies to U.S. parent companies.

V. Tighter export controls

The fourth element of containment should be the use of America's export control program to limit the transfer of U.S. advanced technology to China.

High-end technology has emerged at the center of the U.S.-China trade war. The stated objective of China's Made in China 2025 program is to make China a major competitor in advanced manufacturing. That program involves government subsidies, heavy investments in research and innovation, and targets for local manufacturing industries. Through these means, China plans to dominate leading-edge industries like electric cars, robotics and artificial intelligence.

President Trump has pushed China to drop these plans and to limit transfers of advanced U.S. technology that would support the Made in China 2025 program. On Nov. 22, 2018, the U.S. Department of Commerce called for public comments on whether a list of new technologies that would have national security implications, from artificial intelligence (AI) to microprocessors and robotics, should be subject to more stringent export control rules. The AI technologies that will be considered for tighter controls include technologies such as neural networks, deep learning, computer vision, natural language processing, and audio and video manipulation.

and therefore should be carefully controlled through stringent U.S. export controls. Tighter export controls, however, would affect U.S. manufacturers as well as purchasers in China, since AI is a key element of many computer products made by U.S. tech firms, including smartphones, connected speakers and self-driving cars. Moreover, many high-tech products are used for both military and civilian purposes.

Unfortunately, both U.S. export controls and possible Chinese retaliatory tariffs could increase the costs for U.S. exporters of components and reduce competitiveness of U.S. manufacturers across a range of high-tech sectors. Therefore, export controls need to be very carefully calibrated in order to preserve the competitive position of U.S. exporters in the world marketplace.

VI. Tariffs and the current trade war with China

The fifth step that needs to be undertaken is an effort to defuse the escalating trade hostilities between the United States and China. More than half of Chinese imports now face punitive import tariffs. The tariff rate on $200 billion of Chinese imports was set to climb from 10 percent to 25 percent on Jan. 1, 2019, and President Trump threatened on Sept. 17, 2018, to "immediately" place tariffs on another $267 billion worth of imports "if China takes retaliatory action against our farmers or other industries." Tariffs are a tax on U.S. consumers and it is not at all clear that additional U.S. duties will work to disrupt China's industrial development through its Made in China 2025 program.

Fortunately, a major thaw in the tariff war with China occurred at the G20 meeting in Buenos Aires on Dec. 1, 2018, when President Trump decided not to raise tariffs on $200 billion of Chinese imports from 10 percent to 25 percent on Jan. 1, 2019, as had earlier been threatened. In return, President Xi Jinping of China agreed to "immediately" begin discussions on China's industrial policies, including its coercive licensing of U.S. technology, trade secret theft and nontariff barriers to trade. The agreement has a 90-day deadline for review, which will occur on March 1, 2019. It remains to be seen whether China will live up to its undertakings, and whether the United States will be

VII. Conclusion

The objective of U.S. trade policy should be the containment of China, which must be undertaken through patient, persistent pressure on a variety of fronts. President Trump has said that trade wars are easy to win, and he believes he can wreck the Chinese economy, as Reagan outspent the USSR on defense. He is wrong. While the pace of Chinese economic growth has fallen by half since 2007, China is not the Soviet Union Reagan faced down in the 1980s, any more than it is Japan in 1941, desperate for the oil that President Roosevelt embargoed. It is large enough to supply itself with most of what it needs to survive. Furthermore, the Korean War demonstrates that when China feels its vital interests are being threatened it can and will lash out at the West with devastating consequences.

China's name for the United States is Meiguo, the beautiful country. The history of China's relationship with the United States is one of hope followed by disappointment, but at the end of the day the Chinese people still view America as the beautiful country.

The result has been interdependence, and an entangling embrace that neither can quit. As John Pomfret has pointed out, the relationship between the United States and China "is powered by love and hate, contempt and respect, fear and awe, generosity and greed."

The only constant in international relations is change, and it is the job of statesmen to manage change for the better. The relationship between the United States and China has permanently changed. China is no longer a developing country, entitled to undertake one-sided policies counter to the interests of the United States. It is a rising power that needs to be contained within the norms of a rules-based system. Critics have noted that thus far President Trump has not demonstrated that he has either the foresight or the discipline required to carry out the patient, persistent policy of containment outlined in this article. But Trump will not be president forever. While he remains in office, the elements of containment described herein must remain the order of the day.

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