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China Investment and Competition State-of-Play

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<p>OVERVIEW</p>	<p>In today’s political landscape, it is challenging to find areas of agreement between parties, where each side not only wants the same outcome, but can also agree on a strategy on how to get there. One area that bucks this trend is China. In fact, US-China relations, at a high level, may be one area where the transition between the Trump and Biden Administration was actually quite steady, largely because the changes were negligible. The sanctions policies were left in place, the commitment to Taiwan has been maintained, and key officials rarely leave any question of their skepticism of China’s intentions. With this US-China relations continue to deteriorate as we navigate the 2024 election cycle.</p> <p>In 2023 alone, we have seen frequent action related to China, which will continue heading into an election year given the easy political optics and bipartisan opportunities it currently represents. Key examples have included the creation of the Select Committee on the Chinese Communist Party in the House with significant bipartisan support, outbound investment provisions included in the Senate’s NDAA on a 92-6 vote while others were simultaneously proposed by the Administration, and countless other proposals addressing common concerns related to China. We will cover all of these latest actions, as well as a review of other recent legislative and administrative actions impacting US-China relations and identify some key themes we believe will persist no matter which party occupies the White House or controls Congress come 2025.</p> <p>This deterioration in US-China relations has also had a real impact on how companies operate and navigate the global economy. Just this month, the Department of Commerce (Commerce) reported that imports from China fell 25 percent during the first half of 2023. This has largely been viewed as an effort to de-risk and diversify supply chains. US companies are experiencing increased scrutiny of their ties to China, whether it be in the form of investments, supply chains, partnerships, and more, while politicians are emboldened by the limited political risk that comes with anti-China rhetoric.</p>
<p>OUR VIEW</p>	<p>With tensions showing no signs of easing, we expect US-China relations to be an issue ripe for bipartisan collaboration. This includes the implementation of the Administration’s EO on outbound investment following the comment period, the inclusion of outbound investment provisions in the final version of the FY24 NDAA, and the advancement of additional bipartisan measures intended to incentivize America-first investments and actions. Additionally, as we move through the 2024 election cycle, it should be expected that Members and hopeful candidates will not hesitate to criticize their opponent, the opposing party, or even private companies on issues related to China. With this, it is more important than ever that companies are monitoring the proposals currently advancing in DC to ensure they do not run afoul of emerging restrictions.</p>
<p>OUTBOUND INVESTMENT EXECUTIVE ORDER</p>	<p>Overview</p> <p>On August 9th, President Biden issued an Executive Order (EO) focused on outbound investments to China in an effort to address national security concerns. What some have referred to as “reverse CFIUS,” this proposal was framed as a “small yard, high fence” approach intended to complement existing export controls and inbound investment screening tools (CFIUS). Following this EO, the Department of the Treasury (Treasury) began the rulemaking process</p>

with the issuance of an [ANPRM](#) to solicit public comment on the rule and address specific questions. The order will prevent US investments into semiconductors and microelectronics, quantum information technologies, and artificial intelligence sectors, with the intent of preventing US capital from supporting China’s military ambitions and threatening US national security.

Details

The Administration consistently focused on framing this proposal as a narrowly tailored “national security action, not an economic one.” With this, the details of the proposal shed more light on the focus of the proposal:

- Requires US persons to provide notice of covered transactions involving China to the Treasury (notifiable transactions), while prohibiting others (prohibited transactions).
- “Covered national security technologies and products” – sensitive technologies and products in semiconductors and microelectronics, quantum information technologies, and artificial intelligence sectors, critical for military, intelligence, surveillance, or cyber-enabled capabilities.
 - Determined in consult with the Secretary of Commerce and other relevant agency leadership.
- “Country of concern” – only references the People’s Republic of China (PRC).
- “Excepted Transaction” includes publicly traded securities; investments in index funds, mutual funds, ETF’s and similar investment companies; investing as a limited partner (LP) into a VC fund, PE fund, fund of funds, or other pooled investment funds.
 - LP investments must be solely capital, and the LP cannot participate in managerial decisions or investment operations.
- Will apply to new investments effective after the rulemaking process is complete, but Treasury would like notice of potentially covered investments in the meantime.

Notable Reactions

Reactions to the proposal have been mixed, with most supporting the tailored nature of the proposal, while recognizing that they will be watching to evaluate the rule when it reaches its final form. Senate Banking Committee (SBC) Chair Brown (D-OH), [called](#) on the Administration to “swiftly” implement this order to ensure that “US corporate investment doesn’t help China develop technology that will be used against us.”

In the House, some of the key Republican committee chairs provided more nuanced reactions. House Foreign Affairs Committee (HFAC) Chair McCaul (R-TX) [said](#) he was pleased by the direction of the action, but expressed concern that it failed to “include existing technology investment as well as sectors like biotechnology and energy.” House Select Committee on the Chinese Communist Party Chair Gallagher (R-WI) stated that the EO was “a small step in the right direction” while criticizing loopholes that do not “address the passive flows of US money into malign CCP-affiliated companies.” House Financial Services Committee (HFSC) Chair McHenry (R-NC) and Rep. Luetkemeyer (R-MO) issued a statement supporting the “more thoughtful and targeted approach than initially reported, that will not “undermine bedrock American principles, including the free flow of capital.” This followed a May [letter](#) from Chair McHenry to Treasury Secretary Yellen, requesting more information on the rumored EO and expressing significant concerns about an overly broad approach that expands CFIUS instead of “comprehensively using export controls or sanctions.”

Currently, industry reaction has been subdued as many digest the details of the proposal and prepare their formal comments. That said, there seems to at least be a sense of relief with the narrower scope of the proposal and avoiding a full-on CFIUS-style process for all outbound China investment. The industries with the greatest concern are likely the VC space, where early-stage investments in the covered technologies will be more significantly impacted.

	<p>China’s Response</p> <p>China’s reaction was swift and strongly condemn the measure but did not immediately announce counter measures. The Chinese Foreign Affairs Ministry called the EO “blatant economic coercion and technological bullying.”</p> <p>While not explicitly linking it to the EO, China’s State Council issued guidelines on August 13th to further optimize the country’s foreign investment environment and attract more foreign investment. The materials released outlined 24 principles, some of which demonstrated an effort to address, at least in a messaging sense, some of the concerns that have led to scrutiny, tariffs, and reconsideration of supply chains. This includes principles on increased protections of rights and interests of foreign investors, including intellectual property (IP) rights, as well as a commitment to explore a “convenient and secure management mechanism” for cross-border data flows. The announcement also included guidelines for fiscal support and tax incentives.</p> <p>What to Watch</p> <p>As the comment period unfolds, we will be monitoring submissions from key industries, Additionally, we will have a better understanding of the relevant political pressures following a more fulsome understanding of stakeholder perspectives, which could impact the final rule and timeline. At a minimum, the ongoing NDAA legislative process will have an impact on the narrative around outbound China investment, before considering the ramifications of the NDAA proposal (covered below). Either way, anti-China provisions and actions are politically popular in both parties, making any effort to challenge increased scrutiny, even when arguing over approaches to reach the same objective, will be challenging.</p> <p>Beyond the DC response, those with existing ties and investments in China will want to pay attention to how China’s response unfolds and if they announce any retaliatory measures beyond the State Council’s push for foreign investment. Also, the stated efforts to coordinate these outbound investments review processes with allies, something the Administration is already working on, is likely to proceed slowly but could further impact outbound investment. Current efforts to align interests include working with the G7 and EU to coordinate related programs.</p>
<p>NDAA OUTBOUND INVESTMENT PROVISIONS</p>	<p>Overview</p> <p>The National Defense Authorization Act (NDAA) is the annual budget and authorization bill related to the financing of the US Department of Defense (DOD) and all major national security priorities. Because of this, it is no surprise that the FY24 NDAA package currently under consideration on Capitol Hill includes China related provisions. Prior to leaving town for August recess, both the House and Senate passed their respective versions of the FY24 NDAA and will reconcile the differences between the two once Members return to DC in September. Of the various provisions and differences between the two packages that will have to be reconciled, there is a significant outbound investment provision in the Senate version that will receive attention, particularly on the heels of Biden’s EO.</p> <p>When the NDAA was pending in the Senate, a bipartisan outbound investment screening proposal was adopted as an amendment with a strong bipartisan vote of 91-6. The Senate proposal, formally, the Outbound Investment Transparency Act of 2023 (OITA), sponsored by Sens. John Cornyn (R-TX) and Bob Casey (D-PA), scales back the more expansive National Critical Capabilities Defense Act (NCCDA) which Sens. Cornyn and Casey first introduced in 2021, along with a House counterpart led by Reps. Rosa DeLauro (D-CT), Bill Pascrell (D-NJ), and Brian Fitzpatrick (R-PA). The House version of the NDAA, passed earlier in July, did not include any outbound investment provisions and Rep. Barr (R-KY) is working with the HFSC to prepare a competing bill that would strengthen existing US sanctions authorities, rather than set up a notification regime.</p> <p>The full text, bill report, funding tables, and an executive summary of the Senate FY24 NDAA can be found here and the full text and summary of the House FY24 NDAA can be found here.</p>

Outbound Investment Transparency Act (OITA) – NDAA Amendment Proposal

OITA was attached to the Senate NDAA by an overwhelming bipartisan vote of 91-6, but it remains unclear whether the amendment will survive the conference process with the House, given some House Republicans' criticism of the amendment's scope and lack of an investment blocking mechanism. The amendment involves a more narrowed scope than the NCCDA, also led by Sens. Cornyn and Casey, following opposition from lawmakers, including SBC Ranking Member Scott (R-SC).

The amendment has many similarities to the Administration's EO, while covering more countries and technologies. Key provisions of the OITA NDAA amendment include:

- Requiring US persons to notify the government 14 days in advance of closing (14 days after closing for secured transactions) a range of transactions in countries of concern in specific sectors.
- "US persons" includes citizens and entities organized under US law, which on its face, would not cover offshore funds controlled by US managers and could exclude subsidiaries.
- "Covered Foreign Entities" would include those incorporated in or with a principal place of business in a country of concern; entities with securities primarily traded on an exchange in such a country; and entities in which one of these entities holds >50%.
- "Covered Sectors" include advanced semiconductor and microelectronics; AI; quantum information science and technology; hypersonics; satellite-based communications; and networked laser scanning systems with dual-use applications.
- "Covered transactions" requiring notification would include:
 - Active and passive investment in a covered entity.
 - Debt transactions that afford rights characteristic of equity in a covered entity.
 - Establishment of a wholly owned subsidiary in a country of concern for production, design, testing, manufacturing, fabrication or development.
 - The establishment of a joint venture in a country of concern or with a covered entity for the same purposes as noted above or for research, as well as contractual relationships for research and development.
 - Acquisition with a covered entity of operation cooperation, such as supply or support, the right to board representation or an executive role in a covered foreign entity, governance representation in operating affiliates, and new relationships to share or provide business services (such as financial services, marketing, maintenance, or assembly functions) related to a covered sector.
- Requirements for Treasury include no public disclosure of notified information; coordination with the Commerce and other agencies as needed; coordination with allies on the notification process and implementation of similar outbound investment screening programs.

Sanctions Alternative

As mentioned, the House NDAA did not include a related outbound investment provision. While there is certainly bipartisan support for a provision in line with the OITA amendment, some Republicans support an alternative focused on utilization of sanctions and export controls to achieve similar national security goals as it relates to China. Rep. Barr has been pitching his colleagues on an alternative proposal that builds on the [Chinese Military and Surveillance Company Sanctions Act of 2023](#). We anticipate this new version to be introduced when the House returns to DC in early September. Rep Barr's stated goal with this legislation is to expand the government's ability to blacklist individual Chinese firms, blocking their access to US capital, while avoiding the creation of a new government notice or review function. During a February [hearing](#), in response to Rep Barr's questioning about the current lists maintained by Treasury,

	<p>DOD, and Commerce, the witness highlighted the fact that the Commerce has 1,000 companies on its export control list, but Treasury only has 68 companies that Americans are prohibited from investing in. This seems to be a disparity that Rep. Barr would prefer to address with stepped-up sanctions and export controls, instead of a new review process.</p> <p>This approach has the support of some key House Republicans, including HFSC Chair McHenry who believes the OITA approach “will be cumbersome for capital allocation internationally.” Additionally, HFAC Chair McCaul, who originally cosponsored the House version of the tougher NCCDA, recently indicated his support for Barr’s approach while referring to the NCCDA as “well intentioned” but “very bureaucratic” and not “really workable.” As Reps. Barr and McHenry work to build support among the Republican China Hawks in the House, this proposal currently lacks the bipartisan endorsements that OITA has.</p> <p>While we await the latest version, based on the original bill we know that the intention is to:</p> <ul style="list-style-type: none"> • Require the President to impose property-blocking sanctions on companies listed on the DOD’s Section 1260H List and Treasury’s Chinese Military Industrial Complex Companies (CMIC) list, limiting their access to US capital. • Utilize the existing lists maintained by DOD (Section 1260H) and Treasury (NS-CMIC). • Cover similar technologies as the other proposals. • Give companies a clear red-light / green-light indication as it relates to capital allocation. • Avoid the creation of a new review board or a notice process with limited impact. <p>Our View</p> <p>As Members return to DC in September, we expect to see the new version of Rep. Barr’s bill that he will seek to have marked up by the HFSC while also pushing for consideration in the NDAA conference process. The Senate’s inclusion of the OITA amendment will give the HFSC the opportunity to weigh-in on the NDAA conference process, presenting Reps. Barr and McHenry with a chance to push for a sanctions-based alternative. In addition, we expect that Chair McHenry will seek to have Rep. Barr’s new bill marked up by the HFSC, while working to find sympathetic Senators, willing to introduce a Senate companion.</p> <p>While Rep. Barr’s bill is likely to gain momentum and advance out of the HFSC, at a minimum, the political realities of stopping the OITA amendment in the Senate NDAA will be hard to overcome. Any pull back of support, even when offering what some would argue as a tougher-on-China alternative, presents a political opportunity for Democrats given the political popularity of anti-China votes. This reality, paired with the significant bipartisan support in the Senate and must-pass nature of the NDAA in general, we anticipate that the current OITA amendment makes it through in close to current form. Because of this, Rep. Barr’s proposal should be viewed on a separate timeline than the NDAA, one that could certainly continue after passage of the NDAA, but a process that will require time to build a broader coalition.</p>
<p>CHINA COMPETITION BILL 2.0</p>	<p>Overview</p> <p>Senate Majority Leader Schumer (D-NY) has expressed a desire to pass follow-up legislation to the CHIPS and Science Act (covered below) that incorporates bipartisan priorities not included in the first legislation. In May, Leader Schumer directed Senate Committee Chairs to begin working with their Ranking Members on another bipartisan China competition bill. That said, no substantive discussions on legislation have taken place and it does not appear likely that lawmakers will be able to agree on such an effort this fall or into the near future.</p> <p>Objectives</p> <p>In directive to Senate committee chairs outlined the key policies to be addressed:</p>

	<ol style="list-style-type: none"> 1) Limiting the flow of advanced technology to the Chinese Government – protecting key technologies by strengthening export control laws, identifying opportunities for new sanctions, and deterring the Chinese Government’s coercion. 2) Curtailing the flow of investment to the Chinese Government – blocking US capital to certain Chinese sectors. 3) Securing domestic economic investment – supporting biotech like CHIPS Act. 4) Underscoring our commitment to economic allies and maintaining partner alignment – challenging China’s Belt and Road Initiative. 5) Safeguarding our allies’ and partners' security and maintaining our strategic alliances – commitment to Taiwan and policy measures to deter conflict. <p>What to Watch</p> <p>This effort seems to still be in the early stages. In the months ahead, it should be expected the Committee Chairs begin to hold hearings and refine the policy proposals within their jurisdiction to address the identified priorities. That said, the Administration’s EO and the provision in the NDAA, if it remains, will remove some of the political urgency to pass another anti-China package heading into an election year.</p> <p>Based on some of the commentary from Senate Democrats to date, there seems to be interest in incorporating emissions and environmental provisions in the next package. This includes support for carbon-tariffs on carbon-intensive imports. Sen. Coons (D-DE) has also floated the <i>Providing Reliable Objective, Verifiable Emissions Intensity and Transparency (PROVE IT) Act</i>, targeting the calculation of the emissions intensity of certain industrial products. That said, a full list of possible legislative proposals is still coming together.</p>
HOUSE SELECT COMMITTEE ON THE CHINESE COMMUNIST PARTY	<p>Overview</p> <p>At the beginning of the 118th Congress, the House voted to form the Select Committee on the Chinese Communist Party (Select Committee on China), which was adopted with a vote of 365-65. This large bipartisan support reflects the bipartisan political concerns regarding China, as well as the reality that being anti-China is an easy political win. The Committee is led by Chair Gallagher (R-WI) and Ranking Member Krishnamoorthi (D- IL). Over the eight months since the Committee’s creation, it has been busy with investigations, reports, hearings, and conducting oversight on relevant issues.</p> <p>Key Actions</p> <p>The committee has focused on a variety of issues related to China and has not shied away from targeting major US companies with public letters and information requests. Additionally, the Committee has worked to advance policy proposals, while lobbying the Administration to implement and better enforce existing provisions based on national security, economic, and human rights concerns.</p> <ul style="list-style-type: none"> • Investment of Americans’ savings into blacklisted Chinese companies <ul style="list-style-type: none"> ○ Investigation by the Select Committee into BlackRock and MSCI for either investing or enabling investment into blacklisted Chinese companies. • VC investments in Chinese AI, semiconductors, and quantum companies <ul style="list-style-type: none"> ○ Letters to multiple VC firms expressing concerns and requesting information related to investments into Chinese firms in these industries. • Tightening export controls <ul style="list-style-type: none"> ○ Letter to Commerce Sec. Raimondo requesting a tightening of the 2022 rule restricting advanced semiconductors and equipment from being exported to China, to address concerns of workarounds found by Chinese firms. • Addressing the Administration’s outbound investment Executive Order (EO)

	<ul style="list-style-type: none"> ○ Chair Gallagher sent a letter to President Biden with a list of provisions he would like to see included, prior to the release of the EO. ○ Represented a broader list of provisions and restrictions than in the actual EO. ● Pressure and transparency efforts focused on human rights abuses in Xinjiang. <ul style="list-style-type: none"> ○ The Committee sent letters to Nike, Adidas, Shein, and Temu regarding concerns of “continued use of Uyghur forced labor in their supply chains despite the 2021 Uyghur Forced Labor Prevention Act (UFLPA) which outlawed this practice.” ○ The committee has also released a report criticizing the fast fashion industry’s impact on human rights and advanced human rights focused policy proposals. <p>Policy Proposals</p> <ul style="list-style-type: none"> ● Dump Investments in Troublesome Communist Holdings Act (DITCH) Act – Rep. Gallagher (R-WI) / Sen. Hawley (R-MO) – Targeting the tax-exempt status of non-profits, university endowments, public pension plans, and any other tax-exempt entity invested in Chinese companies. ● Ten for Taiwan – policy recommendations to preserve peace and support Taiwan <p>What to Watch</p> <p>The focus of the Select Committee on China has attempted to tackle a variety of issues related to China and this should be expected to continue. Of note, the focus on investment beyond the scope of the Administration’s EO are noteworthy, as well as their public investigating and pressure tactics. Even if outbound investment remains in compliance with the EO, once the final rule is adopted, this Committee could still seek to deter investment by drawing public attention to related investments. Additionally, Rep. Barr is a member of the Select Committee on China and will be working to persuade other Members, including Chair Gallagher, to support his outbound investment restriction alternative.</p> <p>We have seen the Select Committee on China increase public pressure on financial firms in recent weeks and believe that will continue. Committee Members will head to New York at the beginning of September to meet with various banking, PE, and VC executives.</p>
INTERNATIONAL RELATIONS	<p>Sanctions</p> <p>The relevant sanctions date back to the Trump Administration’s “trade war” with China. This includes the Section 232 steel and aluminum tariffs that involved 25% and 10% tariffs on steel and aluminum respectively, which were imposed on China, as well as other countries, for reasons of national security. The other major sanctions were the Section 301 tariffs, which imposed a 25% tariff on over \$300 billion in Chinese consumer goods. The 301 tariffs were focused on addressing China’s acts, policies, and practices related to technology transfer, IP, and innovation.</p> <p>While the “trade war” is not as prominent in policy discussions as it was, the Biden Administration has largely kept these tariffs in place as it relates to China. In May 2022, the US Trade Representative (USTR) initiated its statutory four-year review of Sec 301 investigation. USTR has been taking public comment on the effectiveness and impact of the tariffs and is expected to complete its review “this fall.” The Sec. 232 tariffs have been challenged by China at the World Trade Organization (WTO) but remain in place. Last week, the WTO also rejected China’s retaliatory tariffs as a violation of WTO rules, but this ruling can still be appealed.</p> <p>More broadly as it relates to sanctions policy, the Treasury Department completed a broad sanctions review in October 2021. This review confirmed that “sanctions remain an essential and effective policy tool,” while acknowledging new challenges related to “digital assets and cybercriminals” Instead of rolling back any of the existing sanctions, this review made</p>

	<p>recommendations that should be considered to bolster the effectiveness of sanctions. The recommendations included:</p> <ul style="list-style-type: none"> • Adopting a policy framework that links sanctions to a clear policy objective. • Multilateral coordination – across Administration and where possible, with allies. • Investing in modernizing sanctions technology, workforce, and infrastructure – cited as a way to address the evolving digital assets and services space. <p>FEND Off Fentanyl Act</p> <p>In June, the SBC passed Ranking Member Scott’s FEND Off Fentanyl Act with unanimous support. If enacted, the FEND Off Fentanyl Act, which seeks to combat the fentanyl crisis in America, would heighten the use of sanctions and anti-money laundering tools to punish Chinese precursor manufacturers and Mexican cartels trafficking fentanyl into the US. More recently, the FEND Off Fentanyl Act was included in the Senate version of the FY24 NDAA. We do not expect this legislation to face significant resistance or opposition given its focus on fentanyl and China and it is likely that it is enacted in the final version of the NDAA that is sent to President Biden’s desk.</p> <p>Taiwan</p> <p>Taiwan represents a topic that is receiving increasing bipartisan support in Washington for both economic and national security reasons. The US-Taiwan relationship has received more attention as of late, with each diplomatic or policy move reaffirming this support serving as a flashpoint in the US-China relationship. We have seen this result in drills in the South China sea and even fears that China will invade Taiwan. That said, the US government continues their efforts to advance policies to strengthen ties with Taiwan, focusing on enhancing security and defense cooperation to counter potential threats, fostering robust economic partnerships for growth and access to advanced markets, and providing diplomatic recognition that elevates Taiwan’s global influence and champions its democratic values on the international platform.</p> <ul style="list-style-type: none"> • House Select Committee on China’s Ten for Taiwan report. • FY24 NDAA provisions, including some from the Ten for Taiwan Report <ul style="list-style-type: none"> ○ Greater military coordination between the US and Taiwan, addresses arms deliveries backlog, and defense training. • Trade Oversight Law Enacted Amid US-Taiwan Tax Deal Talks. • Alleviating double-taxation, particularly to increase investment in semiconductors and other high-tech industries. <ul style="list-style-type: none"> ○ Competing proposals between the respective foreign policy (The Taiwan Tax Agreement Act of 2023) and tax (The US-Taiwan Expedited Double-Tax Relief Act) committees in the House and Senate.
<p>RECENT RELATED LEGISLATION</p>	<p>FIRRMA – CFIUS Modernization</p> <p>Before the current focus on increasing scrutiny of outbound investment to address economic and national security concerns, the focus was on inbound investment and US companies with efforts to modernize the Committee on Foreign Investment in the United States (CFIUS) review process. In 2018, the Foreign Investment Risk Review Modernization Act (FIRRMA) was enacted to “address growing national security concerns over foreign exploitation of certain investment structures” outside of CFIUS jurisdiction.</p> <p>Among other things, the legislation expanded the scope of covered transactions to including a purchase, lease of real estate by a foreign person in proximity to sensitive government facilities, investments that afford a foreign person access to material nonpublic technical information, and changes in foreign investor’s rights resulting in foreign control of a US business. Additionally, the legislation instituted a “light filing” process through a new “declarations” procedure intended to reduce review times as the program expanded. Other provisions related to an increased review period and strengthening of mitigation agreements.</p>

More recently, the Biden Administration has continued to update the CFIUS review process in response to evolving risks. A September 2022, [Executive Order](#), entitled *Ensuring Robust Consideration of Evolving National Security Risks by the CFIUS*, elaborated and expanded on existing factors that CFIUS considers when reviewing transactions for national security risks, [including](#) things like the resilience of the US supply chain, impact on US technological leadership, data access, and cyber security threats. Additionally, there is additional [rulemaking](#) underway to amend the “military installation” definition in the real estate provision adopted under FIRREA.

CHIPS Act

In August 2022, President Biden signed the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act (CHIPS Act), to strengthen American manufacturing supply chains, and national security. Specifically, the proposal was intended to revive US manufacturing of semiconductors while mitigating supply chain concentration risks, along with investments in research and development to “keep the US the leader in the industries of tomorrow.”

In total, the CHIPS Act authorizes more than \$200 billion* in federal funding, however only \$52.7 billion of the funds were immediately appropriated, along with a 25% tax credit created for investments in semiconductor manufacturing facilities. These funds are controlled by Commerce to support American semiconductor research, development, manufacturing, and workforce development.

- \$39 billion in manufacturing incentives – Chips for America Fund
 - \$6 billion appropriated for direct loans and loan guarantees
- \$2 billion for the CHIPS for American Defense Fund – legacy chips in autos and defense
- \$13.2 billion in R&D and workforce development
- \$500 million for semiconductor supply chain security coordination

**The majority of the spending from the CHIPS Act was in the form of authorizations that will still have to be funded in future government spending bills over the next decade.*

As of the one-year anniversary of the CHIPS Act, Commerce reported having received more than 460 statements of interest in the Chips for America Fund and the various loans and guarantees offered by the CHIPS Act.

While Congress works to develop a broader China Competition 2.0 proposal, there is also bipartisan, bicameral legislation focused on federal environmental reviews related to CHIPS Act projects. The *Building Chips in America Act* is intended to streamline the approval process for projects supported by the CHIPS Act, to get these projects up and running in a timely manner.

Inflation Reduction Act (IRA) – Related Incentives

The IRA, which represents one of the Biden Administration’s key accomplishments, included significant policy priorities and spending related to climate and clean energy. However, many of these same provisions represent an effort to compete with China and chip away at its dominate position as a beneficiary of the global transition to clean energy. The hope is that these IRA provisions will work to counter Chinese investment and leadership in the clean energy supply chain, where significant investments have been made for years and the Chinese government subsidizes companies to protect their global positioning. Since the early 2000s China has outspent the US when it comes to clean energy.

The IRA included nearly \$400 billion in clean energy and climate funding over the next decade in the forms of tax incentives, grants, loans, and guarantees, many intended to boost manufacturing.

- \$30 billion – 45X Advanced Manufacturing Production Credit – to stimulate US manufacturing of solar modules, wind turbines, inverters, batteries for electric vehicles (EV) and power storage, and the extraction and refining of critical minerals.

- It is estimated that 85 percent of solar cell manufacturing capacity is located in China, while only 0.6 percent is located in North America, according to the International Energy Agency (IEA).
- \$20 billion to finance loans to support domestic EV manufacturing.
- \$10 billion in investment tax credits to incentivize the production of EV, wind turbine, and solar panel factories.
- Restrictions on EV tax credits prohibiting “battery components manufactured or assembled by a foreign entity of concern” and “batteries cannot contain critical minerals extracted, processed or recycled by a foreign entity of concern.”
 - It is estimated that China produces three-quarters of all lithium-ion batteries and that it holds 70 percent of the production capacity for cathodes and 85 percent for anodes, which are key components in lithium-ion battery production.

While this legislation gave President Biden significant political wins on healthcare and taxes as well, time will tell if the related clean energy supply chain provisions allow the US to better compete with China. It is likely that the IRA will assist the US in reaching climate targets and establishing itself as a strong leader in the climate field, but global supply chains will still likely rely on China for some time to come. Even in the context of climate changes, this requires careful management of the US-China trade relationship, including all associated risks.

Beyond China, these clean energy incentives also caught the attention of many of our typical trading partners, as these investments in domestic manufacturing and other incentives have the potential to entice companies to relocate from places other than China.

Republican Scrutiny

While the IRA will be front and center in President Biden’s reelection campaign, the scale of the spending and advancement of Democrat priorities has ensured significant criticism from Republicans. House Republicans have threatened to repeal some of these provisions on various occasions and with Republicans taking back control of the House in the 2022 midterm election, they have pursued oversight of the IRA’s spending provisions. This includes a focus on how China can benefit from IRA tax incentives. In April, the House Ways and Means Committee (W&M) held a [hearing](#) addressing IRA tax provisions that are allowing “hundreds of billions of dollars to flow to big banks, corporations, and the Chinese Communist Party” based on a recent Joint Committee on Taxation (JCT) [analysis](#). Committee leadership specifically called out Ford for ‘exploiting the law to qualify for taxpayer-funded credits using Chinese workers and technologies’ as well as LONGi Green Energy Technologies, a solar panel manufacturer with ties to the CCP that is partnering with a US firm on a plant in Ohio utilizing IRA tax credits. While the criticism of IRA provisions will remain, any repeal effort would require a skewed election performance in favor of Republicans and a willingness to impact many investments already underway in various Members’ districts. Instead, it is more likely that the oversight will continue, with a focus on who benefits from these IRA provisions.

Oversight of Chinese Company Accounting

Since 2020, there have been a variety of legislative moves to address concerns about Chinese accounting practices and an inability for US audit regulators to inspect audits for Chinese companies listed on US exchanges. In 2020, there were roughly 1,000 Chinese companies listed on US exchanges. As of January 9, 2023, this number was down to 252, with a major reason being the new audit requirements included in the legislation discussed below. The below outlines the key events related to this effort:

- [Holding Foreign Companies Accountable Act](#) (HFCAA) – Sen. Kennedy (R-LA) and Sen. Van Hollen (D-MD) – enacted in 2020 to address a standoff between US audit regulators and the Chinese government over China’s refusal to allow inspections of audits for US-listed companies from China and Hong Kong. Under the law, those

	<p>companies would be subject to a trading ban in the US after three consecutive non-inspection years.</p> <ul style="list-style-type: none"> ○ Took until December 2022 for the PCAOB to gain complete access to inspect and investigate audit firms based in mainland China and Hong Kong. ● Accelerating Holding Foreign Companies Accountable Act – Sen. Rubio (R-FL) and Sen. Kennedy – enacted as part of the FY23 omnibus appropriations bill. Reduced the time needed to trigger a trading ban of securities of foreign companies that refuse to provide the required access to their books from three years to two consecutive years. ● May 2023, the PCAOB announced it discovered significant shortcomings in audits of companies based in China and Hong Kong listed on US exchanges. The PCAOB’s findings, paired with reports of Chinese companies controlled by the CCP violating US and international laws, forced labor, and producing false financial statements have spurred additional concerns and proposals that are now pending. ● Holding Chinese Listed Companies Accountable Act – Rep. Luetkemeyer and Rep. Sherman (D-CA) – Would increase the frequency with which auditors of Chinese companies must be inspected by the PCAOB under the HFCA to annually. ● Holding Foreign Insiders Accountable Act – Sen Kennedy and Sen Van Hollen – Addressing reports of Chinese investors of corporations listed on US exchanges avoiding billions of dollars in losses by making “seemingly informed” stock sales ahead of declines in share prices. Would require executives of public companies based outside the US to make electronic disclosures of trades in their own company’s stocks to the SEC within two business days. The SEC would then make that information available to the public, as they currently do with US-based firms.
<p>CONSISTENT THEMES</p>	<p>While there has been no shortage of action related to China, as demonstrated above, the below represent some higher-level themes that seem to always come up no matter the proposal. These are items we believe will be front-of-mind for business leaders and politicians alike for years to come as it relates to China.</p> <p>Supply Chain and Onshoring</p> <p>Over the last few decades, the narrative of jobs going overseas has been constant and one that both parties wanted to address but failed to see any material shift. However, additional events over the last few years, including the pandemic, trade wars, legislation related to sourcing, ESG initiatives, and the volatility resulting from US-China diplomatic tensions seem to have stimulated action. All of these causes seem to be accounted for in the current market trend of “de-risking” and diversifying supply chains. This de-risking is evidenced by the 25% drop in Chinese imports over the first half of 2023, as well as Apple, a major US company and major manufacturer of goods in China, beginning the production of their latest iPhone in India. Whether it be through onshoring, or diversification and de-risking by investing in other countries, supply chains will continue to be an area of focus in DC and the board room. Some key examples include:</p> <ul style="list-style-type: none"> ● IRA incentives to allow US workers to benefit from the clean energy transition. ● CHIPS Act incentives to address concentration risk and national security concerns stemming from the current semiconductor supply chain. ● Biden Administration’s review of key supply chains (semiconductors, batteries, critical minerals, and pharmaceuticals) to assess vulnerabilities, boost resiliency, and address pandemic-affected supply chains – established the Supply Chain Disruptions Task Force. ● The Medical Supply Chain Resiliency Act – proposed bipartisan legislation to authorize the President to engage in trade negotiations to strengthen the US medical supply chain. ● The Uyghur Forced Labor Prevention Act – enacted in 2022 – prohibits the importation of goods made with forced labor from the Xinjiang Uyghur Autonomous Region of China and applies to 13 key product categories.

IP Theft Protection

Whether it be DOD officials concerned about the latest military technology or an executive worried about protecting their company's IP, theft and transfer of technology are an ever-present concern when dealing with China. A 2018 [analysis](#) of IP theft by the USTR found that the Chinese government "conducted and supported cyber intrusions into US commercial networks, targeting confidential business information held by US firms." This concern is not exclusive to the US-China relationship—the EU, Japan, and South Korea have all expressed similar concerns. Over the years, efforts have been made to address these concerns, with limited success:

- 2015 trade agreement between the US and China that included IP protection provisions – US government has challenged claims of implementation of these provisions.
- Section 301 tariffs, which imposed a 25% tariff on \$300 billion in Chinese consumer goods – the 301 investigation has focused on addressing China's "acts, policies, and practices related to technology transfer, intellectual property, and innovation."
- Select Committee on China Chair Gallagher and House Small Business Committee Chair Williams (R-TX) sent a [letter](#) to Attorney General Garland in June asking about the DOJ's efforts in addressing the issue and about the implementation of the [Protect American IP Act](#), which was signed into law in January.
- [Fair Trade with China Enforcement Act](#) – Sen. Rubio (R-FL) – Directs Commerce to prohibit the export of certain US technology and IP to China; places a shareholder cap on Chinese in certain US entities; and increase taxes on multinational corporations' income earned in China at "a rate similar to" the value of stolen IP and technology.

National Security

As was made most recently exemplified by the administrations focus on branding the outbound investment EO as one for national security reasons and not economic, most policy decisions involving China are going to have a national security angle. While blocking US funding of the companies and technologies critical to the CCP's ambitions doesn't seem like a stretch, in other cases it may seem a little farther fetched. That said, whether it be tariffs on consumer goods, metals, inbound investments on land near sensitive military installations, or even US consumer data, the citation of National Security is common throughout. While the CCP will claim these actions are all intended to ensure the US positioning as the leading economic power, very few elected officials are going to see it this way.

- Section 232 Steel and Aluminum tariffs were implemented to address national security concerns, which has been challenged at the WTO.
- FIRRMA – variety of CFIUS reforms addressing concerns ranging from technology transfer through acquisitions to land purchases near sensitive military installations.
- CHIPS Act – supported as a way to ensure national security to onshoring and controlling supply chains for critical national security related technologies.
- Diplomatic and military support for Taiwan.

ADDITIONAL PENDING OUTBOUND INVESTMENT SCRUTINY

DITCH Act

The [Dump Investments in Troublesome Communist Holdings](#) (DITCH) Act has been proposed in the House by Select Committee on China Chair Gallaher, and in the Senate by Sen. Hawley (R-MO). This proposal would force non-profits, university endowments, and public pension plans to divest from disqualified Chinese companies or lose their tax-exempt status. The DITCH Act defines disqualified Chinese companies as any company that is incorporated or based in China or is directly or indirectly owned by a Chinese entity, including through a derivative instrument or other contractual arrangements, or a company in which Chinese entities own at least 10% of the stock. The proposal would allow for Treasury to grant waivers if a non-profit's need to hold certain Chinese assets outweighs the national security risk. However, this scenario would require public disclosure of the reasoning and submit regular reports on the investment.

While the DITCH Act's odds of enactment in the near future are significantly lower than the other outbound investment provisions discussed, it reinforces this continued focus on scrutinizing and prohibiting support for China in all forms. The inclusion of public pensions also aligns with the Select Committee on China's scrutiny of how Americans' retirement savings are being spent in China, following the recent inquiries sent to BlackRock and MSCI.

Scrutiny of Political Activities of Tax-Exempt Organizations

Last week, House W&M Chair Smith (R-MO) and Oversight Subcommittee Chair Schweikert (R-AZ) published an [open letter](#) seeking input on laws prohibiting political activities by tax-exempt organizations. In the letter, the two lawmakers say they are concerned about reports that tax-exempt organizations are being used to influence elections, including by foreign funds, and that 501(c)(4) organizations have taken advantage of ambiguities in tax law to essentially operate as political committees, without any disclosure obligations. While the request is in the early stages, it will be worth monitoring the responses. Given the political motivations related to China, it is not farfetched to imagine a situation where this legislation is offered as an amendment or that the definitions of covered Chinese entities carry over into other bills.