Generation Shift: Recent Developments in US-China Business Relations and the Path Ahead Under President-elect Trump

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Overview

The US-China relationship is arguably the most important and complicated bilateral relationship in the early 21st century, owing in large part to the fact that China is the largest US trading partner that is not a strategic ally. US-China competition regarding security and global influence can spur innovative solutions or impede trade and other areas of cooperation. Here we begin to take stock of some key recent developments and discuss the path ahead.

Illustrative data points since 2015 include the following:

1) China and the US have entered into historic agreements regarding commercial espionage and climate change;
2) Chinese investment into the United States has skyrocketed; and
3) China and the US have continued to advance a bilateral investment treaty.

However, over the same period, the US security establishment has scuttled several Chinese acquisitions of US companies and targeted a major Chinese company for significant export controls enforcement.

The election of Mr. Donald J. Trump ushers in an era of uncertainty, but also potentially a period of deal making and economic development. On the one hand, the president-elect has signaled that he may create barriers to US-China trade and investment, and that he may take a more hawkish approach to security issues than the Obama Administration. On the other hand, the president-elect has already taken steps to encourage business investments into the United States by Asian business leaders, including those from the People’s Republic of China (PRC). The Committee on Foreign Investment in the United States (CFIUS), which sits at the intersection of international investment in the US and US security concerns, is expected to continue actively policing Chinese direct investment in the US and could become a potential flashpoint in the Trump Administration.

We’ll start with some positive developments before discussing more challenging events of the recent past and possible signals for the future.

Agreement Between President Xi and President Obama to Reduce Commercial Espionage
During the state visit by President Xi Jinping in September 2015, the two countries reached a historic agreement to combat certain cyber activities, including commercial espionage. In signing the agreement, the parties committed to share information concerning malicious cyber activities, to refrain from conducting or knowingly supporting cyber-enabled theft of intellectual property, and to establish a high-level joint dialogue on fighting cybercrime, among other things. The fact that the US and China were able to enter this agreement was a positive step towards cooperation in an area of primary concern to both countries.

China and the US were also among the members of the G20 who accepted the norm against conducting or supporting the cyber-enabled theft of intellectual property in November 2015. Specifically, the parties affirmed that international law, including the UN Charter, applies to nation-state conduct in cyberspace and that no country should conduct or support the cyber-enabled theft of intellectual property with the intent of providing competitive advantages to its companies or commercial sectors.

China and the US have held three rounds of joint dialogues since signing their agreement, the most recent on December 8, 2016. The dialogues were lauded by the Obama Administration as being “beneficial to bilateral communications and enhanced cooperation.” President Xi expressed that coordination on the cyber issue would benefit both China and the US. A fourth dialogue is slated to take place in 2017 under the Trump Administration.

For several years, the US has led efforts to establish norms of cyberspace conduct. China is a key partner in these efforts, and the Trump Administration has the opportunity to continue international advancement in this critical realm.

**High Level of Chinese Investment into the US**

Another noteworthy positive trend concerns Chinese investments into the US. In recent years, Chinese companies have made major investments into the US, the EU, and more recently along the New Silk Road. The Rhodium Group found that outbound deals from China to the US have mushroomed from $500 million in 2008 to more than $45 billion in 2016. This surge in activity has led China’s investments into the US to outpace the level of US investments into China, which had been consistently higher until 2015. This active acquisitions trend has included several high-profile deals, many of which have been cleared by CFIUS.

The largest overseas acquisition by a Chinese company was cleared by CFIUS in August 2016. State-owned ChemChina agreed to pay $43 billion to purchase seed giant Syngenta, which supplies one-fifth of the world’s pesticides and 10% of soybean seeds to US farmers. Some members of Congress expressed concern over the transaction; Senator Debbie Stabenow and other members of the Senate Agriculture Committee urged CFIUS to carefully review the deal given its “consequences for food security, food safety, biosecurity, and the highly competitive US farm sector as a whole.” Notwithstanding this congressional pressure, CFIUS cleared the deal.

Other significant Chinese deals have been greenlighted by CFIUS as well, including Apex Technology Consortium’s $3.6 billion acquisition of Lexmark; Haier’s $5.6 billion purchase of GE Appliances; and HNA Group’s $6 billion deal with Ingram Micro Inc.

Chinese interest in US companies, and the US government’s non-interference in transactions between private parties (with a few exceptions, as noted below), have been indicators of the maturing relationship between the two countries, which as noted above, has not been limited to investment.

**Historic Cooperation on Environmental Issues**

Another point of collaboration has been the environment. After negotiating the landmark Paris Agreement last year, the US and China announced in September 2016, on the eve of the G20 Summit, that they would implement the pact. In making the announcement, President Obama stated that “despite our differences on other issues, we hope that our willingness to work together on [climate change] will inspire greater ambition and greater action around the world.” Indeed, many heralded the cooperation between the world’s two largest carbon emitters as a historic and positive step.

The Paris Agreement entered into force on November 4, 2016, and has nearly 200 signatories who are obliged to meet emissions-cutting pledges made in December 2016. However, it is unclear how the Paris Agreement will fare under the new administration.

**Some CFIUS Problems and Congressional Proposals**

While we have categorized the high level of Chinese investment interest in the US and the US government’s receptiveness as a positive recent development, not all investments attempted in 2016 had positive outcomes. For example, the following Chinese investments related to the US semiconductor industry have been particularly challenging:
- Philips N.V. On January 22, Dutch-based Philips announced the termination of a deal between China’s GO Scale Capital and California subsidiary Philips Lumileds. According to Philips’ CEO, CFIUS ultimately would not clear the acquisition “despite the extensive efforts of Philips and GO Scale Capital to mitigate” CFIUS concerns. Though the parties did not disclose the nature of the CFIUS objection, US government concerns about Lumileds’ semiconductor materials development apparently loomed large.

- Fairchild Semiconductor International Inc. On February 16, Fairchild Semiconductor announced it had declined a $22-per-share takeover bid from China Resources Microelectronics Ltd and Hua Capital Management Co Ltd. CFIUS did not reject or even directly affect this transaction. Rather, Fairchild simply found “an unacceptable level of risk for failure to obtain CFIUS approval.”

- Western Digital Corp. One week after Fairchild’s announcement, US electronic storage technology company Western Digital revealed that Chinese state-owned Tsinghua Unisplendour pulled out of a deal to acquire 15% of the company for $3.78 billion. Again, CFIUS did not reject this transaction. The decision made by Unisplendour followed a determination by CFIUS that it had jurisdiction over the transaction, which apparently created too much risk for the parties to proceed.

- Aixtron, Inc. On December 2, President Obama issued an Executive Order to block the proposed acquisition of Aixtron, Inc. by Fujian Grand Chip Investment Fund. This block was notable in that it was only the third presidential block since CFIUS was created. Additionally, it was the first presidential block in which the US company was already owned by a foreign parent, as Aixtron is a US subsidiary of a German parent company, Aixtron SE.

These and other high-profile CFIUS matters have contributed to congressional calls for CFIUS reform. Sixteen bipartisan US lawmakers wrote to the Government Accountability Office (GAO) requesting a report to review the CFIUS process. Their letter renewed calls for CFIUS to add a “net economic benefit test” to their process rather than focusing exclusively on security concerns, as CFIUS does now.

Separately, while the ChemChina and Syngenta deal was pending, senators from the US Senate Agriculture Committee pressed Treasury to focus more on “food security.” Pointing to growing investment concerns from abroad in US agriculture, the group asked Treasury Secretary Jack Lew to include both the Department of Agriculture and the Food and Drug Administration when reviewing major US agriculture deals.

It is unclear if efforts to push CFIUS toward considering issues beyond traditional security concerns will gain traction. The incoming Trump Administration has indicated it may boost these efforts, which has the potential to create hurdles to continued high-profile Chinese investment in the US.

Exports Controls Enforcement

In 2016, a Chinese company became embroiled in a significant US export controls enforcement case. In March 2016, the US Department of Commerce placed Chinese telecom equipment giant ZTE Corp. and three of its subsidiaries on the Bureau of Industry and Security (BIS) Entity List for alleged violations of US export controls to Iran. This addition, which the PRC government opposed, is notable given the size of the company and its significant international trading presence. It is possible that the incoming Trump administration is considering settling with ZTE over the purported scheme.

The New US Administration

Having run an unconventional campaign, President-elect Trump now heads into the White House eager to break with tradition.

Significantly, the president-elect has signaled that his administration may decide to re-examine the US’s relationship with Taiwan. It remains to be seen how policy in this area will develop in a Trump Administration, but if the “One China” policy is revised that could lead to changes in the relationship between the United States and the PRC.

On the economic front, the president-elect has suggested a “hardline stance” may be taken by invoking trade and CFIUS tools. On the campaign trail, there was rhetoric indicating that a 45% tariff might be applied to Chinese imports. A unilateral decision to apply high tariffs could have severe repercussions on the economic relationship between the two countries, including WTO litigation and retaliatory tariffs. It remains to be seen whether the threat of tariffs is simply part of the opening gambit in US efforts directed at negotiating, or re-negotiating, international trade deals.

Regarding CFIUS changes, the new administration may leverage the committee to advance trade and other economic priorities. As we have written previously, the Trump Administration may seek to effectuate changes to CFIUS by pushing Congress to enact amending legislation broadening CFIUS reviews to include considerations such as “economic security,” or by pushing CFIUS, whether via Executive Order or informal mechanisms, to broaden considerations to encompass similar factors. Arguably, CFIUS consideration of “economic security” would be permissible only with legislative amendment, but the president-elect could find himself bolstered by recent requests from US lawmakers and force the changes himself.
However, President-elect Trump’s key appointments and recent meetings with Chinese business leaders may offer a clue into his actual China strategy. Interestingly, President-elect Trump has appointed President Xi’s “old friend” Iowa Governor Terry Branstad as ambassador to China. Branstad and Xi met during a 1985 agricultural exchange, when Xi was a provincial official, and the two have met numerous times since. In accepting the position, Branstad said he “look[ed] forward to building on our long friendship to cultivate and strengthen the relationship between our two countries.” China’s Foreign Ministry spokesman returned the gesture and “welcome[ed] him to play a greater role in advancing the development of China-US relations.”

More recently, President-elect Trump met with Mr. Jack Ma, Executive Chairman of top Chinese e-commerce site Alibaba, to discuss Alibaba’s plan to bring US businesses onto its platform. The meeting has been viewed positively by business media in both the US and China, and may be indicative of the new president’s open and transaction-specific approach to China and business.

**Conclusion**

The recent past has seen numerous developments – both positive and more challenging – in the relationship between China and the US. Now, with the swearing in of an unconventional president, that relationship may be significantly reshaped.

**Practices**

**National Security/CFIUS**

**Economic Sanctions**

**Export Controls**

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