                                    **The Endgame with China**

                              by Bart S. Fisher

I.  Introduction

    Language tells us a great deal about national psyches and self-perceptions.  Accordingly, understanding the Chinese language will tell us much of what we need to know regarding China's global aspirations.  The character for China is a rectangle with a line down its middle.  This character, Zhongguo, means Middle Kingdom, the place between heaven and earth.  In other words, the center of the universe.  For 5,000 years China has viewed itself as the center of the universe, the leading power on earth in terms of the quality of its civilization. Accordingly, it views the last 260 years of American history, as an aberration, a mere blip interfering with China's rightful place at the center of the universe. In the same vein, the character for house, jia, is a roof over two housing sides, with a pig underneath that roof.   That should be a tip-off as to the significance of China feeling compelled to place tariffs on pigs.  Cutting off or even limiting U.S. pork exports to China thus strikes at the very heart of what the Chinese consider a rightful part of their home.

    This linguistic insight into the Chinese worldview thus has to inform the United States, and other countries, as to the way to counter China's quest for global influence, as a rising power, or, as the Chinese would see it, their rightful place at the center of the universe.

    There are three dimensions to the struggle for global dominance with China, economic, political, and military.   No one dimension can be considered in isolation.   Thus, the so-called trade war with China has to be considered in the context of China's quest for military and political dominance in Asia.

    We need to first consider the economic prong of China's quest for global domination.

    China continues to run a non-market-oriented economy, provide subsidies to its state-owned enterprises, dump its exports unfairly, manipulate its currency, appropriate U.S. intellectual property, including patents, copyrights, and trademarks, and, most devastatingly, use the Internet to seize an almost insurmountable advantage in the world of electronic commerce.   China's use of global Internet platforms has allowed Jack Ma, CEO of Alibaba, to become the richest man in China.  Alibaba now flies its own aircraft into the United States to fulfill orders,  bypassing the U.S. customs system and all U.S. regulations.  As we enter the new world of electronic commerce it is now clear that China has made a mockery of the entire U.S. customs system, not to mention the U.S. Office of Patents and Trademarks.   How many Americans know that, largely as a result of China's subsidies, 19,664 largely bogus trademark applications were filed in 2018 at the U.S. Patent and Trademark Office from Shenzhen alone, fueled by subsidies from the Government of China, making a joke and mockery of the U.S. trademark system, overwhelming examiners unable to keep up with this bogus flow of applications?

    The problem with the Trump Administration's Section 301 complaint against China is that, while its objectives are correct, there is no well defined end game, only fragments yet to be stitched into the coherent fabric of an overall policy that makes sense.

    Several steps have been taken thus far, but much more needs to be done.

**II.  Promotion of U.S. Foreign Investment:  The BUILD Act**

    The first step to counter China's quest for global economic dominance was taken on October 5,2018, when President Trump signed into law the statute entitled Better Utilization of Investments Leading to Development (BUILD) Act, which creates a new foreign aid agency--the United States International Development Finance Corporation (IDFC).  This legislation consolidates the Development Credit Agency (DCA) of the U.S. Agency for International Development (USAID) with the Overseas Private Investment Corporation (OPIC), and triples the financing authority of OPIC from $22 billion annually to $60 billion. Instead of abolishing the OPIC, as President Trump had originally urged, he signed this largely-overlooked legislation as a mechanism for the United States and its corporations to counter the Belt and Road initiative of the Government of China, which has as its goal the creation of a new silk road for Chinese trade and investment through the developing world.  This new agency will have authority to provide loans, loan guarantees and insurance to companies willing to do business in developing nations.  The drafters of the BUILD act made clear that its intent is to counter China's drive towards global dominance by stating that IDFC's goal is to provide 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, especially Venezuela, 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,  So much of our foreign policy now is focused on trying to check China, especially their nefarious activities."

**III.  Restrictions on Inward Foreign Investment:  CFIUS Reforms**

    The second step to counter China's growing influence in the United States is the strengthening of the Committee on Foreign Investments in the United States, knows as CFIUS. The challenge here is to maintain the balance between the desire to maintain commercial engagement with China while checking 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."  On August 1, 2018, Congress passed the Foreign Investment Risk Review Modernization Act (FIRRMA) to expand the government's power to review investments from foreign countries--a response to China's efforts to obtain U.S. technology through mergers, acquisitions, and takeovers.  Last month, the Treasury Department released interim rules to implement the new law, and the Justice Department will work with Treasury on further developing those regulations.  The Justice Department will also target Chinese threats to U.S. companies that provide components for sensitive technologies, especially those in the telecommunications sector as it readies for the transition to the 5G network..  Under the strengthened CFIUS legislation, minority shares of U.S. companies will also be reviewed by the CFIUS inter-agency committee.  This essential legislation will provide for strengthened national security reviews of prospective Chinese investments in the United States.

    FIRRMA principally expands CFIUS' jurisdiction in two ways.  First, it will cover real estate transactions located within important ports or near military installations or other sensitive U.S. government facilities.   Second, the bill would also expand CFIUS' jurisdiction to include any other 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.  These "other investments" will include investments in U.S. businesses that would not otherwise be covered by CFIUS and which afford a foreign person (a) 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..  Such "other investments" will not include indirect investments in U.S. businesses by a foreign person through an investment fund as a limited partner, 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 such as Russia, will have to thread a very narrow needle in order to invest in what CFIUS believes to be a critical U.S. technology or infrastructure.  It would appear to permit the foreign investor to be only a minority, non-control, passive investor in a fund managed by a U.S. entity as the general partner.

**IV.  Tighter U.S. Export Controls**

    The third front in the new cold war against China is export controls.    On November 22, 2018, the Trump Administration announced that it is considering tighter curbs on technology exports, a step that Deutsche Bank AG said would have a "profound and long lasting adverse impact" on relations between the United States and China."  This new front was launched with a call for comments from the public by the U.S. Department of Commerce asking if a list of new technologies that have national security implications--from artificial intelligence to microprocessors and robotics--should be subject to more stringent export control rules.   These proposals would affect U.S. manufacturers as well as purchasers in China.  These proposed new controls could have a devastating effect on high-tech trade with China, as many products are used for both military and civilian purposes.  High-end technology has emerged at the center of the U.S.-Chinese trade war, as President Trump has pushed China to drop its plans to dominate leading-edge industries like electric vehicles, robotics, and artificial intelligence (AI).

    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.

    Artificial intelligence is a key element of many computer products made by U.S. tech firms including smartphones, connected speakers and self-driving cars.  AI can also have applications for military purposes.

    The United States is examining controls for "specific emerging technologies" that would avoid "negatively impacting U.S. leadership in the science, technology, engineering, and manufacturing sector," said the federal register notice.

**V.  Tax Reform**

The fourth step taken to promote U.S. economic interests vis a vis China has been on international tax reform.  American economic power becomes diminished and China's enhanced when "Runaway Mills" flee the United States and invest in China instead of the United States.  This trend of outsourcing through the use of foreign subsidiaries in China has been encouraged by the U.S. tax policy of deferral of foreign source income when earned by foreign subsidiaries.   This issue was addressed with the passage of the U.S. federal tax legislation that entered into force on January 1, 2018.  The new U.S. tax legislation reduces the U.S. corporate rate of taxation from 35% to 21 percent, which will encourage investment in the United States over foreign locations.  Moreover, the new legislation has a deemed repatriation rate of 15.5 percent on the undistributed earnings of overseas affiliates that consist of cash or cash equivalent, and a rate of 8 percent on undistributed earnings that do not consist of cash or cash equivalents.   The U.S.shareholder will be allowed to pay the newly assessed U.S. tax over an 8-year period.  The latter provision represents a significant erosion of the current policy of deferral of taxation on foreign affiliates.  Coupled with the newly granted 100 percent tax exemption for dividends received from a foreign corporation, the new U.S. international tax policy will discourage direct foreign investment by U.S. enterprises, and encourage the repatriation of dividends, steps that should significantly increase investment in the United States, and decrease foreign imports.

**V.  World Trade Organization**

    The fifth arena of conflict is the World Trade Organization (WTO), which may be marginalized by the ongoing disputes between the United States and China.  There is a deadline for resolving the WTO reform issue, which is December 2019.  This is when the WTO legal system will grind to a halt unless the Trump administration lifts its veto blocking appointment of new judges to the Geneva panel system that mediates trade disputes among the 164 members of the WTO.  Washington has used its veto power to cut the size of the seven-judge court down to three members, the bare minimum needed to hear a case.  The terms of two of those remaining judges expire December 10, 2019.    If they aren't replaced, the WTO's "appellate body" will effectively shut down, leaving the organization's dispute settlement powers in limbo.   Under that scenario, every trade case becomes a trade war, and the state of nature will apply.   At that pont the entire fabric of the international trade law dispute resolution process would become unraveled.

**VI.  Tariffs and the Current Trade War with China**

    The sixth step that needs to undertaken is an effort to defuse the short-term trade crisis that now haunts the U.S. equity markets.  Thus far, the Trump Administration has imposed a series of tariffs affecting China: national security tariffs of 25% on steel and 10% on aluminum pursuant to Section 232 of the Trade Expansion Act of 1962, and additional tariffs of 10% on $250 billion of Chinese imports, with the tariff rate on the latter tranche of $200 billion set to climb from 10% to 25% on January 1,2019..  More than half of Chinese imports now face punitive import tariffs. In addition, Trump has threatened on September 17, 2018, to "immediately" place tariffs on another $267 billion worth of imports "if China takes retaliatory action against our farmers or other industries."

    President Trump is wrong when he says that trade wars are easy to win.  In fact, for the United States a trade war is a short-term railroad.  Very soon American suburban housewives will tire of paying 25% more for their purchases at the local Wal-Mart.   American farmers will not be happy with the prospect of losing China as their primary export market for soybeans, wheat, and other agricultural products.  Chinese officials have divided the U.S. demands into 142 separate items, which they have placed into three categories.  Of the demands, 30% to 40% could be negotiated over time; and 20% were off limits because they involve national security or other sensitive issues.  Chinese officials have said that 122 of the 142 items are considered to be negotiable.

**VII.  Conclusion**

    Douglas MacArthur once said that history is a series of biographies of great men.  While admittedly an overstatement there is a kernel of truth to it.   The personalities and egos of leaders matters a great deal.   Xi Jinping is not only the President of China, he is also the General Secretary of the Communist Party of China Central Committee, and chairman of the Central Military Commission.   He has in short consolidated power to an almost unimaginable degree.   What he decides to do becomes the de facto policy of China.  And one thing he cannot be seen to be doing is to kowtow to the President of the United States.  Donald J. Trump, the U.S. President, has stated that he could shoot someone on Fifth Avenue in New York, and not be arrested.   Democrats will not criticize Trump on trade if he is tough on China, and he cannot be seen, at least in his own mind, as caving in to China.   The decisions of these two men will be critical in determining whether China and the United States continue on a collision course.  The end game for China has yet to be played out.   As Santayana said, history does not repeat itself, but it does rhyme.   China is not the Soviet Union Reagan faced down by 1989, and China is not Japan in 1941, desperate for oil that President Roosevelt embargoed..   Trump believes he can wreck the Chinese economy, as Reagan outspent the USSR on defense, but he is wrong.   China is so large it can largely supply itself with what it needs to survive.  But 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.

    I began this discussion on a linguistic note, and will end it on a linguistic one as well.  China's name for the United States is Meiguo, the Beautiful Country.  The history of the United States - Chinese relationship is one of hope followed by disappointment, but at the end of the day the Chinese people still view America as the Beautiful Country.  Conflicted feelings exist on both sides. Yet these two great powers are mutually dependent upon each other, and our relationship is doomed to succeed.  While some Americans, such as President Trump, are asking whether we have given China too much, some Chinese are beginning to ask whether they have pushed America too far.  These fluctuations are rooted in history, with both nations irresistibly and inevitably drawn back to one another.  The result is 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.   That is the task before us, and the jury is out on whether or not we will succeed in that endeavor.