THE CONFERENCE BOARD

Updating Assumptions About US- and EU-China Futures for 2022 and Beyond

Insights for What's Ahead from the China Center Deep Dive Exchange Virtual Meeting, March 10, 2022

Meeting Context

MNCs in China are facing an increasingly fraught geopolitical landscape as US- and EU-China tensions reach new highs. The space that once existed between business and politics has narrowed dramatically and threatens to disappear altogether in some sectors if China is too supportive of Russian positions on the Ukraine and invites expanded US and EU sanctions and trade restrictions as a result.

With companies working to mitigate policy risks with regulators on both sides, members convened for the first China Center Deep Dive Exchange of the year. More than 50 China Center members representing sectors ranging from industrial, pharmaceutical, automotive, retail, ICT and more, discussed US-China and EU-China relations looking forward, and how geopolitics, trade and domestic policy developments are likely to shape the China business environment for MNCs in 2022 and beyond.

The meeting featured perspectives from Washington, D.C. and Brussels with remarks from Jeremie Waterman, Vice President, Greater China, U.S. Chamber of Commerce and Joerg

China Center **Deep Dive Exchanges** are immersive meetings with functional peers to share market intelligence and business practice insights on specific, "thorny", China management and business development topics. Members interact with experts and peers to exchange ideas and validate assumptions. The China Center convenes two to three such meetings each year. Topics are proposed by China Center members.

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Wuttke, President of the European Union Chamber of Commerce in China & Vice President and Chief Representative of BASF China.

Setup slides framing the key issues can be found here.

The focal questions for the session were threefold:

1. What new US and/or EU restrictions and/or sanctions should be expected?
2. In response, what changes in regulator engagement in China should be expected and prepared for?
3. What are the key US/EU-China geopolitical risk management priorities, near-term and beyond?

Insights for What's Ahead

- The trendlines in Sino-western relations are not positive at all. The combination of partisan US politics, acute concerns about the Taiwan issue, and the Ukraine situation is toxic for China policy.
- The US and Europe are expected to adopt a more unified hard stance on China going forward. The Ukraine situation has broken the EU's inertia on taking a tougher position on China, as well as removed the hesitancy on siding with the US on China policy.
- China trade and investment will become more restricted and complicated. For some companies in some sectors, the middle ground between Chinese and Western regulations may become unnavigable.
- The three headline developments to prepare for in 2022 are:
  - The severity of US enforcement of the **Uyghur Forced Labor Prevention Act (UFLPA)** when enforcement operations come into effect on June 21.
  - The scope and forcefulness of the US Trade Representative's (USTR) pending **Section 301** investigation of Chinese subsidies and industrial policies.
  - Deliberations in the US and Europe on previously stalled outbound **investment screening** policies for China.
- All of these and more are likely to come into force more quickly and significantly depending on the extent to which China provides sanctions relief or other support to Russia, real or perceived. Over-supporting Russia's Ukraine position risks greatly exacerbating ongoing US-China/Sino-western tensions and inviting tougher restrictions on China trade, investment, and commerce from the US and Europe. (See China Center commentary, "Sino-Russian 'Friendship' and the Ukraine Situation – A Slippery Slope for China" here)
- Given the many, persistent, highly consequential policy and operating uncertainties at this juncture, companies need to have contingency plans for worst case scenarios for their China businesses, *just in case*. Gray Swans should factor into business planning.

- The unexpected exodus of foreign companies in Russia is relevant. MNC operating calculations are not only defined by regulatory permissions and prohibitions. Ultimately, values and public opinion are paramount influences. Members need to carefully monitor relevant public opinion trends and ready their playbooks to respond to public relations crises.

> "Ukraine has made certain there is no political space for constructive China engagement in the US." – *Member company attendee*

US and European Developments and Observations

- **At this time, carrots should not be expected from Congress on China, only sticks.** Sentiment in Congress is decidedly negative. The pro-Russian propaganda campaign running in China that vilifies the US for causing the Ukraine crisis and, among other things, alleges US covert biolab activity in the country has greatly worsened sentiment. Most US lawmakers assume de facto Chinese complicity in the Ukraine invasion, and already consider Russia and China to be an "axis". A turn-around in this sentiment is highly unlikely.
- **US China policy remains work-in-progress. The current 'holding pattern' can be characterized as "continuity plus multilateralism".** There is no holistic playbook yet, and it's not expected that one will be forthcoming soon. While there is an understanding within the Biden Administration that the China market is important to US companies, there is no consensus on "The China Policy". The administration has been studying and debating internally about what they want to do about China.
- At present, agencies with a say on China policy – NSC, Treasury, Commerce and State, to name a few - are not rowing in the same direction and there is a lot of internal tension. The exception is the Climate team, led by John Kerry, who have a plan, strong leadership, and demonstrable momentum.
- **However, there is agreement and momentum to focus on structural issues including** China's subsidies and industrial policies and data and digital policies.
- **US Industrial and Competition Policy formulation is progressing. The ratification of a beachhead "Make It in America" policy is expected by May 1** (i.e. an integration of the various proposed Acts: Chips Act, Strategic Innovation and Competition Act, etc.).
  - There has been a lack of action on the ICT Supply Chain (ICTS) executive order and no push on China's privacy rules. However most believe it is a matter of 'when', not 'if', that ICTS will be put into place.
  - The Indo Pacific Economic Framework (IPEF) remains formative. With no market access or infrastructure programs yet defined for allies to rally behind, "There's no IPEF value proposition yet for Asia to buy into."

  - USTR's Section 301 investigation of Chinese subsidies will happen, probably in the next two months. It is ready to go.

- **Some $320 billion of US tariffs on China are likely to come to an end on July 1.** The suit filed by US companies against certain Trump Administration tariffs is likely to result in a repeal of List 3 and List 4A tariffs. A ruling by the US Court of International Trade is expected on July 1.
- **But new tariffs in strategic areas are expected** with an orientation toward Chinese exports to the US in batteries, med-tech, pharma, NEVs, etc. It is possible Chinese imports in these categories will be blocked completely.
- **On the sanctions front, it is expected that more Chinese companies and individuals will be incrementally added** to the Specially Designated Nationals and Blocked Persons (SDN) and Chinese Military Industrial Complex (CMIC) lists.
- **Strong enforcement should be assumed the Uyghur Forced Labor Prevention Act (UFLPA) comes into full effect on June 21, 2022.** The UFLPA's scope is broad, instructing U.S. Customs and Border Protection ("CBP") to presume that "any goods, wares, articles, and merchandise mined, produced, or manufactured wholly or in part in" the XUAR were made with forced labor and are therefore unfit for entry at any U.S. ports. Companies are now conducting supply chain due diligence and preemptive adjustments. Many are struggling with this exercise given the lack of transparency in much of the supply chain and the paucity of verification data and information.

  Enforcement will come into effect on June 21, 2022. From then on, US Customer and Border Protection will conduct compliance assessments of US companies and render judgements and penalties.
- **Outbound investment restrictions** are being seriously considered. While beaten back in 2018, the Biden administration is considering restrictions in a number of pilot industries seen to have national security implications: semiconductors, AI, quantum computers, and biotechnology for example. Congress is supportive and legislative proposals are being developed.
- **Bipartisanship will fade as the November 2022 mid-terms approach. With a Republican win of the House majority in the mid-terms** (widely expected), **China policy will necessarily toughen beginning January 2023.**
- **In general, Congressional Republicans are more hawkish** on China and in recent years have become less inclined to heed the advice of the American business community.
- **The Ukraine situation has brought the US and Europe substantively closer together on the foreign policy front. The conjoining is expected to endure, strengthen, and extend to unified and strengthened positions on China in the future.**
- **In Europe, well prior to the Ukraine crisis, China sentiment had been deteriorating significantly**.

- The yawning trade imbalance – European exports to China (not growing) versus Chinese exports to Europe (growing by nearly 25% y-o-y) – is a key sticking point and now a major public opinion issue. "What are we getting from the accommodative relationship with China?"
- China's retaliations on Lithuania for its expanded Taiwan trade engagement greatly alarmed Brussels and governments across Europe. The EU has filed a WTO suit against China on the matter.
- There is growing concern about Europe's industrial dependencies on China and China's consequent commercial leverage. Energy vulnerabilities exposed by the Ukraine crisis are likely to see support strengthened for major industrial policies designed to de-risk European industrial supply chains.
- European politicians have been alarmed by China's full-throated parroting of Russian propaganda on Ukraine and taking steps in response. For example, EU-in-China has been actively posting factual exposes on Weibo about the Ukraine situation and countering Russian fake news. They are the most read and spread posts ever for EU-in-China.

- European leaders are now openly questioning the integrity of China's stated "peaceful coexistence" and "non-intervention" policies.
  - Newfound energy and ambition is expected to give new life to a stalled US-EU Trade and Technology Council (TTC). The widespread perception on The Hill had been that Europe was not prepared for a muscular approach to China that risked access to the China market. This has changed.
  - Longer-term, China is likely to face some blame from Europe for an expected 4-5 million Ukrainian refugees.
- **China is scrambling to rescue the European relationship but appears to be grasping at straws. Its positions are increasingly unreconcilable.**
  - China has increased wheat purchases from Ukraine as a gesture of support.
  - On the March 8th conference call between Xi Jinping, German Chancellor Olaf Scholz and French President Emmanuel Macron, Xi stressed China's non-intervention, non-interference policy, and promised to play a mediating role to help resolve the conflict.
  - The scheduled April 1 China—EU Leadership Summit has no agenda set as of now which is highly unusual.
- **It is expected that the China Government and Chinese firms will broadly comply with Russia sanctions.** "They did so in 2014, and to date – down to the last details."
- **The exodus of European and US firms from Russia will challenge the prevailing notion in China that MNCs will complain about business conditions but never cease investment or leave.**
  - BP walked away from a $25b project in Russia (here).

- Boeing and Airbus parts and service suspensions have grounded, or will ground, most of Russia's commercial fleet.
- Even firms not subject to sanctions have suspended operations: Apple, Ikea, McDonalds, etc.

Selected Discussion Points

What does internal dissonance in China on the Sino-Russo Relationship mean? Despite official statements to the contrary, many in the group are hearing from their respective contacts in the Chinese political class that that the Sino-Russo relationship is one of convenience, not an alliance, that Russia is considered a rogue state, and that the recently upgraded "joint friendship" is/was a policy mistake. What does this dissonance imply about current Chinese leadership dynamics?

Will China step in to save the day on the Ukraine crisis? Any opportunity China had to mediate on the Ukraine situation, and thereby create openings for improved Sino-western relations, is fading fast.

The reported US failure to coopt China before February 24 is a hard fact to distance from.

China's statements calling for a peaceful resolution of the conflict are seen as inauthentic given the prevalence of pro-Russian propaganda circulating in China through both official and unofficial channels. It is taken as a given that China can control the domestic media at its discretion. That this is not being done presents conflicting signals.

Given the deterioration in Sino-western relations, the expanding trade restrictions, and China's increasing preference for self-sufficiency, do western MNCs need to consider winding down operations with a view to re-starting sometime in the future when conditions become favorable again? No one thinks that current conditions call for this course of action yet. But real and detailed contingency planning in this regard is increasingly pressing. The combination of US politics, Taiwan concerns, and the Ukraine situation is toxic enough to warrant planning for the unthinkable.

For Membership Inquiries

David Basmajian | david.basmajian@tcb.org
Claire Xia | claire.xia@tcb.org

Or visit www.conferenceboard.org

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