Threats & opportunities in the U.S.-China business relationship

What boards and executives need to know

By Betsy Atkins

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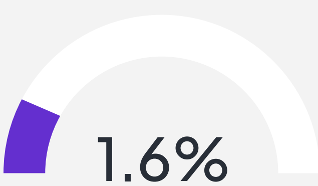
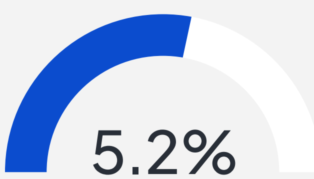
The business relationship between the United States and China is one of the most important in the world, and one that is worth trillions of dollars. But in recent years, that relationship has become increasingly strained due to a number of factors — from trade disputes to intellectual property theft to human rights concerns.

The legislative environment is also evolving rapidly. CEOs, leadership teams and board members must ensure that their companies are not only compliant with all applicable laws and regulations, but also equipped to navigate the complex political environment. They must be mindful of how the U.S.-China relationship, and its reverberations across the globe, can impact their company's bottom line.

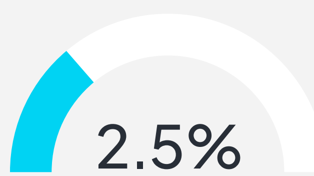
The current landscape



The current U.S. GDP is **$26.85 trillion** (nominal), and the current growth rate is 1.6%, according to the International Monetary Fund (IMF).



The current GDP of China is reported to be **$19.373 trillion** (nominal), and the current growth rate is 5.2%, according to the IMF.



In 2022, the total value of trade between the two countries was **$690.6 billion**. This was an increase of 2.5% from 2021. The U.S. exported **$153.8 billion** worth of goods to China, and imported **$536.8 billion** worth of goods from China. This resulted in a trade deficit of **$382.9 billion** for the U.S.

Risks, rules and protective mechanisms

Executive leadership teams and board members share the responsibility of driving organizational performance while building resilience through risk mitigation.

Some of the factors that merit consideration and discussion are:

- **The trade war:** The United States and China have been engaged in a trade war since 2018. This has led to tariffs on billions of dollars of goods traded between the two countries. These tariffs have had a significant impact on U.S. businesses — both those that export to China, and those that import goods from China.
- **Supply chain disruptions:** The COVID-19 pandemic exposed the vulnerability of global supply chains. Many businesses rely on China for the supply of critical components and materials.
- **Third-party risk:** There are additional supply chain risks brought in whenever third-party vendors, suppliers and/or operators are used. For example, financial risks arise if vendors fail to meet their obligations. There is also the possibility of security failures if the third party experiences a data breach or cyberattack.
- **Single-sourced items:** Many businesses rely on single-sourced items from China. This means that they are only able to get these items from one supplier.

In light of these factors, U.S. businesses need to understand the current trade and legislative environment with China in order to make informed decisions about the continuity of their operations.

Some of the most important pieces of legislation include:

- **The Trade Act of 2018:** This law authorized the Trump administration to impose tariffs on Chinese goods in response to China's unfair trade practices.
- **The Phase One Economic and Trade Agreement between the United States of America and the People's Republic of China:** This agreement was signed in January 2020 and included commitments from both countries to reduce tariffs, increase trade and strengthen IP protection.
- **The Uyghur Forced Labor Prevention Act:** This law, signed by President Biden in December 2021, prohibits the importation of goods made with forced labor from the Xinjiang Uyghur Autonomous Region of China.

In addition to these laws, the U.S. government has taken several other steps to address and mitigate geopolitical risks. These steps include:

The creation of the U.S.-China Economic and Security Review Commission: This commission is responsible for providing Congress with an annual report on the economic and security relationship between the U.S. and China.

The strengthening of intellectual property protection: The U.S. government has imposed sanctions on Chinese individuals and entities that have engaged in IP theft or counterfeiting. For example, in 2019, the U.S. government issued sanctions on the Chinese telecommunications company Huawei for violating U.S. sanctions against Iran.

Moreover, the U.S. government has imposed a number of export controls in an effort to prevent China from acquiring sensitive technology that could be used for military purposes. These controls are administered by the Bureau of Industry and Security (BIS) at the Department of Commerce. See sidebar for more detail on the export controls.

Export controls

- **Controlled Unclassified Information (CUI):** This category includes information that is not classified but that could still be used for military purposes. For example, CUI could include information on manufacturing processes, software or algorithms.

- **National Security Controls (NSC):** This category includes information that is considered to be essential to the national security of the United States. For example, NSC could include information on nuclear weapons, missile technology or cryptography.

- **Emerging and Foundational Technologies (EFT):** This category includes technologies that are considered to be essential to the future of the U.S. economy and national security. For example, EFT could include artificial intelligence, quantum computing or biotechnology.

The BIS has a number of different licensing requirements for export controls on technology. These requirements vary depending on the type of technology and the end-user. For example, some technologies require a license for all exports to China, while others only require a license for exports to certain Chinese entities.

The BIS also enforces a number of sanctions against Chinese entities that are involved in activities that the U.S. government considers a threat to national security. These sanctions can include export restrictions, visa denials and asset seizures.

Conversely, there are also mechanisms in place to protect U.S. interests from foreign investments coming into the country.

The Committee on Foreign Investment in the United States (CFIUS) is an interagency committee that reviews foreign investments in the United States to determine whether they could pose a national security risk.

If such a risk is identified, CFIUS can take a number of actions, including requiring the parties to divest themselves of certain assets, imposing other conditions on the transaction, or prohibiting the transaction altogether.

Factors the CFIUS considers when conducting a review

The nature of the foreign investment: Is the investment a controlling investment? Does it give the foreign investor access to sensitive technology or information?

The identity of the foreign investor: Is the foreign investor a government-owned entity? Does it have a history of engaging in espionage or other activities that could harm the national security of the United States?

The impact of the investment on the U.S. economy: Could the investment lead to job losses or the loss of sensitive technology?

The current legislative landscape

For businesses, it will be critical to understand the current and upcoming legislative agenda as they think about capital investment, selling products and services to China, strengthening their supply chains, and reducing their dependencies on products and services coming from China.

Some notable proposed U.S. legislation being discussed now include:

- **The China Competition Act:** This bill, which is currently being considered by the Senate, would create a new government body to oversee competition in the U.S. economy and take action against Chinese companies engaging in unfair trade practices.
- **The Countering China's Economic Aggression Act:** This bill, which is currently being considered by the House of Representatives, would impose sanctions on Chinese entities that are involved in activities that the U.S. government considers to be a threat to national security.

Addressing vulnerabilities

It is likely that more legislation will be proposed in the future as the U.S. and China continue to compete for economic dominance.

So how do businesses interpret these potential new laws? And what are the risks of outsourcing manufacturing to China, or depending on China as a single-source supplier?

Let's consider the case of semiconductors. There has been significant concern over the availability and continuity of so-called "commodity chips," such as transistors, capacitors and other commodity semiconductors.

These commodity chips are the foundational components of nearly everything —including computers, mobile devices, televisions, cameras, and even the electronic systems in our cars. They are also critical components in essential medical devices, such as pacemakers and defibrillators.

In the 1980s, the United States was the dominant player in the semiconductor industry. However, in the 1990s, Asian countries such as Taiwan, South Korea and China began to emerge as major competitors. These countries offered lower labor costs and government subsidies, which made it difficult for American companies to compete, especially in commodity, low-margin chips.

As a result, many American semiconductor companies began to outsource their manufacturing to countries with lower labor costs. China was a major beneficiary of this trend, as the country offered a large pool of low-cost labor and a supportive government. But as more and more jobs were moved overseas, the American manufacturing base began to decline, which has created even more significant vulnerabilities.

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Questions for boards

To address these risks and vulnerabilities, boards and leadership teams need to think about:

- How much capital is invested in factories and manufacturing outsourced to China?
- What are the risks of IP theft in outsourced factories in China?
- How dependent is current manufacturing on sole-source items from China?
- How soon could the company near-shore or home-shore current manufacturing, should they need to?
- What is the up-cost, and has the company qualified a second source yet for all of the parts for build materials?
- Is there a clear path for the business to have autonomy from China?

So, what do these takeaways mean for boards of directors? What does this mean for management and the boards responsible for mitigating risk?

It would behoove boards to understand their company's current manufacturing and supply chain dependencies.

Directors should ask management:

- Is everything on the supply chain coming from China dual-sourced?
- If the company has outsourced manufacturing, what would happen if there were sanctions put in place and the outsourcers were not able to manufacture or ship out of China?

Given the legislative discussion and buzz around the topic, it appears that the U.S. and China are working toward a less integrated future. As their economic interdependence starts to decrease, it is easy to see how the relationship could become more frayed. Ultimately, boards do have to consider the possibility that their business will not be able to depend on China as a location for manufacturing, or as a source for supplies.

While it is impossible for companies and boards to plan for every potential risk, this is one area where they can certainly anticipate a very real threat. Now is the time to start having deliberate discussions around risk mitigation, and begin implementing contingency plans.

About the author

Betsy Atkins

Betsy Atkins is a former three-time CEO and has served on some of the world's most visible global public company boards. For 30 years, she has worked behind the scenes at companies like Chico's, Vonage, Darden Restaurants, NASDAQ, HealthSouth, Wix and Home Depot Supply. She has served on over 30 boards and been through 13 IPOs, and she has served on many private equity- and venture capital-backed private boards. Betsy started her career as an entrepreneur, co-founding several successful digital tech and consumer companies, including blockbuster $5.4 billion Ascend Communications. She currently serves on the boards of Wynn Resorts, Volvo Cars and Diligent Corporation. Betsy is the author of the book Be Board Ready: The Secrets to Landing a Board Seat and Being a Great Director, and she is a regular contributor to WSJ, the Financial Times, Forbes, CNBC PowerLunch, Bloomberg and Yahoo! Finance.

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info@diligent.com | diligent.com

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