China – U.S. Trade Relations at Possible Turning Point

PRESENTED BY PAUL HASTINGS

Turning for the Better or Worse?

The two nations are at a unique point in their trade history. The Chinese government has made plans to improve the competitiveness of key industries, while the U.S. President tries to prevent American businesses from falling behind. Add trade tariffs, military tensions, a high-level Chinese business executive facing possible U.S. criminal prosecution, as well as increased scrutiny of Chinese investment in U.S. companies, and this is a recipe for a potent stew neither side may want to swallow.

Shifting economic power muddies trade waters

Given the political tension between the U.S. and China, Chinese investment activities have come to a halt. There have been hundreds of Committee on Foreign Investment in the United States (CFIUS) reviews in just the past decade. The restrictions prevent a much broader range of foreign transactions deemed a threat to national security. Chinese transactions have grown significantly in both voluntary filings and requested filings, yet the actual impact on the investment activities is too early to comment.

Stricter scrutiny of some Chinese investments in U.S. companies

U.S. Congress approved the Foreign Investment Risk Review Modernization Act (FIRRMA) in 2018. The administration has since made it known that its authority through CFIUS would be used very broadly to examine any foreign transaction involving a U.S. business that designs or produces technology related to 27 industries, including telecommunications, semiconductors and computers. The change is mostly the result of fear of the Chinese military gaining access to sensitive technology.

Under prior rules, CFIUS could only review takeovers and controlling stakes in American companies by foreign entities. Now, it can consider foreign joint ventures and smaller investments in American businesses that make technology deemed critical for national security.

CFIUS can review and prevent a proposed deal involving a foreign investor and a business making sensitive technology. If that investor could gain access to nonpublic, technical information, or if it can engage in substantial decision making over the company, such as obtaining a seat on a board of directors, the deal is subject to scrutiny and may be stopped.

“There’s been a significant increase in Chinese transactions being reviewed by CFIUS in recent years,” according to Vivian Lam, Partner at Paul Hastings, which helps both Chinese and American companies with CFIUS matters.

Chinese entities have shown a strong appetite for investing in American high tech companies, according to a New York Times article.[1] The article reports that Public Citizen, a U.S. advocacy group and think tank, estimates 56% of Chinese investments in the U.S. in 2017 involved industries that the Chinese government considers “strategic,” including aviation, biotechnology and alternative energy vehicles. This is an increase from 25% in 2016.

The Trump administration’s trade measures have substantially slowed Chinese investment in the U.S., falling more than 90% from the first half of 2017 to the first half of 2018. This was the lowest level in Chinese investment in seven years, according to the Rhodium Group, an independent research group.

“New FIRRMA regulations have made some voluntary reviews mandatory, and CFIUS jurisdiction has been expanded,” says Lam. “This increased scrutiny and difficulty in getting transactions approved has discouraged Chinese investments in U.S. companies. Investments to the U.S. have suffered, but the benefits, if any, for U.S. security may be difficult, if not impossible, to measure. ”

Short-term pain, but potential long-term gain for both countries

How this all plays out has yet to be seen. China may decide to blunt its goals for economic growth and give concessions to countries objecting to its trade practices, while Western nations may lessen their distrust of Chinese plans and see Chinese trade and investment as benefitting all parties.

“Unless tensions are resolved, the situation may result in something businesses in the U.S. and China want to avoid – uncertainty – which will result in a slowdown of trade, income, profits and employment,” says Lam. “Trade involving both sides of the Pacific brings great potential benefits for all parties, but that will only happen when the U.S. and China agree on the rules of their evolving trade relationship.”

For more information, please contact ***Vivian Lam****, Partner at Paul Hastings or visit paulhastings.com.*

[1] In New Slap at China, U.S. Expands Power to Block Foreign Investments, The New York Times, October 10, 2018, **https://www.nytimes.com/2018/10/10/business/us-china-investment-cfius.html**