Stop-and-Go: How Washington Can Speed Up Strategic Decoupling with China

Produced by the
Vandenberg National Security Council's Asia Directorate
Summer 2024

The Vandenberg National Security Council (VNSC) is a small group of the most promising up-and-coming experts on key foreign policy and national security issues. VNSC members work alongside the Vandenberg Coalition's staff and senior members of the advisory board, and collaborate within and across directorates mirroring the president's National Security Council (NSC) to develop policy proposals for America's national security. This VNSC report was edited by advisory board members Jamieson Greer and Jacqueline Deal.

When China became a member of the World Trade Organization twenty-two years ago, many U.S. policy makers believed it would result in greater economic and political freedoms for the Chinese people, international stability, and improved U.S.-China relations. Since then, the U.S. government has shifted its policy to counter China's goal of replacing the United States as the global dominant power. Key to the United States' efforts to counter China is ensuring our commercial engagement does not fuel the growth of China's strategic industries, military modernization, or its surveillance state.

While the United States is decoupling from the People's Republic of China (PRC), this process is occurring slowly with key gaps in U.S. strategy. This policy review examines a selection of Biden administration policies and Congressional initiatives over the past two years vis-a-vis the U.S.-China economic relationship and grades their progress. Each initiative is graded on a stoplight scale, from **GREEN** (moving ahead) to **YELLOW** (slowed/stalled) to **RED** (stopped). In addition to background and progress assessment, each entry is accompanied by a set of policy recommendations.

We examine five policy initiatives in this study:

- **Outbound Investment Restrictions:** The Biden administration has taken the first step in limiting American capital from funding China's military and strategic technologies. But it and Congress can go beyond this narrow, initial policy step to ensure the United States does not subsidize Xi Jinping's malign agenda at home and abroad.

- **The Uyghur Forced Labor Prevention Act:** This bipartisan legislation, which was enacted into law December 2021, has immense potential to eliminate goods made with forced labor from Xinjiang entering U.S. supply chains. However, it has had a more limited impact on decoupling than one might expect.

- **The Information and Communications Technology and Services (ICTS) Process:** This little-known Executive Order created in the Trump administration and continued in the Biden administration allows Washington to limit the cross-border transfer of data. The Commerce Department just launched an investigation into Chinese-made connected vehicles. It has the opportunity to open similar investigations into other items that pose data-security risks for Americans, such as data centers and cellular modules.

- **'Foundational' Semiconductors:** Biden has rightly worked to limit the growth of China's 'advanced' semiconductors, but his policy may miss the importance of 'legacy' or 'foundational' semiconductors, which are essential to modern economic life. If China were to dominate their production, it could spell strategic disaster for the United States.

- **The 'De Minimis' Loophole:** Goods imported into the United States with a value less than $800 are not subject to tariffs. This trade loophole is central to the business strategies of PRC e-commerce giants Shein and Temu. Congress has an opportunity to close this loophole this year.

GREEN LIGHT

OUTBOUND INVESTMENT RESTRICTIONS

Background: In August 2022, the Biden administration unveiled draft rules limiting outbound investment into China that covers private equity and venture capital investments into semiconductors, quantum computing, and artificial intelligence.[1] Some of the rules are outright bans on investment (such as into advanced semiconductors), while others include only a notification requirement (such as into 'legacy' semiconductors). It has not yet come into effect.

In Congress, House members are split between this sectoral approach to limiting outbound investment and another that would empower the Treasury Department to apply U.S. dollar sanctions to individual Chinese companies. This latter approach, while well-intentioned, would not work. China usually dodges Washington's efforts to single out individual Chinese companies with workarounds as simple as creating shell firms.[2] The way to eliminate this problem is to prohibit investments into strategic sectors altogether.

Assessment: For the first time, the United States will implement limited prohibitions on private U.S. investment into China. While this is a positive step forward by the Biden administration, the draft rules have significant gaps that must be addressed. We recommend that the Treasury and Commerce Departments consider the following expansions to their rules to ensure that U.S. capital and know-how does not fuel China's military modernization, its surveillance state, or its strategic industries.

Recommendations:

1. Prohibit capital into additional sectors: These investment prohibitions could be expanded to impact all of the technology categories outlined by the White House's Science and Technology Council as "critical and emerging technologies" in 2022.[3] Special focus should be given to biotech, hypersonics, networked sensors, robotics, aviation, and space technology, given the dire strategic implications if China were to get ahead in these technologies.

2. Include ban on public investment: The administration's rules are limited to private U.S. investment, such as private equity and venture capital, seemingly on the belief that Washington's focus should stay on the know-how transfer that these private investment relationships often entail. But if Washington doesn't want U.S. know-how and tech to flow to these targeted sectors, investment into publicly-listed companies via index funds should also be prohibited.

3. Implement authority to retroactively clawback investments: As currently structured, the prohibition on funding rules only apply to future investments. This leaves out investments that Washington would otherwise seek to prohibit, such as Goldman Sachs' investment into Chinese military semiconductor manufacturing equipment firm Advanced Micro-Fabrication Equipment (AMEC).[4]

4. Hold the line on Critical Sectors: The existing rules only ban investment in quantum and AI technologies when the product is meant to be "exclusively" or "primarily" used for malign uses. But the Communist Party's 'Military Civil Fusion' strategy means that any technology developed in China, however well intentioned, will be harnessed for military and strategic uses. The administration should categorically deny investment into critical sectors.

5. Provide clarity on timing for implementation: There has been no public indication about the status of the draft rules since the White House unveiled them in August 2023. The administration should urgently work to launch these rules to send a strong signal to investors.

YELLOW LIGHT

UYGHUR FORCED LABOR PREVENTION ACT

Background: The Uyghur Forced Labor Prevention Act (UFLPA) was signed into law by President Biden in December 2021 and aims to ban the import of goods from Xinjiang made with forced labor into the United States in response to the PRC's ongoing genocide of Uyghurs. The law, which entered into force in June 2022, establishes a rebuttable presumption that any imports of goods made in Xinjiang using forced labor are prohibited under Section 307 of the Tariff Act of 1930 and are banned from entry into the United States. This presumption rule applies unless the importer can prove that the goods were not made using forced labor. Enforcement of UFLPA also requires U.S. Customs and Border Protection (CBP) to maintain a list of Chinese companies that are known to use forced labor in their supply chains for goods sent to the United States.[5]

In addition, the law amends the Uyghur Human Rights Policy Act of 2020 to require the president to submit a report to Congress on foreign persons identified as being involved in human rights abuses in Xinjiang against Uyghurs and other minority groups. Following the submission of this list, the president must invoke sanctions against such persons using his authority under the Global Magnitsky Human Rights Accountability Act. This authority allows the U.S. government to block property transfers, freeze assets, and revoke visas against malign foreign actors —including government officials—who commit or help to commit "gross human rights violations."

Assessment: While the bipartisanship legislation has well-intentioned objectives, the UFLPA has been poorly implemented by the Biden administration, despite the Department of Homeland Security (DHS) Secretary Alejandro Mayorkas calling its enforcement a "moral imperative"[6] to ensure that goods produced by forced labor do not enter the United States. For example, the solar industry remains one of the top industries vulnerable to forced labor inputs from China, creating a sore spot for an administration that has prioritized green energy expansion. According to the Department of Labor, as of 2020, 95 percent of solar panels are made with polysilicon and fully half of global polysilicon production comes from Xinjiang. While CBP initially blocked over a thousand solar panel shipments in the first six months following UFLPA implementation, *Reuters* found that that they have reportedly begun releasing some of these goods from detention as U.S. imports of solar panels continue to steadily increase, which has allowed China to exploit this lucrative market without consequence.[7] Several lawmakers in Congress have also raised this issue repeatedly with the administration to no avail. In May 2023, President Biden vetoed a bill that would reimpose tariffs on solar products coming from China through third countries in Southeast Asia, citing concerns with the ability of the United States to shore up domestic solar production in the near term. The administration is clearly hesitating to take action on what should be a massive effort to enforce its trade laws to hold Chinese manufacturers accountable for their use of forced labor.

The administration's approach to UFLPA also lacks necessary interagency coordination between DHS, the State Department and other key agencies to punish PRC firms and entities for their involvement in forced labor and human rights abuses against Uyghurs. Since the bill's passage, the Biden administration has only imposed new sanctions against two PRC entities in December 2023, despite maintaining a list of companies actively involved in the use of Uyghur forced labor.[8] The Biden administration must add teeth to UFLPA enforcement by coordinating a combination of policy tools like sanctions, visa bans, and trade enforcement authorities, all of which are available under existing law.

Recommendations:

1. Interagency Campaign: Launch an interagency campaign between DHS, State, and Treasury to coordinate trade, diplomatic, and sanctions tools to hold the PRC government and companies accountable for their human rights abuses against Uyghurs and other minorities in Xinjiang.

2. Policy Harmonization: Harmonize the UFLPA list with other government trade/sanctions lists to ensure that Chinese companies receive the full punishment for using forced labor in their supply chains.

3. Sanctions Designations: In addition to the recent sanctions, the Biden administration should make public its list to Congress of the foreign entities—including PRC government officials—that are subject to sanctions under the Uyghur Human Rights Act of 2020.

THE INFORMATION COMMUNICATIONS TECHNOLOGY AND SERVICES (ICTS) PROCESS

Background: This little-known but potentially hugely consequential interagency authority—called the Information Communications Technology and Services (ICTS) process—gives the U.S. government the authority to regulate hardware and software in the ICTS supply chain. The Trump administration first developed this authority in 2019 under EO 13873, which allows the Commerce Department to review ICTS transactions on a case-by-case basis and prohibit those originating from foreign adversaries that could pose a national security risk to the United States. The interagency process was built in the final days of the Trump administration and was then reaffirmed by the Biden administration in a June 2021 executive order.

The Biden administration used this authority for the first time in unveiling an investigation into PRC 'Connected Vehicles' and the subcomponents within them.[9] This investigation could be used to block the coming flood of Chinese-made ultra-competitive electric vehicles coming soon to the U.S. market, and the software and hardware within them.

Assessment: The Biden administration's connected cars investigation should serve as a springboard to launch similar investigations into other items in the ICTS supply chain that pose data risks to the United States.

Recommendations: The Commerce Department could launch investigations into PRC-made hardware and software that pose risks to U.S. data security and national security. For example:

1. Cloud Firms: China's cloud service providers often operate in the United States, providing potentially significant risk of data transfer from the United States to China. Both Alibaba Cloud and Tencent Cloud have data centers in Northern Virginia (home to Amazon Web Services' most important data center) and Silicon Valley.[10] The United States should use the ICTS process to mitigate the risk of misuse of sensitive American data by prohibiting these firms from transmitting data to China from the United States.

2. Cellular Modules: These are key components that enable Internet of Things (IoT) devices to the internet. They are crucial for cars, medical equipment, smart cities, drones, etc. As the bipartisan House Select Committee on China put it, "*if the CCP can control the module, it may be able to effectively exfiltrate data or shut down the IoT device*."[11] China's key players in this sector are Quectel and Fibocom. The Commerce Department should investigate the risks posed by these devices throughout the ICTS supply chain.

RED LIGHT

'FOUNDATIONAL' SEMICONDUCTORS

Background: The Biden administration's semiconductor competition policy toward China has until now centered on slowing the growth of China's advanced chip manufacturing. The idea is to halt the export of U.S. and allied chips and semiconductor machine tools to block China's cutting-edge technological development. 'Legacy' or 'foundational' semiconductors are the other half of the policy agenda this approach currently leaves unaddressed. They constitute the vast majority of chips used by Americans today, powering almost all consumer electronics, cars, planes, factories, medical devices and military systems. Simply put, modern life is built on legacy chips, and that will remain so for years to come.

China is on the path to become the world's leading manufacturer of legacy semiconductors. It already accounts for about 30 percent of worldwide manufacturing capacity for legacy logic chips, and that number is set to grow tremendously on the back of its industrial-policy playbook and its potential annexation of Taiwan.

If Beijing were to capture the global production of this supply chain, it would give it dangerous leverage over the United States. Along with its key place in the critical mineral, pharmaceutical, solar, electric vehicle, and shipbuilding supply chains, China is on the verge of capturing enough coercive leverage over the United States to limit its freedom of action.

Assessment: The Biden administration appears to be clearly telegraphing its worries about the risks of reliance on PRC production of legacy semiconductors. This began with the Commerce Department publishing on December 21st a Congressionally-mandated report on the chips supply chain, which highlighted how "PRC overcapacity threatens to make these products [legacy chips] financially nonviable in the United States and allied economies."[12] Immediately after finishing the study, the Commerce Department revealed it would begin a January survey on its own initiative on where more than 100 U.S. firms source their current-generation and legacy-node semiconductors.[13]

Recommendations: The Biden administration has multiple tools it can use to prevent U.S. reliance on Chinese-made semiconductors. But some of these will be stronger than others. Many would advocate that Washington turn to authorities it is familiar with for semiconductors and technology, such as expanding existing chip export controls on China to include tools needed for legacy manufacturing. The issue is that this approach will not be enough to stop the flood of Chinese legacy chips into the U.S. market, since China already has the access to inputs needed for legacy production (through stockpiling and domesticated technology).

Instead, the United States should use the statutory tools intended by Congress to defend its market from unfair Chinese trade practices. Washington has multiple authorities that would allow it to prevent goods made with Chinese semiconductors from entering the U.S. market. The United States could apply duties to counter PRC dumping, use "Section 337" authorities to counter IP theft, or "Section 232" rules to protect national security. Washington's best route would likely be in "Section 301," which gives the U.S. Trade Representative wide authority to investigate and remedy actions that burden U.S. commerce.

"DE MINIMIS" LOOPHOLE

Background: The de minimis rule is a tariff and tax exemption for "trivial" or low-value goods entering the United States. Established over a century ago[14] as an amendment to the Tariff Act of 1930, it was initially proposed to minimize the burden on U.S. customs officials for inspecting small gifts or souvenirs being brought back by American citizens traveling abroad. In 2015, Congress, under pressure from e-commerce platforms and importer interests, increased the maximum threshold of the exemption from $200 to $800 under the Trade Facilitation and Trade Enforcement Act of 2015 (P.L. 114-125) to expand its scope. Today, the rule exempts goods priced at $800 or below from tariffs if they are addressed and shipped to individual people in the United States. This level is much, much higher than any U.S. trading partner's de minimis level.

Contrary to what the law was initially designed to do, it now is mainly applied to purchases made from online retailers for goods shipped into the United States. Robert Silvers, Under Secretary of Homeland Security for Strategy, Policy, and Plans, testified that the de minimis shipments to the United States have increased to an estimated 685 million packages in 2022, likely due to the rise of online retail shopping during the COVID-19 pandemic.[15] This represents close to a 70 percent increase from 2018. The value of such shipments from the PRC, by some estimates, was valued at $188 billion in 2022.[16] Because the rule exempts such goods from tariffs—including Section 301 tariffs on China—U.S. Customs and Border Protection (CBP) is not required to inspect and review these packages when entering the United States, which has begun to raise serious concerns amid growing trade tensions with the PRC. According to the U.S. House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party's June 2023 interim report on Uyghur forced labor in China, major online Chinese retailers such as Shein and Temu are allegedly responsible for more than a third of all de minimis shipments into the United States.[17] Of course, this is also used by American e-commerce companies to import Chinese goods as well. Temu, a growing popular Chinese shopping platform, was flagged in the report for committing significant violations of U.S. law for failing to "maintain even the façade of a meaningful compliance program" for its supply chains and for promoting forced labor shipment of products into the United States on a "regular basis."

Assessment: This century-old rule is long overdue for legislative reform. It has allowed Chinese businesses to not only evade tariffs but also avoid customs inspections for goods that may have been made using forced labor from companies like Temu. The trade loophole also makes it difficult to track illicit goods being shipped to the United States, such as drugs or other counterfeit goods entering the country, despite CBP efforts to track or collect data on individual orders through Type 86 orders. For example, in March 2024, CBP seized a de minimis shipment in Louisville, Kentucky, worth $11 million that contained counterfeit watches en route from Hong Kong to Puerto Rico.[18] Additionally, the de minimis exemption undermines other administration efforts like enforcement of the UFLPA by letting Chinese firms evade U.S. laws and standards. CBP must increase its scrutiny and enforcement efforts to track what is entering the country through this loophole to ensure the UFLPA and other U.S. customer regulations are enforced appropriately.

Recommendations: The Biden Administration should work with Congress to pass reforms of the de minimis rule, which should include lowering the threshold back to the previous rate of $200 or lower. The United States' current tariff exemption is considered an outlier compared to most other countries which set much lower thresholds. This change would bring the United States in line with global standards.

REFERENCES

[1] U.S. Department of the Treasury, Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern (Washington, D.C.: Office of Investment Security, August 2023).

[2] Gregory Allen et al., "Improved Export Controls Enforcement Technology Needs US National Security," Center for Strategic & International Studies, November 30, 2022.

[3] U.S. National Science and Technology Council, Critical and Emerging Technologies List Update (Washington, D.C.: U.S. National Science and Technology Council, February 2022).

[4] "Advanced Micro-Fabrication Equipment (AMEC) – Overview," Crunchbase, accessed February 20, 2024.

[5] "UFLPA Entity List," U.S. Department of Homeland Security, last updated July 2024.

[6] "Press Release: Statement on First Anniversary of President Biden Signing the Uyghur Forced Labor Prevention Act into Law," U.S. Department of Homeland Security, December 23, 2022.

[7] Nichola Groom and Ricard Valdmanis, "Exclusive: U.S. Solar Panel Imports from China Grow, Alleviating Gridlock, Officials Say," Reuters, March 6, 2023.

[8] "Press Release: McCaul, Foxx, Green, Gallagher Criticize Mayorkas' Decisions with Enforcing UFLPA," U.S. House Committee on Foreign Affairs, September 27, 2023.

[9] The Department of Commerce, Securing the Information and Communications Technology and Services Supply China; Connected Vehicles (Washington, D.C., The Industry and Security Bureau, March 2024).

[10] "Alibaba's Cloud Global Infrastructure," "Tencent Cloud Global Infrastructure."

[11] Congressmen Mike Gallagher and Raja Krishnamoorthi, Letter to Jessica Rosenworcel (Chairwomen of the Federal Communications Commission), August 7, 2023.

[12] Bureau of Industry and Security, Assessment of the Status of the Microelectronics Industrial Base in the United States (Washington, D.C.: U.S. Department of Commerce, December 2023).

[13] "Press Release: Commerce Department Announces Industrial Base Survey of American Semiconductor Supply Chain," U.S. Department of Commerce, December 21, 2023.

[14] 19 U.S.C. §1321.

[15] U.S. Department of Homeland Security Under Secretary Robert Silvers, "Testimony on Corporate Complexity: Subsidizing the PRC's Human Rights Violations," U.S. Congressional-Executive Commission on China, July 11, 2023; U.S. Customs and Border Protection, "Trade Statistics," U.S. Department of Homeland Security, last updated February 9, 2024.

[16] Jeff Ferry, "De Minimis China Imports Hit $188 Billion Last Year," Coalition for a Prosperous America, May 15, 2023.

[17] U.S. House Select Committee on the Chinese Communist Party, Fast Fashion and Uyghur Genocide: Interim Findings (Washington, D.C.: U.S. House Select Committee on the Chinese Communist Party, June 22, 2023).

[18] "Press Release: De Minimis Shipment Worth Over $11 Million Stopped by Louisville CBP," U.S. Customs and Border Protection, March 11, 2024.