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Expanding the Transatlantic Toolbox for Economic and Strategic Competition with China: Export Control, Foreign Subsidy Rules, and Investment Screening

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The June 2021 G7 meeting in Cornwall, England ended with the issuance of a communique that reflected real progress in rebuilding transatlantic relations. While directly referred to only three times, China loomed large in the joint statement summarizing shared views on economic recovery from the pandemic, investing in green infrastructure, and reforming the world trading system. The partners promised to harness “the power of democracy, freedom, equality, the rule of law, and respect for human rights to answer the biggest questions and overcome the greatest challenges.”

In the American view, many of those great challenges emanate from China and a united transatlantic front is key to constraining China’s ability to play outside global norms. Particularly in the quest to stop undesirable technology transfers, shared aims and methods are viewed as essential to prevent China from using a “divide and conquer” strategy.

The European Union now identifies China as “an economic competitor and a systemic rival,” but major European exporting states are reluctant to create an adversarial relationship with Beijing and risk economic retaliation of the sort experienced by South Korea and Australia. Moreover, weary of the unpredictable and aggressive stance of former U.S. President Donald Trump, in early 2021 the EU adopted a new approach to trade policy, stressing the need to make autonomous decisions in keeping with its own interests and values. Nevertheless, recent Chinese actions, notably sanctions against European parliamentarians, have hardened attitudes across the continent and opened new avenues for transatlantic cooperation to counter China’s economic ambitions.

Concern about undesirable technology acquisition through selective purchases of Western technology companies is broadly shared in the transatlantic region, where there has been a confluence of policy reforms. Through the 2018 Foreign Investment Risk Review and Modernization Act, the United States expanded the scope of inbound foreign investment subject to review. The new regulations include mandatory review of transactions involving “critical technologies,” a designation that moves beyond military and “dual-use” to include “emerging and foundational technologies.”

Europe has also taken action to tighten and expand inward investment screening. An FDI screening regulation adopted in May 2019 established an EU-wide framework in which the

European Commission and the Member States can coordinate their actions on foreign investments. More recently, the European Commission has called upon all Member States to set up fully-fledged screening mechanisms for inward investment and most have done so. Such a mechanism was created in Germany, prompted by a rapid rise in Chinese purchases of domestic technology companies. The German legislation expanded notification requirements to emerging tech sectors, lowered the foreign-share threshold for notification, and expanded them to equity top-ups.

Export controls have long been used to retard the diffusion of new technology to states viewed as potential adversaries. The United States updated and strengthened its ability to use these tools with the Export Control Reform Act of 2018. ECRA codified existing U.S. government practices into law by replacing executive orders that had been issued annually since 2001. Under the law, Congress tasked the Bureau of Industry and Security (BIS) in the Department of Commerce to update U.S. export controls on "emerging and foundational technologies" that were "essential to the national security of the United States."[1]

With ECRA, Congress mandated that BIS ensure the multilateral adoption of any new U.S. controls, noting that unilateral U.S. export controls on "widely available" goods would be ineffective. This task is easier to legislate than accomplish as the United States and its transatlantic and Asian allies do not agree on the necessity of limiting access to some technologies. One divisive issue is the advantage conferred by export controls on incumbent suppliers and their ability to create both winners and losers among allies. American sanctions placed on Huawei, for example, badly damaged their hardware business while opening new market opportunities for other suppliers. That the move also harms consuming countries, some of whom do not share the American security concerns, illustrates the divergent commercial interests that make it difficult to reach consensus on a common set of goods needing export control.

On the cusp of major technological advances in energy, biotechnology, and artificial intelligence, it is likely that intensifying U.S. demands for multilateral export controls will be met by opposition from across the Atlantic. Not all allies see China as the threat that Washington describes, and some are wary of American abuse of national security justifications. Many prefer a more targeted, less combative approach than the one the United States has taken over the past five years.

Existing mechanisms by which coordination and cooperation can be achieved are weak or lacking. The current basis for multilateral cooperation on export controls, the Wassenaar Arrangement, was designed to prevent nuclear proliferation to rogue states and not to prevent diffusion of cutting-edge technology to the world's largest economy. With neither transatlantic

[1] For a discussion of the history of U.S. export controls and the challenges of restraining their use, see Chad P Bown, "*Export Controls: America's Other National Security Threat*," Working Paper 20-8, Peterson Institute for International Economics, Washington, DC. https://www.piie.com/system/files/documents/wp20-8.pdf

rhetoric nor approaches aligned, the new EU-U.S. Trade and Technology Council faces skepticism on both sides of the Atlantic. But such a platform for resolving differences is needed on a variety of tech issues, including export controls.[2] The platform could serve as a constraint on U.S. ambitions and a prod for EU action on common security threats.

The recent U.S.-EU deal to suspend mutual punitive tariffs over aircraft subsidies has revealed heightened transatlantic anxiety about the competitive effects of Chinese industrial policies. That the tariffs have been suspended, rather than removed, is telling – each side seeks to hold the other accountable for commitments of subsidy reform. The time horizon for resolving differences is five years, a period long enough perhaps for progress to be made on the difficult task of sorting good government support from that which offends. Because there is ample economic justification for industrial subsidies, and because subsidies affect trade and investment in multiple ways, technical discernment of trade-distorting policies has proved quite challenging. Continued reliance on the market/non-market distinction will prove less helpful than current political rhetoric suggests because market prices are affected by subsidies in ways that, as seen by the length and complexity of the Airbus-Boeing dispute, are difficult to trace and measure.

Subsidy concerns are often viewed through the lens of unfair trade practices, with remedies found in nationally administered protection (e*.g.,* anti-dumping duties, countervailing duties) and in the WTO (if the dispute settlement mechanism can be revived). Such remedies are typically too little, too late – they restrain trade after significant damage has been done to the industry in the non-subsidizing country. Moreover, remedies often fail to dislodge market positions gained through subsidization and thus can lead to a perpetual cycle of trade conflict.

Conflicts from industrial subsidies may grow with their increased use on both sides of the Atlantic to promote economic recovery from the pandemic, to encourage decarbonization, and to increase economic inclusion. The prospect for trade conflict looms as the politics of domestic job creation pushes against agreements on open procurement and national treatment. The transatlantic track record of resolving differences over industrial subsidies does not lead one to optimism. The trilateral statement issued by the European Union, the United States, and Japan in January 2020 is often held up as proof that multilateral negotiations can be effective in resolving differences. However, the declaration falls back on the need for market-oriented conditions and does little to resolve fundamental disagreements about how counterfactual market prices are to be determined in their absence.

Through recent legislation and diplomatic declarations, American and European leaders call for international coordination in meeting the China challenge. Coordination and cooperation are indeed vital. The high degree of interdependence embodied in global value chains, cross-border

[2] According to reporting by *The New York Times*, "A senior American official said that the council would operate as an interagency body and coordinate with Brussels in priority areas like standards for artificial intelligence, quantum computing and biotechnology, supply chain resilience and export controls." https://www.nytimes.com/2021/06/15/business/US-EU-Airbus-Boeing.html

R&D and human capital flows, and foreign investment imply that national economic and security risks cannot be adequately contained through unilateral action. Unilateral export controls, investment screens, and countervailing duties are less effective and more costly as targeted activities are simply diverted rather than deflected in the absence of effective multilateral coordination.

As the Biden Administration steps away from the free-form approach of its predecessor, we may be seeing the start of a more productive period of transatlantic statecraft. Despite remaining disagreements and weak coordinating mechanisms, there is transatlantic agreement on the benefits of cooperation and the dangers of inaction. The approach recently taken by the new U.S. administration to address the security challenge of foreign-owned social media apps – affirming values and goals, creating a transparent and rules-based process, applying them universally and not to particular countries or companies, and inviting allies to join – may be the blueprint for U.S. policy toward constraining undesired tech transfer while building domestic capacity. Whether and how the United States incorporates the European impulse for strategic autonomy remains to be seen.