



Chinese Export Controls

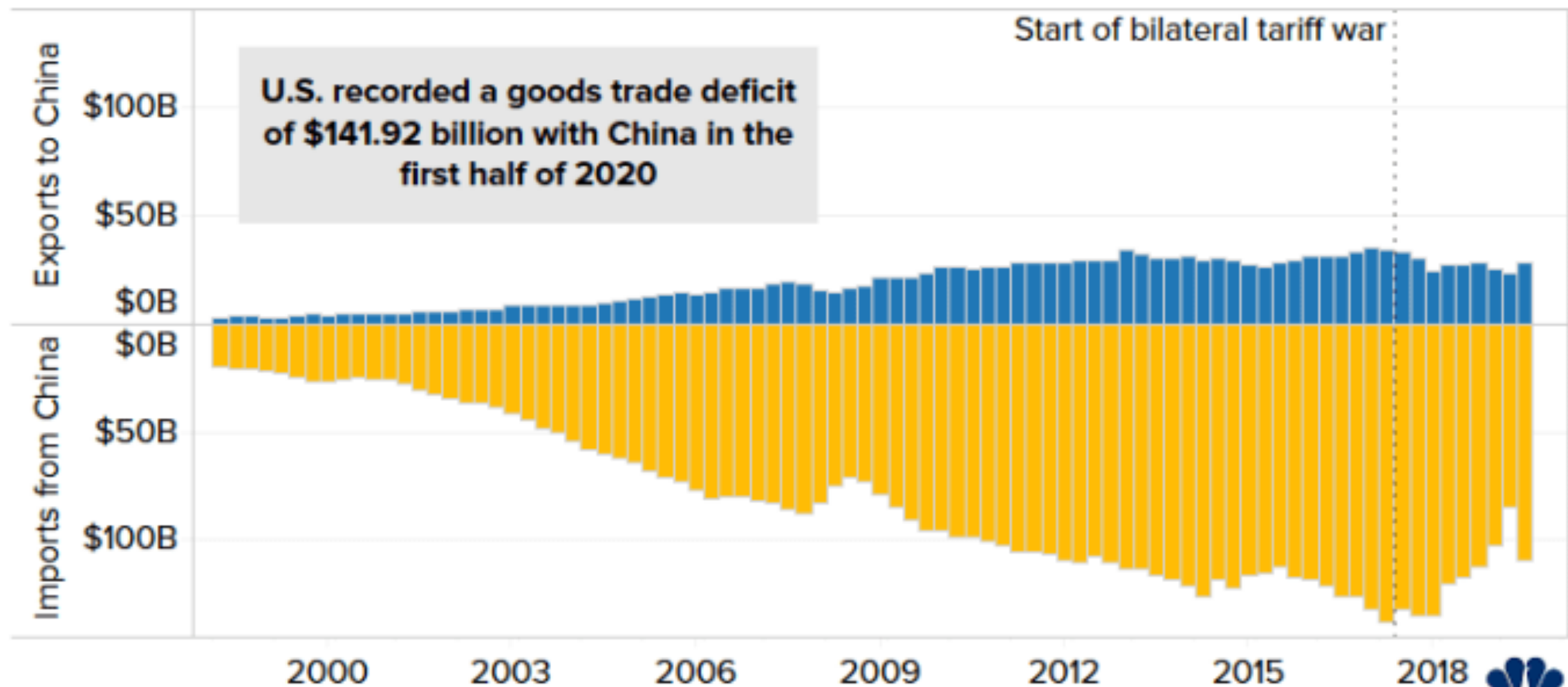
Trade School

October 23rd, 2020

Pete Mento

Mento LLC

U.S. goods trade with China

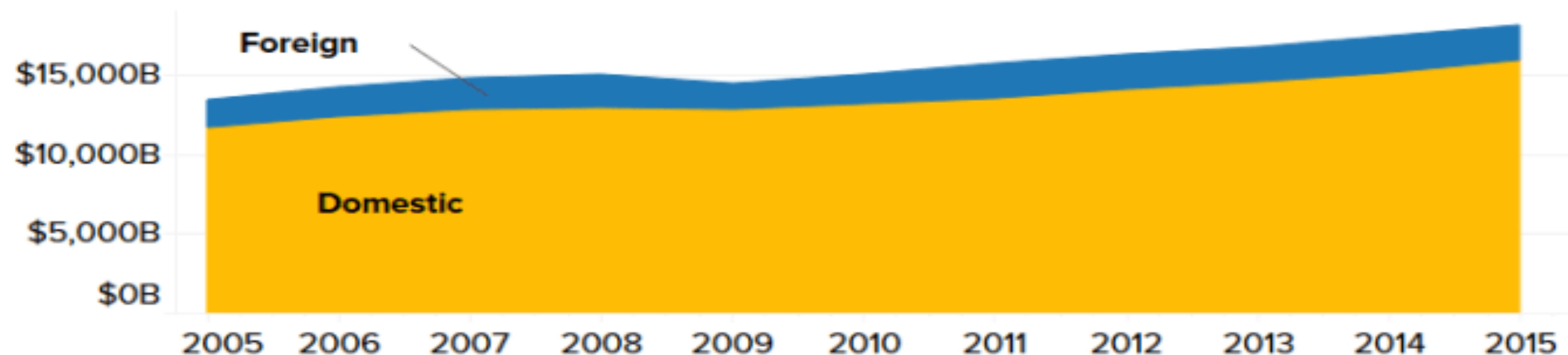


SOURCE: U.S. Bureau of Economic Analysis

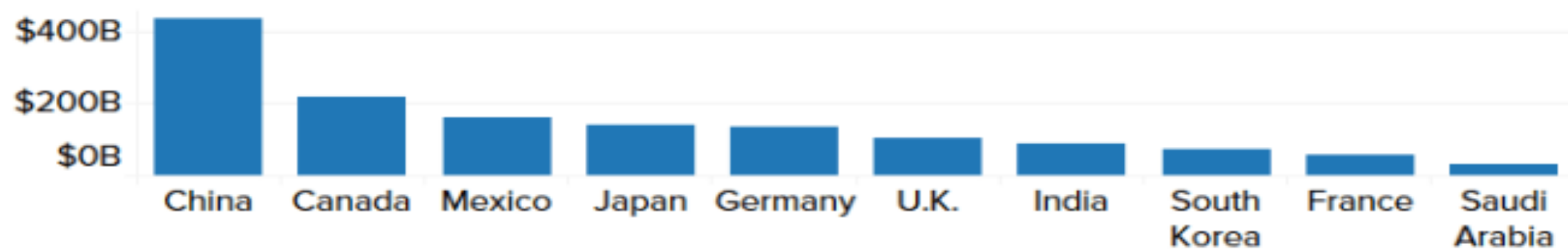


U.S. dependence on global supply chains

Input composition of goods and services consumed in the U.S.



Top 10 sources of foreign input in 2015

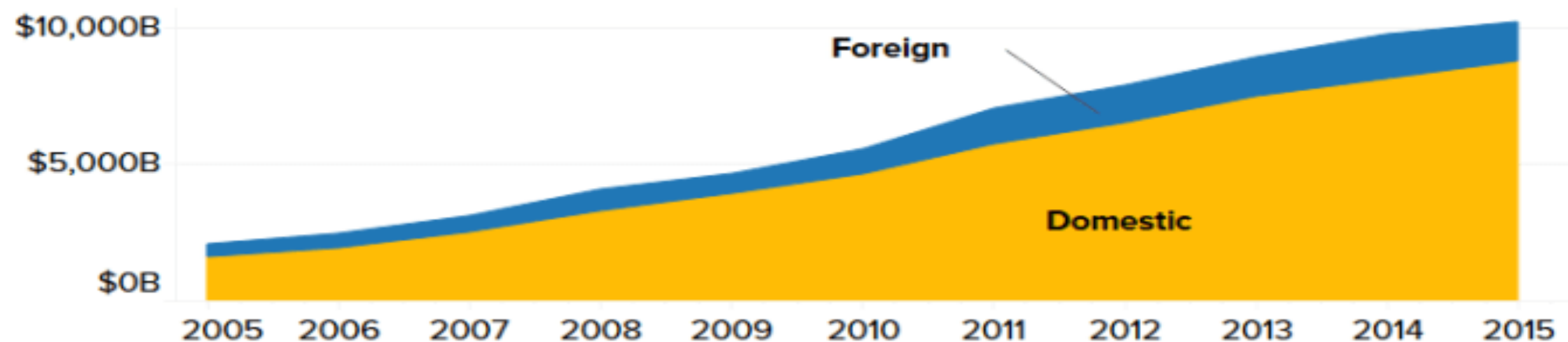


SOURCE: OECD's Trade in Value Added database (2018)

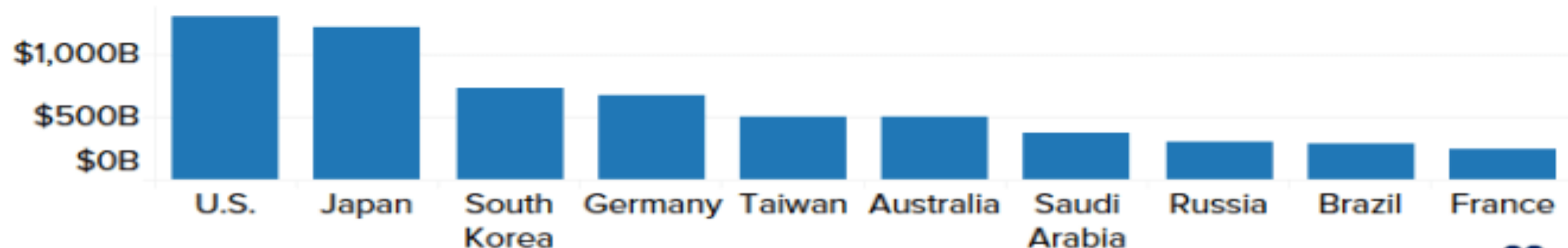


Chinese dependence on global supply chains

Input composition of goods and services consumed in China

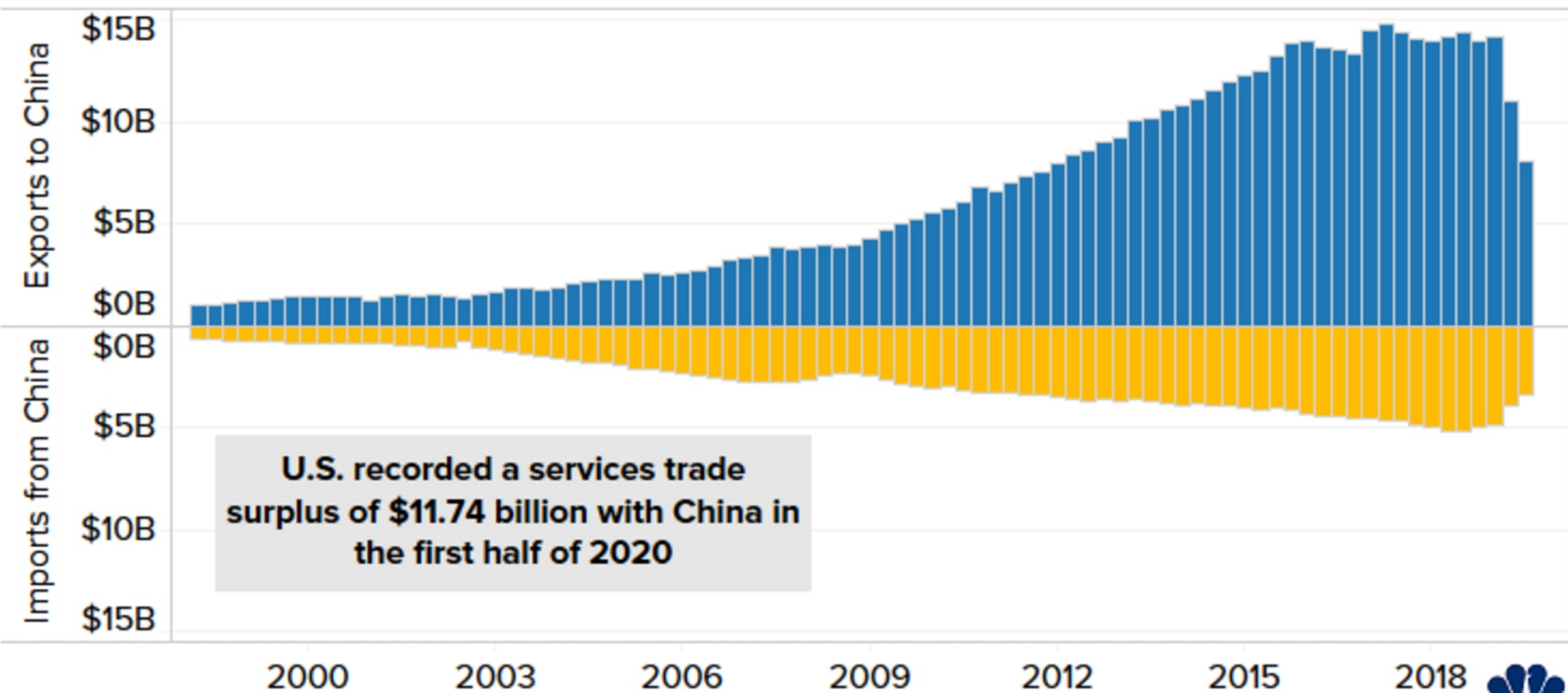


Top 10 sources of foreign input in 2015



SOURCE: OECD's Trade in Value Added database (2018)

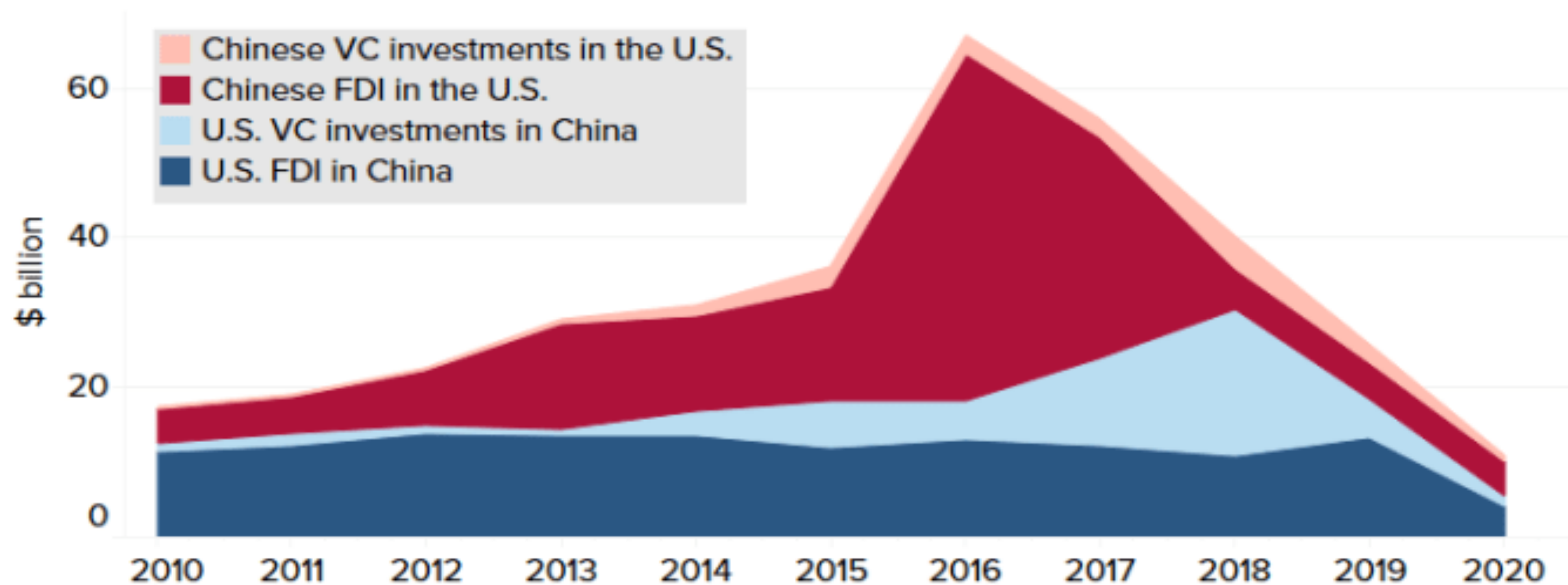
U.S. services trade with China



SOURCE: U.S. Bureau of Economic Analysis

U.S.-China investment flows

**Data for 2020 covers January to June only



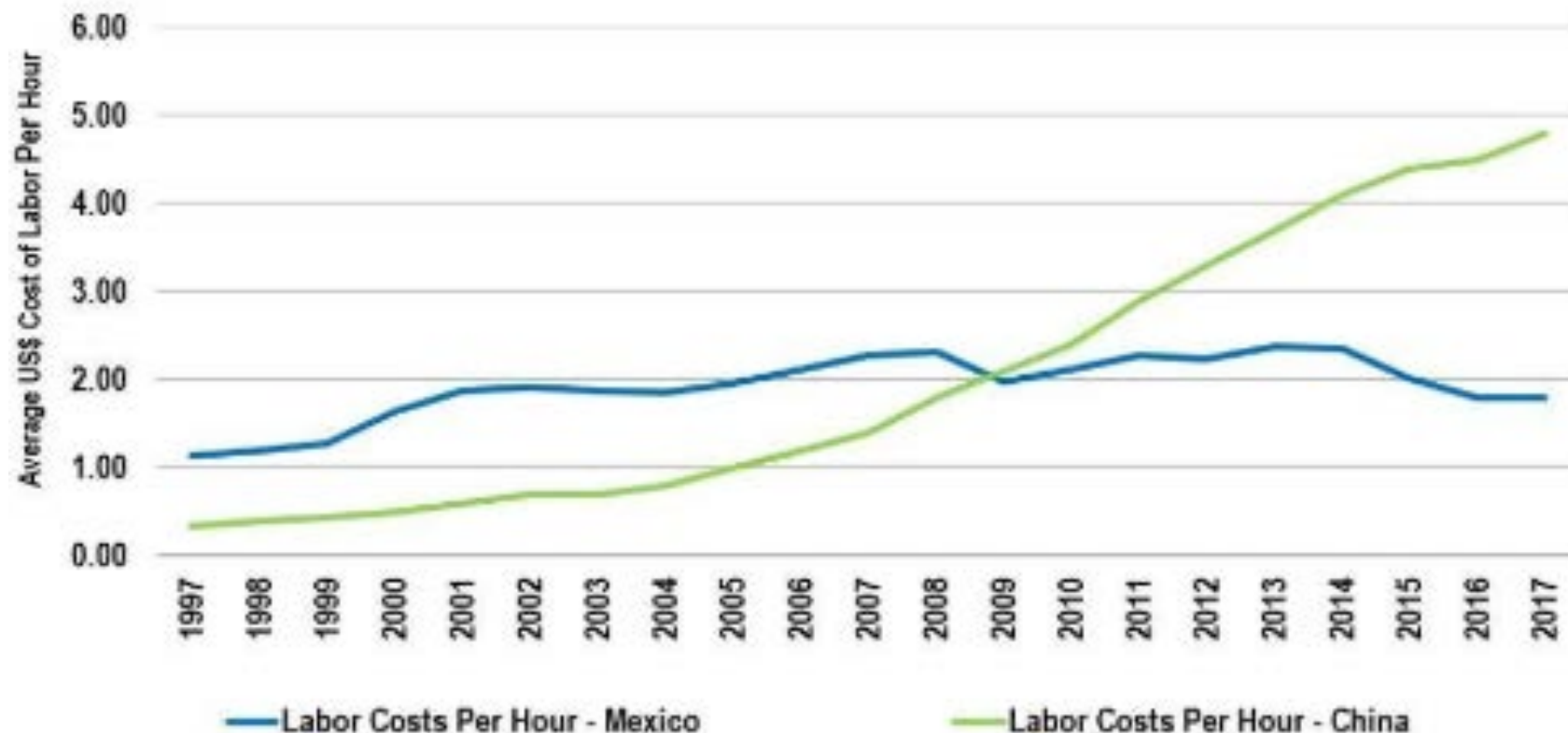
SOURCE: Rhodium Group, National Committee on U.S.-China Relations



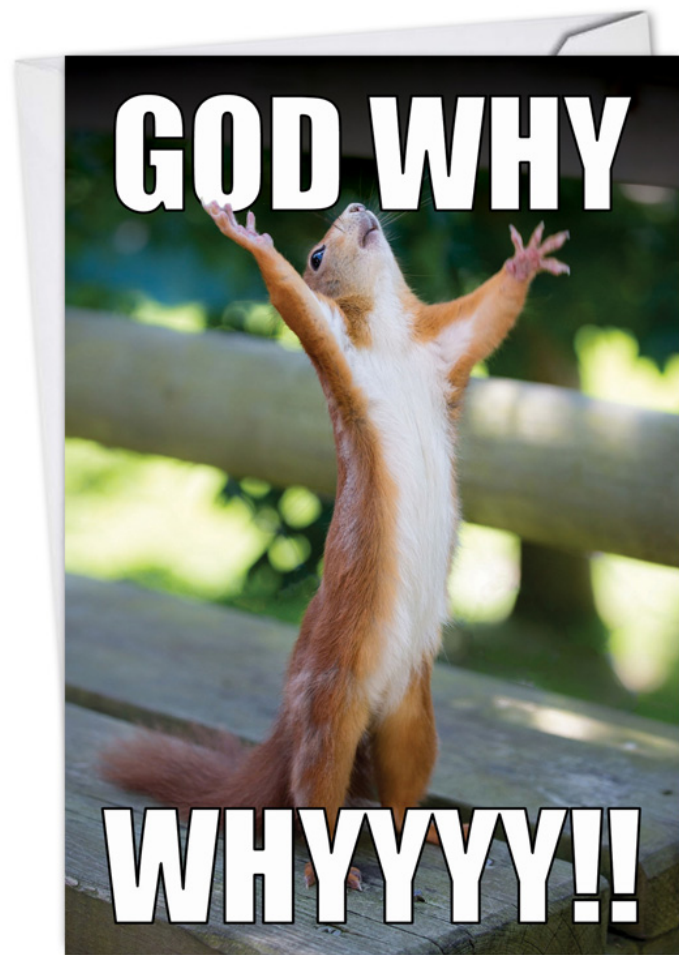
Mexico Offers Cheaper Manufacturing Labor



1997 – 2017

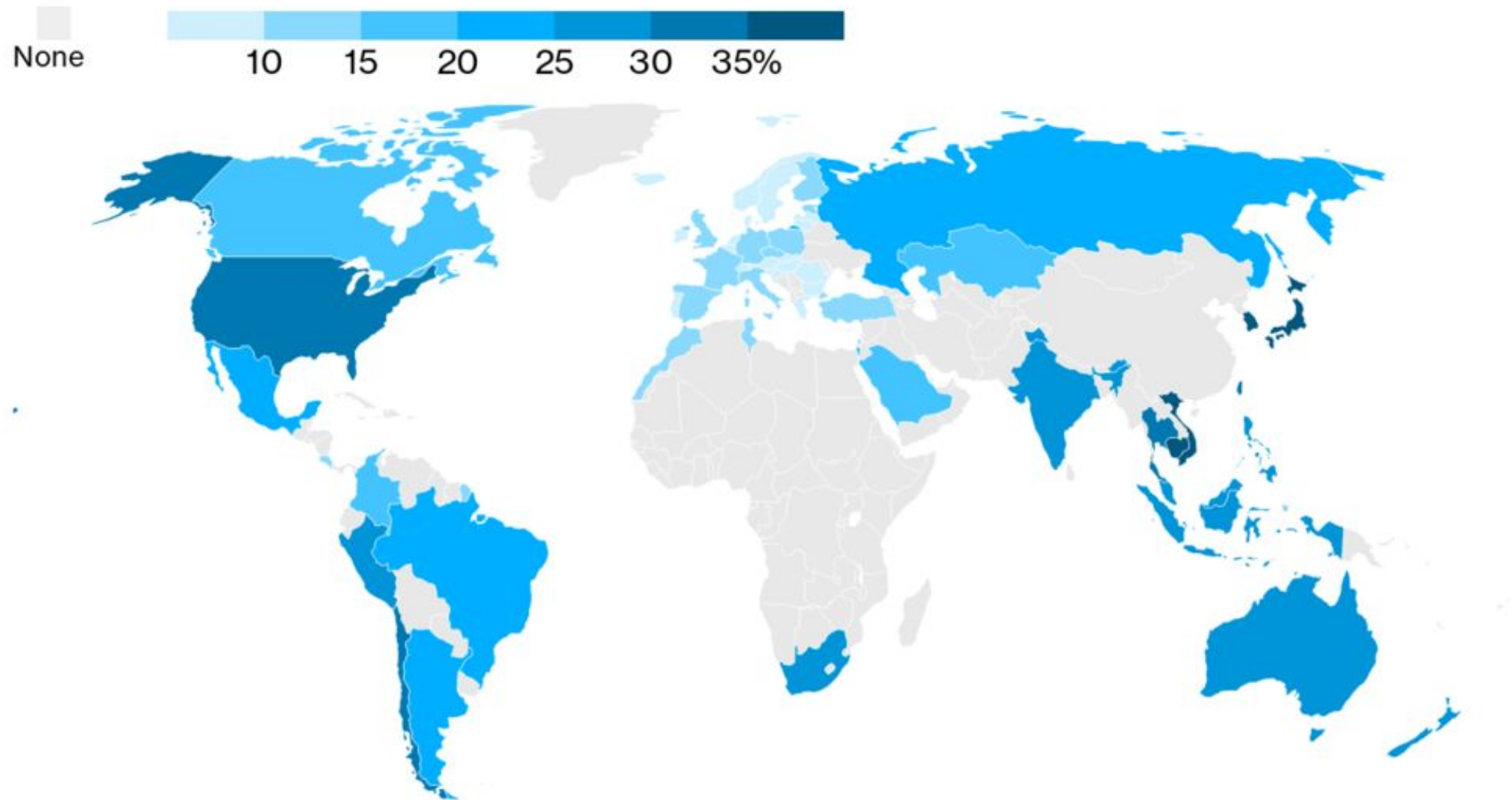


Source: The Economist Intelligence Unit (EIU). Calculation based on data from China Statistical Yearbook and International Labour Organization (ILO) data on hours worked, as of 2018. This chart is for illustrative purposes only and does not reflect the past or future performance or portfolio composition of any Franklin Templeton fund. **Past performance does not guarantee future results.**



How the Coronavirus Can Hit Global Supply Chains

Share of all imports of intermediate manufacturing products from China



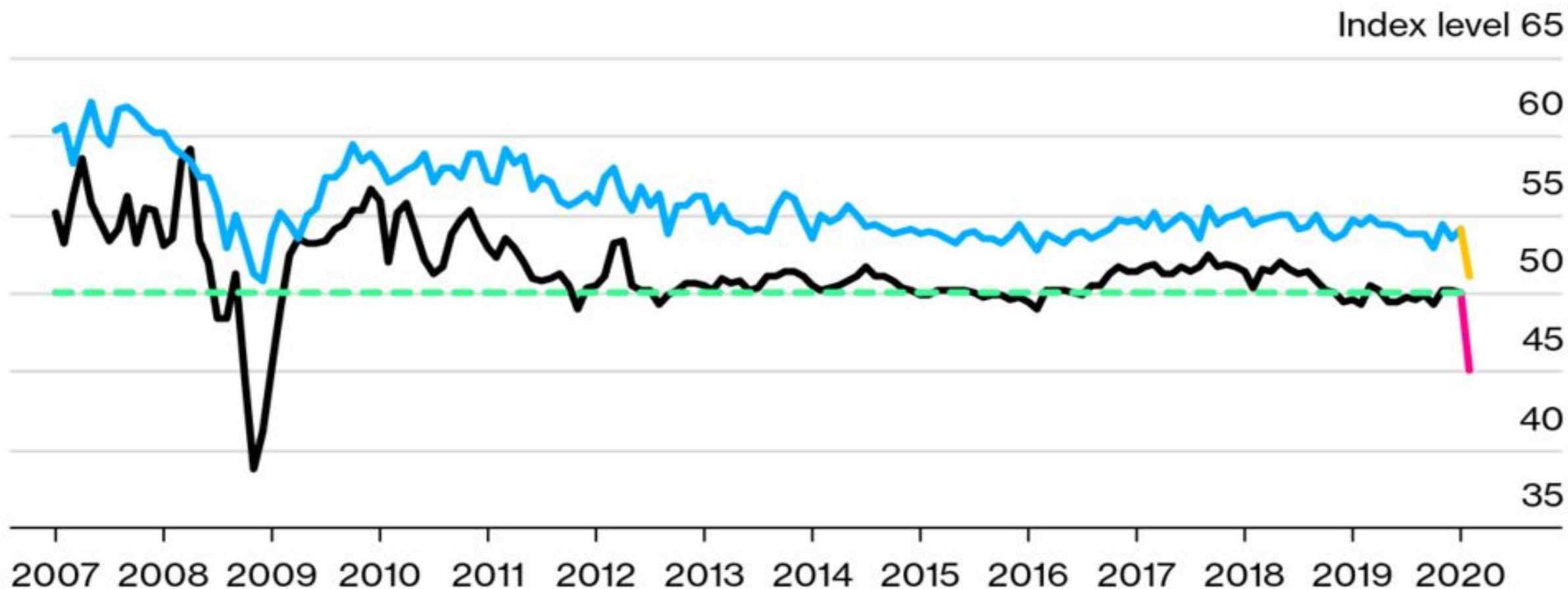
Source: OECD TiVA, Bloomberg Economics

Bloomberg

Economic Damage

China's economy seen as worst since global financial crisis after outbreak

Manufacturing PMI Forecast Non-Manufacturing PMI Forecast
Dividing line between expansion and contraction



Source: China's National Bureau of Statistics, Bloomberg surveys

The Second American Industrial Revolution

- To say that the United States is changing the face of humanity at the moment, is an understatement.
- Space exploration, quantum computing, alternate transportation, data transmission, genetic medicines, CRISP-R, alternative material design, Artificial Intelligence/Machine Learning, weapons development and Cyber-Organic Connections like neural link.
- The ideas require protection.
- They also require rare materials.

The Number are Enough to Make You Sick

- Consider that Chinese firms are said to supply more than 90 percent of US antibiotics, 70 percent of acetaminophen (that's Tylenol), and almost half of the anti-coagulant heparin.
- Studies suggest up to 80 percent of the basic ingredients in US drugs come from the PRC. China is also the second largest exporter of biologics and the prime source of medical devices per the FDA.
- India is a prime source of a key import – generics, however, that hides the fact that India sources up to 75% of its own pharma ingredients from China.

Critical Industries List (Comrade)

- The COVID Crisis opened the door to the creation of a “critical industries list.”
- *Allowing politicians to label what matters and deserves protection in an economy is seen as a license to broader, politically driven protectionism.*
- However President Trump’s efforts to subsidize steel, autos, and much more using tariffs has accomplished this in a fashion.
- The criteria ought to be high, bipartisan, and include the White House and Congress as well as (gasp) the Trade.

Задачи, поставленные Центральным Комитетом партии на шестую пятилетку, огромны. Они потребуют от партии и от всего народа больших усилий и напряженного труда.

Из доклада Н. А. Булавкина
„Дирекции XX съезда КПСС по
исполнению пятилетнего плана разви-
тия народного хозяйства СССР
на 1956-1960 годы“

Now China Might Be Forcing Our Hand

- The Standing Committee of the 13th National People's Congress promulgated the Export Control Law of the People's Republic of China (ECL or the Law) on October 17, 2020.
- The Law will enter into effect on December 1, 2020.
- The Law formalizes China's export control regime which also includes the recently updated Catalogue of Technologies Prohibited or Restricted from Export that restricts or bans the export of certain cutting-edge technologies on the grounds of national security, public interest or environmental protection, such as AI technologies

What is Covered?

- In total, 53 items have been deleted, added, or revised – with new restrictions imposed on the export of 23 cutting edge technologies, which are either based on China's indigenous intellectual property or are data-based personalized products that have become sensitive due to geopolitical assessment or foreign government scrutiny.
- As you would imagine, all of these technologies are things we either don't have or have a deficit of.
- Just because something isn't on there doesn't mean it can't be placed on it for a two-year period.

China Throwing Haymakers

- China has also issued the Provisions on the Unreliable Entities List (the Entities List Provisions) targeting parties that harm the national sovereignty or national security of China, and/or Chinese entities.
- Both the ECL and the Entities List Provisions provide China with more powerful tools to retaliate against restrictions by the United States'

“Because I Feel Like it Peter”

- The Law provides that controlled items (goods, technology and services characterized as (i) dual-use; (ii) military; (iii) nuclear; or (iv) otherwise related to the performance of international obligations and protection of national security and interests) also include such data as technological materials on these items (Article 2).
- Organizations and individuals in China (including foreign-invested enterprises) may not provide export-controlled information overseas that may harm China’s national security or interests (Articles 1 and 32).
- The reference to national interests and to national security, provides a broad basis to determine the grounds for the imposition of export controls.

This Blacklist Doesn't Star James Spader

- In determining whether to approve a license to export controlled items, the export control authority shall take into consideration *national security and national interests, the sensitivity of the controlled items, the target country or region and the end user/end use* (Article 13).
- China will establish an export control blacklist system for foreign importers or end users which violate the end user/end use requirements, endanger China's national security or national interests, or use controlled items for purposes of terrorism. ***The State will prohibit or restrict transactions with blacklisted entities.***

What's Good For the Goose

- The Law provides that no organization or individual may provide such services as agency, freight, delivery, customs declarations, third-party e-commerce trading platforms, or financial services for exporters engaging in illegal export control activities (Article 20).
- Organizations and individuals outside China will be held accountable for breaking export control regulations, harming Chinese national security or interests, or obstructing the implementation of non-proliferation obligations (Article 44).

Globally Written, American Directed.

- China may adopt retaliatory measures against countries or regions that endanger Chinese national security or interests by abusing its own export control measures (Article 48).
- This provides China with a more formal legal foundation to respond with tit-for-tat export control measures to export control restrictions by the United States or other countries.

This One Will Suck

- Depending on the nature of the offense, penalties may include fines of up to (\$750K) or ten times the gains made from the illegal activities, business suspension, revocation of export business qualifications, and restrictions on the responsible individuals' future involvement in export activities.
- Where administrative violations of ECL also constitute crimes, criminal penalties may also apply.

License Procedure – Phase 1

- **Filing:** The applicant shall file the application before the competent foreign trade department under the State Council.
- **Examination:** The competent foreign trade department in conjunction with the science and technology administrative department under the State Council shall examine the application and, within 30 working days from the date of receipt of the application shall approve or disapprove it.
- **Issuance of a letter of intent:** In case of approval, the competent foreign trade department under the State Council shall issue a letter of intent for licensing the technology export.
- **Negotiation and signature of the contract:** After obtaining the letter of intent for licensing the technology export, the applicant may begin substantive negotiation and conclude a contract for the technology export.

License Procedure – Phase 2

- **Application for the license for technology export:** The applicant shall submit to the competent foreign trade department under the State Council the letter of intent previously obtained, a copy of the technology export contract, a list of technical information relating to the export, and any regulatory document certifying the legal status of the two parties to the contract.
- **Examination:** The competent foreign trade department under the State Council examines the authenticity of the technology export contract and decides, within 15 working days from the date of receipt of the documents provided, on approval or disapproval of the technology export.
- **License issuance:** In case of approval, the competent foreign trade department under the State Council issues the technology export license.

Likely Retaliation?

- Well No.
- Until such a time as we have this election behind us, I don't see any real new retaliation coming from DC – and neither did the Chinese.
- The last thing we are getting out of Washington DC between now and the end of the year is a resolution to this mess.
- And the Chinese knew this, and wisely used the opportunity to irritate us.



If he is taking his ease,
give him no rest. If his
forces are united,
separate them.

SUN TZU



**"BE POLITE, BE PROFESSIONAL.
BUT HAVE A PLAN TO KILL EVERYBODY YOU MEET."**

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