Statement of the Problem

In March 2017, ZTE had agreed to pay both a civil and criminal penalty fine of $1.19 billion as a punishment for selling to North Korea and Iran telecom equipment that contained U.S. technology. This violated the current trade embargos that are imposed on both nations and ZTE agreed to a seven-year ban on buying US tech if they complied with other penalties, such as disciplining the employees that orchestrated these deals with Iran and North Korea. However, ZTE lied about doing this and ended up paying full bonuses to each of the employees in question. According to one expert, this was about Iran and the need for ZTE and other China companies to respect U.S. regulatory authorities.

However, a year later and the evolving trade wars that has been occurring these past few months has evolved in the ZTE situation becoming a central part of the current negotiating process. Last month, the seven-year ban was announced and then on Friday, 25 May, 2018, President Trump tweeted saying that ZTE may continue to operate in the U.S. as long as they are required to purchase American parts. This is considered a major shift in policy as Trump builds leverage with China's president Xi in negotiations pertaining to updating trade agreements between the two countries.

Questions Covered in this memo include:

1..) Will ZTE be sanctioned by the U.S.?

2.) If not, then what companies likely will be sanctioned by the U.S.?

3.) Is Congress currently working on bills to sanction China? If so, what committees?

4.) Who in Congress is leading the charge against China?

5.) What likely actions will come from the trade war as a whole?

Report: Off-the-record regarding the ZTE sanction issue and future of trade negotiations with China: current-future outcome

This includes reports from several off-the-record sources, who are policy experts in US-China relations, international trade, technology, finance, and security-related fields.

1.) Will ZTE be sanctioned by the U.S.?

Right now it is a sticky situation between Trump and policy makers in Congress. Both Trump and Xi have managed to use ZTE as a bargaining chip for advancing both countries trade agendas. In fact, the announcement of letting ZTE sell its smart phones to the United States on condition of them using only U.S. parts as a way to ensure security, had correlated with the announcement that the Chinese government's regulator arm would allow for the merger between Qualcomm and NXPI Semiconductors to occur. This is considered to being monumental since Qualcomm has been undergoing a lengthy process (1.5 years) to acquire NXPI, a Dutch semiconductor firm that will help Qualcomm merge into microchips for automated devices and Internet of Things (IoT) in general. China's regulating arm is the last one to approve the acquisition and they have been stalling it for several months because of trade tensions with the United States. The latest approval by the Chinese government in correlation with Trump's announcement pertaining to ZTE is significant since it represents both sides relieving tensions. In addition, Qualcomm is a supplier of semiconductor microchips for the ZTE smart phone.

The agreement to allow Qualcomm to merge with NXPI Semiconductors in conjunction with Trump's willingness to keep ZTE in the United States indicates a possible growing relationship between the U.S. government and Qualcomm. A couple months ago US CFIUS denied Broadcom from acquiring Qualcomm through a hostile takeover attempt. Qualcomm is considered a top leader and researcher in semiconductor chips, while making lots of money via royalties with various smart phone manufacturers. When 5G wireless technologies become more streamlined, Qualcomm will be leading the U.S. and the world as a seller/facilitator of this technology. China's Huawei, is expected to leading 5G on the Chinese end. Huawei and ZTE combined have been considered as previously regulated companies. Also their products have been labeled as being national security concerns since the US government believes that the Chinese government is using these products to spy on American citizens. Trump claims that high-level security guarantees will be made to prevent ZTE products from becoming national security concerns. Possibly, the potential requirement of using only American hardware (Qualcomm) indicates less of a national security concern, which may be enough to satisfy the current sentiments shown by Congress over the ease of sanctions.

At the moment, members of Congress from both parties have not shared support of President Trump's differing stance on allowing ZTE to stay in the United States. Noted senators like Marco Rubio (Republican) and Chuck Schumer (Democrat) have criticized and challenged Trump on his stance to alter ZTE sanctions. They have expressed concern and intention to try to kill this deal but it seems difficult to achieve this since China has agreed to lower tariffs on energy and agriculture products (pork, wine, etc.). However, Congress can still try to do this via annual defense authorization bills that already prohibit products from Huaweii and ZTE from ever being used for national security purposes. They can also draft new legislation pertaining to banning sales of intellectual property and technology that are considered as being sensitive to U.S. national security as well.

2.) If not, then what companies likely will be sanctioned by the U.S.?

Huawei: There are other companies that can be sanctioned by the U.S. in case ZTE is not one of them. **Huawei** is another leading Chinese telecom company that comes to mind. Their products have been on the national security list. However, the past couple of months they have been under investigation by the U.S. government and have been banned by the Pentagon for making similar sales to Iran and North Korea that ZTE conducted. It's likely that Huawei will not get the same treatment by Trump that ZTE seems to be getting since the Qualcomm deal was used as a bargaining chip.

COMAC: Another potential company that can be targeted by the US would be the Commercial Aircraft Corporation of China (COMAC). Other than the fact it is difficult to sell their C919 mid-sized commercial air craft in the U.S. market, the COMAC still sells about $1 billion in aerospace parts and systems to the United States. They have not reached the heights of firms like Boeing and Airbus, and tariffs placed on them would hurt their long-term growth.

Beike Biotechnology: This company is a possible target by the U.S. since they develop medical technologies that can help treat ailments like cancer. They mainly build medical robots and have had high intentions of selling to the U.S. market.

3.) Is Congress currently working on bills to sanction China? If so, what committees?

Congress is currently undergoing the process of drafting a bill that provides the United States government Committee on Foreign Investment (CFIUS) more blocking power of business deals between American and Chinese companies that pertain to national security concerns. The idea behind this bill is to tighten the vetting process for inbound and outbound investments between foreign and American firms both inside and outside the United States.

<u>Thursday, 24 May 2018 – Passing of National Defense Authorization Act – H.R. 5515</u>

The U.S. House of Representatives passed their annual defense bill that bars federal agencies and federal grant recipients from using technology provided by Chinese telecommunications firms such as ZTE and Huaweii. This was called the National Defense Authorization Act of 2019, also known as H.R. 5515, submitted by 115th Congress, 2D Session, House Armed Services Committee. This bill was first introduced to the U.S. House by Rep. Mac Thornberry (R-TX-13). H.R. 5515 will give U.S. agencies up to three years (2021) to cut ties with Chinese firms and their U.S. affiliates. This process will scrub these Chinese firms from the agencies supply chains. This is a strong indication of the U.S. government anticipating addition tensions with the Chinese government for years to come since they have now decided to take a proactive stance on countering Chinese trade abuses, intellectual property theft, and ongoing tensions in the South China Sea. According to experts, this decision by Congress actually correlates with Trumps National Security Strategy/doctrine that the White House produced in Fall 2017. In fact this bill was passed 351-66. The timeliness that this was introduced and passed is also significant as it took a little over one month to finalize, which is also another indicator of Congress's long term perspective of U.S.-China relations.

<u>Thursday, 24 May 2018 – Proposed Senate Legislation – John S. McCain National Defense Authorization Act for Fiscal Year 2019</u>

On the same day as H.R. 5515 was passed by the House of Representatives, the Senate Committee on Armed Services voted overwhelmingly 25-2 to advance proposed legislation called the John S. McCain National Defense Authorization Act for Fiscal Year 2019. This is a yearly process that typically deals with U.S. military defense strategy, funding, and security policy. However, this year both the House and the Senate have sought to streamline this process in regards to heightened competition with China and Russia. In fact experts point out that this draft proposal refers to the latest National Defense Strategy that was produced by the Department of Defense, under Secretary James Mattis. This also deals with security concerns and increasing competition with China going forward. This illustrates Congress's growing concern and willingness to address these security issues and to ensure that Trump's policy towards ZTE is not hampering the process while he's tackling the economic issues of the ongoing trade negotiations.

4.) Who in Congress is leading the charge against China?

A Bipartisan group of 27 senators sent President Trump a letter urging caution in regards to the trade negotiations with China. This was also in response to the updated policy regarding ZTE that they opposed. The names of the senators are:

- John Cornyn (R-TX), Chuck Schumer (D-NY), Marco Rubio (R-FL), Dianne Feinstein (D-CA), Martin Heinrich (D-NM), Steve Daines (R-MT), Susan Collins (R-ME), Mike Rounds (R-SD), John Thune (R-SD), Sherrod Brown (D-OH), Johnny Isakson (R-GA), Mark Warner (D-VA), Roy Blunt (R-MO), Bob Casey (D-PA), Bill Cassidy (R-LA), Ted Cruz (R-TX), Ben Sasse (R-NE), Joe Manchin (D-WV), Chuck Grassley (R-IA), Jack Reed (D-RI), Bill Nelson (D-FL), David Perdue (R-GA), Debbie Stabenow (D-MI), Ron Wyden (D-OR), Tom Cotton (R-AR), Kamala Harris (D-CA), and Angus King (I-ME).

5.) What likely actions will come from the trade war as a whole?

Experts believe that Congress will go to greater lengths in insuring that Chinese firms like ZTE and Huaweii are still considered threats to national security by ensuring Trump's negotiations on the ZTE issue remain a non-security matter and more of an economic issue, if possible. However, China's recent threat to pull all existing trade agreements if the United States decides to enforce trade tariffs may end up being big deal breaker over the ZTE issue. Either way, Congress seems to be heavily united against Trump on ZTE and regarding the proactivity of countering China as a growing security, economic, and global competitor in the long term. There is also a possibility that this could be a ploy by Trump to get Congress united on the ZTE and China issue as well. After all, his national security strategy doctrine that was published in fall 2017 deals with a harder and realistic view of dealing with China and Russia as great power competitors.

Some other actions that come to mind include the increasing of measures that focus on national security threats such as cyber, intellectual property theft, and a new agreements pertaining to trade security issues between the U.S. and China. Both nations are making concessions to smoothen their tense partnership at the moment. However, both countries are working their agendas as they are both positioning themselves for the next few decades with expectations that future trade clashes may occur once again. Also, both nations may be protectionist-oriented going forward. China may even further push their Belt and Road initiative even further as a result of this situation, since stronger interconnected economic ties in Asia could make future sanctions against them to be less impactful at some point. The U.S. as a result of the trade war will be more aware of the enhanced competition with the Chinese government. They may be more inclined to increase and strengthen its economic and security relations with other countries that may pertain to their relationship with China.