Opinion **US-China relations**

Key US commission heralds coming capital wars

Finance may be the next frontier for decoupling from China, with new limits on business between the two countries

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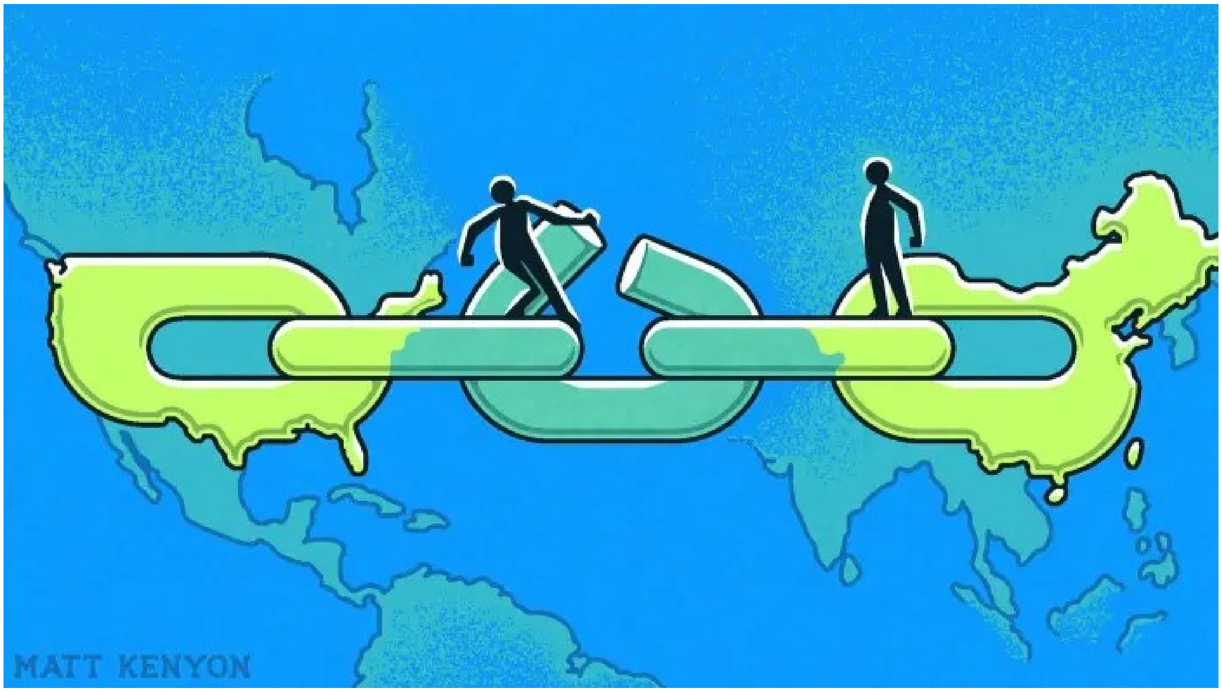

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Rana Foroohar YESTERDAY

If there's one thing both Republicans and Democrats can agree on, it's that China is America's biggest long-term strategic threat. And yet US financial firms couldn't be more bullish on the Middle Kingdom. Banks like Citigroup, Goldman Sachs and JPMorgan Chase are expanding their business there, as are asset managers like BlackRock. But what will happen when Wall Street's aspirations for riches in China meet the political realities of Main Street America?

It's a question that has been put front and centre by the annual US-China Economic and Security Review Commission report, issued to Congress last week, which recommended a host of new limits on business between the two countries, not just on goods and labour, but also capital flows.

The commission, whose members are appointed by both minority and majority leaders in Congress, has a good record for predicting legislative and regulatory trends. It was the first to raise Huawei as an issue (in 2004), highlighted risks within crucial supply chains in areas such as pharmaceuticals as early as 2010, and put the issue of forced labour in Xinjiang on the political map.

As the most recent report put it, not only is the Chinese Communist party using economic coercion and increasing state control to advance its own political model, "Chinese policymakers are courting foreign capital and fund managers as they work to make China's capital markets serve as a vehicle to fund the CCP's technology and Exchange Commission to require companies to disclose whether they are sourcing from or invested in companies that utilise forced labour in Xinjiang or are on the US Department of Commerce's Entity List or Treasury's Military-Industrial Complex Companies; and mandating that public US companies report whether there is a Chinese Communist party committee anywhere in their operations. There are also suggestions on limiting the use of cloud computing and data servicing operations owned by Chinese firms.

The potential market implications should such rules become law are myriad. Consider just the idea of forcing "publicly traded US companies with facilities in China" to report on an annual basis "whether there is a Chinese Communist party committee in their operations and summarise the actions and corporate decisions in which such committees may have participated." This may seem an extreme move, but the overlap between non-state firms and the Communist party in China has grown tremendously in recent years.

Citing figures used by the CCP's own Organisation Department (and also cited by western scholars), the report notes that "in 1998, a mere 0.9 per cent of non-state firms had CCP committees, a figure that rose to 16 per cent by 2008. By 2013, committee presence in non-state firms expanded to 58 per cent, and by 2017 it reached 73 per cent, accounting for 1.9 million firms." Assuming these figures are accurate, it's hard to imagine a western company or financial institution doing business in China that wouldn't have a potential problem. It's also hard to imagine that western financial institutions purporting to prioritise ESG concerns won't come under increasing pressure to justify the hypocrisies of working with an autocratic government.

On the flip side, the commission is also recommending protections for US investors in Chinese assets. In particular, the report flags VIEs, which are used by Chinese companies to get around rules prohibiting them from having foreign investors. Such vehicles include the largest percentage of Chinese issues by value sold on US exchanges. But they are opaque; regulators like the SEC have raised concerns about the risks they pose for investors, who often don't get the same amount of information as for typical listed firms, and don't have any governing control in any case.

Should it come to pass, the combination of regulating VIEs, index providers that have

China as reflecting a continued wilful blindness about the “one world, two systems” paradigm.

It’s worth noting that the US China Economic and Security Review Commission itself was formed by Congress in 2000 as a way to monitor the evolution of relations between the two nations, even as China was en route to becoming a member of the World Trade Organization. There were high hopes — but also doubts, even back then — that China would get freer as it got richer. The doubts have, of course, proved well founded.

Anyone who thinks that there won’t be more constraints on business between the two countries would be wise to read the report carefully.

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