Trump doesn’t like China’s economic nationalism. So why is his administration stirring it up?

By Henry Farrell, Can Huang and Abraham Newman  April 24

On April 16, the Commerce Department denied export privileges to the Chinese phone and telecoms giant ZTE for seven years. This ban means that ZTE will no longer be able to buy technology from American suppliers, including chips and other critical components central to its products.

The ban didn’t get much attention outside the specialist business press in the United States. In China, it is being treated as a political and economic earthquake — and one that may have dramatic aftershocks. For years, the United States complained that China’s economic policy is driven by nationalism and the desire to protect native companies. Now, Chinese political debate depicts U.S. regulators as an existential threat. The Chinese government is marshaling a national strategy to make companies like ZTE less dependent on foreign suppliers.

This punishment is an existential threat to ZTE

The U.S. announcement was the result of a dispute over U.S. export controls. ZTE pleaded guilty last year to having broken U.S. rules by exporting equipment with U.S. components to Iran. The company was fined $900 million, given a suspended seven-year ban and $300 million fine, and required to comply with several requirements, including dismissing four senior employees and taking action against others. The U.S. government now says that ZTE repeatedly misled it before and after the settlement, prompting the ban. This action also comes in the context of renewed economic tensions between the United States and China, and the stated intention of the Trump administration to punish Chinese firms for taking advantage of the United States. ZTE has said that the ban is “extremely unfair” and has suggested that it intends to take legal action.

Whatever ZTE does, it is clear that the ban puts the company in a very difficult position. ZTE depends on U.S. companies like the chip manufacturer Qualcomm for critical components of its products. The company has stated that “the Denial Order will severely impact the survival and development of ZTE,” and the chairman, Yimin Yin, has warned that “such sanctions could put the company immediately into a coma.”

This has landed like a bombshell in Chinese political debate
ZTE is the fourth-largest telecommunications manufacturer worldwide and the second-largest in China, and employs 75,000 people across the globe. This explains why the news has shocked Chinese public opinion. There is now heated debate in China about the Commerce Department’s investigation, the timing of the order (as trade tensions between the two countries are rising), ZTE’s management of the investigation and compliance with the order, and, perhaps most important, the chip industry in China and future industrial policy of the country.

**China wants to make sure that this can’t happen in future**

The response by the Chinese government is swift and clear. Following the incident, the People’s Daily (the official newspaper of the Communist Party of China) published consecutive editorials April 18 and 19. The title of the first editorial is “China cannot be half-hearted about developing domestic chip industry anymore,” and the second is “We cannot be strong without an indigenous chip industry.”

On April 20 and 21, the Chinese government held a high-level national conference on cybersecurity and information policy that was attended by all seven members of the standing committee of the Politburo of the Communist Party of China Central Committee. President Xi Jinping stressed in the conference that China will endeavor to achieve breakthroughs in core information technologies. He said China needs to stay patient and keep focused in this cause. The government will systematically build up industry, emphasizing technology and industrial development policy. He also said China will improve the institutional environment including finance, tax, international trade, human resource, intellectual property protection and so on.

The U.S. government and U.S. political commentators have often been critical of China’s industrial policy, arguing that China’s focus on supporting national champions and domestic industrial capacities disadvantages U.S. firms. The United States sees China as a strategic competitor, playing offense. Now, however, the Chinese government has clear defensive reasons to want to build up its chip industry, since this will protect Chinese companies that rely on foreign producers from the edicts of U.S. regulators.

**This may be the beginning of a transformation of the global economy**

Economic globalization relies heavily on global supply chains. High-tech companies do not make every component of their final products. Instead, they rely on networks of subcontractors and suppliers to provide key components. This produced worries in China that chips are a key weakness in China’s innovation model. China imports a large volume of chips from overseas — $230 billion worth in 2016 — and hence relies heavily on foreign core technologies. In fact, China spent twice as much that year importing chips as importing petroleum.

This has prompted repeated calls for indigenous R&D to reduce reliance on foreign chips. However, the advanced semiconductor industry has complex requirements and requires vast capital investment, making it difficult for countries like China to play catch-up.

Now, the risks to Chinese firms are practical rather than abstract. If Chinese high-tech companies are denied the advanced technologies embodied in the critical components imported from another country such as the United States, their fundamental
business can be disrupted at any moment. The U.S. denial order has shocked Chinese policymakers and high-tech companies into starting the practical process of kick-starting indigenous innovation. Moreover, the Chinese government may turn to its own regulatory tools to put pressure on U.S. firms. Days after the ZTE announcement, the Chinese antitrust regulator threw up road blocks to a planned merger between U.S. chipmaker Qualcomm and its Dutch rival NXP.

In the future when we look back at the ZTE incident, we may find that it has had a far-reaching impact. Other companies — including United States and European companies — face similar risks. Affiliate chains, mergers and acquisitions, supply chains and foreign direct investment, expose these companies to a host of regulatory risks. Governments will be tempted to use anti-sanctions rules, export controls and privacy laws as sources of leverage. In a world of increased confrontation over both trade and security questions, Western companies, too, may find that they are faced with massive disruptions, leading to a partial unraveling of globalization.

Henry Farrell is professor of political science and international affairs at George Washington University.

Can Huang is professor at the School of Management, Zhejiang University, Hangzhou, China.

Abraham Newman is professor of international affairs at Georgetown University.

This post came from a meeting of the Georgetown University U.S.-China Initiative.