

# U.S.-China Economic and Security Review Commission

## Economics and Trade Bulletin



July 13, 2021

### Highlights of This Month's Edition

- **U.S.-China Trade:** In May 2021, U.S. exports to China were \$12.4 billion, an increase of nearly 29 percent over the same month in 2020, while imports from China totaled \$38.7 billion, up 5.8 percent; year-to-date, the U.S. goods deficit with China continued to grow, reaching \$130.7 billion.
- **Supply Chain Security:** The Biden Administration formulates strategy to revitalize U.S. manufacturing capabilities in key industries following review of supply chain vulnerabilities.
- **Forced Labor:** The Biden Administration and the U.S. Congress took additional steps to restrict imports related to forced labor in Xinjiang, reflecting broad bipartisan recognition of abuses and need for action.
- **China's Anti-Foreign Sanctions Law:** China's National People's Congress passed broad legislation to counter foreign sanctions with potentially significant consequences for foreign business and entities operating in China.
- **COVID-19 Economic Disruptions:** COVID-19-related lockdowns at Guangdong ports precipitated a regional shipping bottleneck, exacerbating the rise in global shipping prices; Chinese government extended border restrictions to the second half of 2022, indicating China's economy is unlikely to reopen fully for at least a year.
- **Cryptocurrency Crackdown:** Chinese government's expanding crackdowns on cryptocurrency mining and related business cause rapid drop in value in digital currency markets.
- **In Focus: China's Data Governance:** The June passage of China's Data Security Law, the latest in a series of laws on data, underscores the Chinese government's increasing efforts to gain control of data stored in China and to influence international data governance practices.

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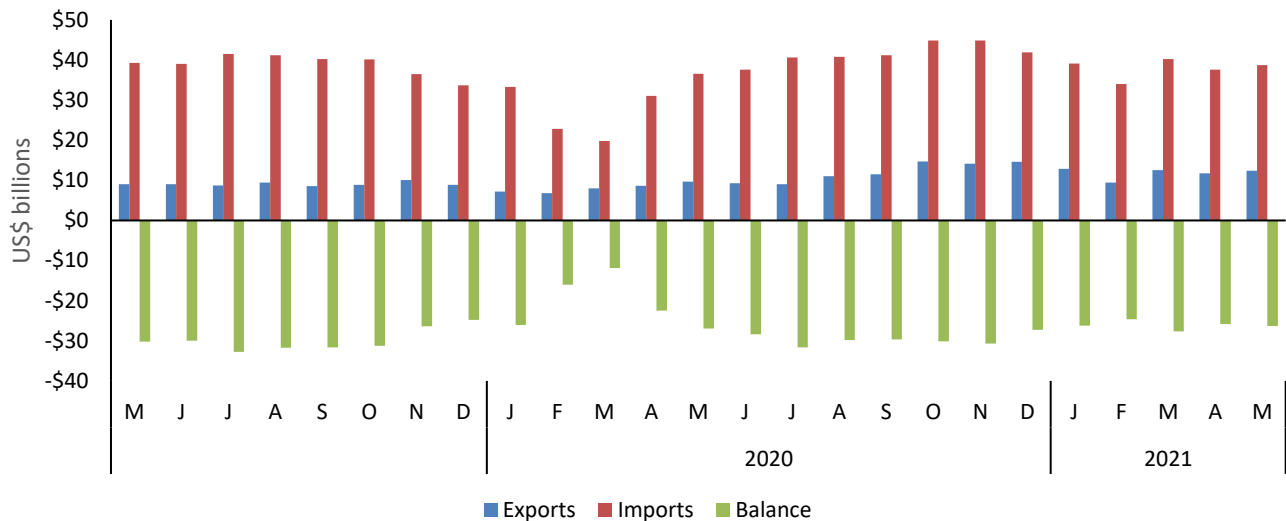
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## U.S.-China Goods Trade Continues to Grow in May 2021

In May 2021, the U.S. goods deficit with China reached \$26.3 billion, up 2.4 percent year-on-year. U.S. exports to China were \$12.4 billion, an increase of nearly 29 percent over the same month in 2020, while imports from China totaled \$38.7 billion, up 5.8 percent (see Figure 1).<sup>1</sup> Recovery in both economies from the novel coronavirus (COVID-19) pandemic has contributed to the increase in U.S.-China trade; reflecting this trend, the U.S. trade deficit with the world was also up in May.<sup>2</sup>

Figure 1: U.S.-China Goods Trade, May 2019–May 2021



Source: U.S. Census Bureau, *Trade in Goods with China*, July 2, 2021. <https://www.census.gov/foreign-trade/balance/c5700.html>.

Despite China’s purchase commitments under the Phase One deal, year-to-date the U.S. goods deficit with China continued to grow, reaching \$130.7 billion, an increase of 26.5 percent year-on-year. U.S. goods exports to China in the first five months of 2021 were up 46.6 percent to reach nearly \$60 billion, though imports continued to rise as well, reaching \$189.7 billion, an increase of 32 percent.<sup>3</sup> According to Chad Bown, senior fellow at the Peterson Institute for International Economics, in the first five months of 2021 China’s purchases of covered U.S. products stood at \$56.9 billion, compared with a year-to-date target of \$82.0 billion.<sup>\*4</sup>

## Biden Administration Emphasizes Strengthening Supply Chains

**The Biden Administration’s sweeping supply chain review finds weaknesses in U.S. domestic manufacturing capacity.** On June 8, the Biden Administration released a 250-page report assessing supply chain risks and vulnerabilities across four classes of products for which the United States relies on imports and faces risks of supply chain disruption. Completed pursuant to Executive Order 14017, the report compiles individual 100-day reviews<sup>†</sup> conducted by the U.S. Department of Commerce (DOC) on semiconductor manufacturing and advanced packaging; the U.S. Department of Energy (DOE) on large-capacity batteries; the U.S. Department of Defense (DOD) on

\* As part of its Phase One trade deal commitments, China pledged increases in its purchases of particular U.S. “manufactured goods, agricultural goods, energy products, and services,” whereby purchase amounts “exceed the corresponding 2017 baseline amount by no less than \$200 billion.” Research by Dr. Bown tracks China’s purchases of U.S. goods covered by the agreement and compares them to annual targets prorated on a monthly basis. For more on the methodology, see Chad Bown, “U.S.-China Phase One Tracker: China’s Purchases of U.S. Goods,” *Peterson Institute for International Economics*, June 29, 2021. <https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods>.

† The order also mandates a separate one-year review of the overall resilience of the defense, healthcare, technology, energy, transport, and agricultural sectors. For further detail on Executive Order 14017 and background on its issuance, see “Biden Administration Prioritizes Supply Chain Security in Economic Competition with China” in March 2021 Trade Bulletin, *U.S.-China Economic and Security Review Commission*, March 9, 2021. [https://www.uscc.gov/sites/default/files/2021-03/March\\_2021\\_Trade\\_Bulletin.pdf](https://www.uscc.gov/sites/default/files/2021-03/March_2021_Trade_Bulletin.pdf).

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critical materials and minerals; and the U.S. Department of Health and Human Services (DHHS) on pharmaceuticals and active pharmaceutical ingredients (APIs).<sup>5</sup> Key findings for each product review included:

- *Semiconductor manufacturing and advanced packaging*: U.S. firms rely on foreign sources located chiefly in Asia to produce leading-edge semiconductors. In response, DOC’s review recommends strengthening the U.S. semiconductor manufacturing ecosystem.<sup>6</sup>
- *Large-capacity batteries*: Bolstering U.S. production chains for large-capacity batteries used in electric vehicles and grid storage is essential as the United States transitions away from fossil fuels for power generation. DOE’s review recommends the U.S. government stimulate demand for batteries used in the transport and utilities sectors to spur development of large-capacity battery manufacturing capabilities.<sup>7</sup>
- *Critical materials and minerals*: China dominates large portions of the supply chain for the critical minerals and materials the United States needs to develop clean energy technologies and power modern consumer electronics and national defense systems. DOD’s review recommends the United States expand domestic stockpiles and invest in sustainable domestic and international production and processing of these resources.<sup>8</sup>
- *Pharmaceuticals and APIs*: The generic pharmaceuticals industry, which accounts for 90 percent of the drugs prescribed to Americans, has outsourced production to China and India in pursuit of lower labor and manufacturing costs. DHHS recommends establishing a public-private consortium for the advanced manufacturing and onshoring of essential medicines production.<sup>9</sup>

**In addition to sector-specific vulnerabilities, the report identifies structural drivers of U.S. supply chain insecurity that cut across these four critical products.** In particular, it points to insufficient U.S. manufacturing capacity, heavy government support for manufacturing among U.S. trading partners (notably China), geographic concentration of production outside the United States, and limited multilateral engagement as key drivers of U.S. supply chain vulnerabilities.<sup>10</sup> In response, the report outlines a strategy to strengthen U.S. supply chain security by bolstering domestic industrial capabilities, pursuing supply chain cooperation with allies and partners, and using trade policy to defend against unfair economic practices, especially vis-à-vis China.

**The Biden Administration’s strategy for strengthening U.S. supply chain security prioritizes reshoring.** DOC, DOD, DOE, and DHHS each offered recommendations on invoking the Defense Production Act to incentivize onshore or nearshore production.\* The Biden Administration plans to develop a list of critical products designated for additional preferences under the Buy American Act to increase federal government procurement of U.S.-made products.<sup>11</sup> Read together, these recommendations underscore the Biden Administration’s focus on restoring U.S. domestic manufacturing capacity. In remarks to reporters delivered after the report’s release, Peter Harrell, senior director for international economics and competitiveness for the National Security Council, said, “We would expect to encourage both foreign and American companies to invest here in the United States.”<sup>12</sup>

**Policymakers in the United States as well as U.S. allies and partners are focusing on achieving self-sufficiency in key tech sectors which may narrow the scope for multilateral cooperation on supply chain diversification.** While the United States and EU launched an EU-U.S. Trade and Technology Council on June 15 that will establish working groups to coordinate semiconductor supply chain security,<sup>13</sup> other EU policies are eyeing self-sufficiency. According to the EU Digital Compass initiative, for example, the EU seeks to account for 20 percent of global semiconductor production by 2030.<sup>14</sup> EU countries also seek to advance “strategic autonomy” and reshore production of products assessed in the Biden Administration’s supply chain review, such as lithium batteries.<sup>15</sup> Separately, the Japanese government is seeking to upgrade Japan’s 84 semiconductor foundries to produce more leading-edge chips.<sup>16</sup>

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\* Specifically, DOC recommended leveraging the Defense Production Act to ensure the Committee on Foreign Investment in the United States liaises with foreign partners in sharing information related to the semiconductor industry and acquisition trends to strengthen national security-based investment screening regimes. Separately, DOE recommended using Defense Production Act Title III and VII authorities to support the sustainable extraction of domestic lithium resources. Both DOD and DHHS recommended using Title VII authorities to convene consortia of the U.S. government and industry stakeholders to coordinate on the expansion of domestic critical minerals and pharmaceutical production, respectively. White House, *Building Resilient Supply Chains, Revitalizing American Manufacturing, and Fostering Broad-Based Growth: 100-Day Reviews under Executive Order 14017*, June 2021, 80, 139, 198–199, 242–243. <https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf>.

**The Biden Administration is signaling continued use of trade enforcement action to defend against China's unfair economic practices.** The Biden Administration plans to establish a U.S. Trade Representative-led “trade strike force” to coordinate unilateral and multilateral enforcement actions against unfair foreign trade practices harming U.S. supply chains.<sup>17</sup> The report suggests this strike force will target China’s trade practices, noting “supply chain resilience [will be] incorporated into the U.S. trade policy approach towards China.”<sup>18</sup> The report also indicates DOC will consider initiating a Section 232 investigation into the national security impact of neodymium magnet imports, which the United States sources chiefly from China.<sup>\* 19</sup>

## U.S. Government Sharpens Focus on Xinjiang Forced Labor

**U.S. agencies are stepping up trade enforcement to combat the use of forced labor in Xinjiang, demonstrating coordinated, whole-of-government action consistent with domestic and international commitments.** The June 13 White House statement on joint actions of the G7 specifically notes common concern about Xinjiang-based production that involves “state-sponsored forced labor of vulnerable groups and minorities and supply chains of the agricultural, solar, and garment sectors.”<sup>20</sup>

- On June 24, the Bureau of Industry and Security under DOC added five Chinese entities to the Entity List for their use of forced labor and repression of Muslim minority groups in the Xinjiang Uyghur Autonomous Region (XUAR).<sup>21</sup> In a separate announcement on July 9, the Bureau of Industry and Security added 14 more Chinese companies for enabling “Beijing’s campaign of repression, mass detention, and high-technology surveillance” against Muslim minority groups in XUAR.<sup>22</sup>
- Also on June 24, the Department of Homeland Security’s Customs and Border Protection (CBP) simultaneously issued a withhold release order (WRO)<sup>†</sup> on silica-based products from one of the entities added, Hoshine Silicone Industry Co. Ltd., a silicone firm located in the XUAR. Silica-derived products and polysilicon are ubiquitous in a broad range of products from electronics to construction materials, as well as a key component of solar panels and renewable energy storage.<sup>23</sup> The WRO also applies to Hoshine subsidiaries, along with any materials or goods derived from silica, to prohibit the entry of such products beyond U.S. ports.<sup>24</sup> The WRO builds on recent CBP restrictions on the import of Xinjiang-sourced cotton and tomatoes, making this the eighth action that CBP has against Chinese companies implicated in the use of forced labor in Xinjiang.
- Concurrently, the U.S. Department of Labor updated its List of Goods Produced by Child Labor or Forced Labor to include polysilicon from China. The design of the list is to raise awareness of ongoing child labor and forced labor practiced, but it is not directly accompanied by any punitive actions.<sup>25</sup> This addition marked the first time the department updated its list outside its two-year update cycle.<sup>26</sup> In the last regular update of the list in September 2020, the department had already added other products from China,

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\* Neodymium magnets, created from an alloy of the rare earth mineral neodymium, iron, and boron, are used in a broad array of products including smartphones, computer hard disk drives, magnetic resonance imaging, automotive motors and wind turbines, as well as products with national security applications such as precision guided munitions. In 2020, U.S. imports of neodymium magnets reached \$151.7 million, with China accounting for 70.2 percent (\$106.5 million) of total imports. In its supply chain review of critical materials and minerals, DOE noted China is the only country that occupies a position at all stages of the production chain for such magnets. China’s dominance in the production and export of neodymium magnets is attributable to its outsized supply of neodymium and other rare earth minerals. According to a 2017 U.S. Geological Survey study, China provided about 90 percent of the world’s supply of rare earth minerals, on average, since the 1990s. White House, *Building Resilient Supply Chains, Revitalizing American Manufacturing, and Fostering Broad-based Growth: 100-Day Reviews Under Executive Order 14017*, June 2021, 155-157, 160, 187. <https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf>; U.S. Census Bureau, USA Trade Online, July 2, 2021. <https://usatrade.census.gov/>; Bradley S. Van Gosen et al., “Critical Mineral Resources for the United States—Economic and Environmental Geology and Prospects for Future Supply,” *U.S. Geological Survey*, 2017, 4. <https://pubs.usgs.gov/pp/1802/o/pp1802o.pdf>.

† A withhold release order (also called a denial order) suspends the import of specified goods that CBP determines to be produced or manufactured in whole or in part from forced labor (including prison labor and child labor). Importers are still eligible to receive the goods if they can submit evidence to the contrary along with a certificate of origin within three months of the order’s issuance. M.E. Dey & Company, “Withhold Release Order (WRO),” September 2020. <https://www.medey.com/wp-content/uploads/2020/09/Withhold-Release-Order-WRO.pdf>.

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including cotton, garments, footwear, electronics, gloves, hair products (e.g., wigs), textiles, yarn, and tomato products.<sup>27</sup>

**In Congress, the U.S. Senate Foreign Relations Committee also moved forward with legislation to address forced labor abuses in Xinjiang with the passage of the Uyghur Forced Labor Prevention Act.** While the bill had overwhelming bipartisan support in the committee, it must still pass the House and Senate and be signed by President Biden before becoming law.<sup>28</sup> The bill mandates the development of an interagency strategy to prohibit the import of goods made or produced from the XUAR while also establishing a presumption of import prohibition on goods produced wholly or in part in the XUAR.<sup>29</sup> Imports could be allowed only if firms can prove absence of forced labor in any Xinjiang-related supply chains.

**Companies and compliance experts have noted the difficulty of achieving thorough verification along the supply chain as the Uyghur Forced Labor Act would require.**<sup>30</sup> The solar industry has moved to increase auditing in anticipation of more stringent U.S. government policy as well as in response to growing U.S. public and Congressional pressure for supply chain transparency.<sup>31</sup> As these initiatives are underway, the Chinese government has restricted third-party auditors' access to facilities while also threatening auditors.<sup>32</sup>

## China Issues Anti-Foreign Sanctions Law

**The National People's Congress (NPC) passed the Anti-Foreign Sanctions Law under a confidential session to be effective immediately.** Neither drafts nor text of the law were publicly available until after its passage on June 10, an unusual development for Chinese lawmaking, which normally provides for three publicly available drafts prior to finalization with at least one opportunity for public comment.<sup>33</sup> Formulation of the law began in March 2021 with an explicit goal of developing legal tools to counter sanctions.<sup>34</sup> Chinese state media has specifically called out U.S. "long arm jurisdiction" as a key driver in the Chinese government's advancement of the Anti-Foreign Sanctions Law, but has been careful to emphasize that it is not only a direct reaction to U.S. measures and addresses a range of "foreign sanctions instigators."<sup>35</sup>

**Scholars of China's legal system believe the primary purpose of the law is formalizing China's sanctions process as well as prohibiting all companies operating in China from complying with foreign sanctions.** Many of the terms used in the law are not defined, including key concepts such as "development interests," "countermeasures," and "discriminatory restrictive measures of foreign nations." The law states that the State Council will set up a separate mechanism to counter foreign sanctions and coordinate other activities relevant to the Anti-Foreign Sanctions Law. Henry Gao, associate professor of law at Singapore Management University, anticipates that the Chinese government will reference the law in relation to sanctions already in place, such as those on former Secretary of State Mike Pompeo, the Mercator Institute for China Studies, and certain members of the EU Parliament who supported European sanctions against China related to Xinjiang.<sup>36</sup> While the Chinese government did not previously rely on a formal legal tool to impose sanctions, the formalization of such punishments is designed to chill further sanctions and establish that China has greater means and intent to retaliate.

**The scope of punishable entities under the law is exceptionally broad.** It targets "persons or organizations that directly or indirectly participate in the drafting, decision-making, or implementation of the discriminatory restrictive measures."<sup>37</sup> The law also extends potential retaliation to family members, associates, and organizational affiliates of any such person or organization identified with China-directed sanctions.<sup>38</sup> Under Article 6 of the Anti-Foreign Sanctions Law, punishments for violators include, but are not limited to, denial or cancellation of visas, deportation, asset seizure or freezing, and prohibition or restriction on transactions.<sup>39</sup> The law also provides for the Chinese government to exact countermeasures for "conduct endangering our nation's sovereignty, security, or development interests."<sup>40</sup> "Countermeasures" may include any of the punishments under Article 6 of the law, but are otherwise not defined and may be broader in practical implementation.

**The law increases risk for foreign companies operating in China as they navigate bilateral tensions and compliance with conflicting legal regimes.** Along with prohibiting companies from complying with foreign sanctions, the Anti-Foreign Sanctions Law provides that the government may sue violators for any related compensation loss.<sup>41</sup> For instance, a Chinese supplier placed on the Entity List could sue a foreign purchaser for canceling a contract in compliance with U.S. law. The Anti-Foreign Sanctions Law could also apply to Hong Kong, which the American Chamber of Commerce in China described as "further erod[ing] the city's autonomy."<sup>42</sup> Beijing

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lawmakers would still need to pass a motion to include it in Hong Kong’s Basic Law.<sup>43</sup> Application of the law in Hong Kong could have significant consequences for U.S. and other foreign financial firms.

## COVID-19 Lockdowns and Border Closures Disrupt Global Trade and Stall China’s Re-Opening

**COVID-19 outbreaks at a key Chinese export hub sparked stringent lockdowns and global shipping delays.** On May 21, 2021, Chinese authorities identified numerous COVID-19 cases near the Yantian container port in Shenzhen.<sup>44</sup> Chinese authorities responded to the outbreak with lockdowns that reduced the port’s operating capacity to 30 percent and prompted an influx of traffic to nearby Guangdong ports like Shekou, Chiwan, and Nansha.<sup>45</sup> These ports also began to implement strict COVID-19 protocols limiting the number of ships able to make port calls, exacerbating port congestion.<sup>46</sup> Because Shenzhen is the third-largest shipping center in the world with an annual capacity of 27.7 million 20-foot equivalent units (TEUs),<sup>\*</sup> delays and lockdowns at its ports and those nearby have had a compounding effect on shipping throughout the region as nearby ports have been forced to absorb excess traffic. While the Yantian port announced it had returned to full operating capacity on June 24, 2021, port congestion may take six to eight weeks to clear and ultimately impact peak shipping season for the United States and Europe, which begins in August.<sup>47</sup> Since Yantian accounts for approximately 25 percent of U.S.-bound Chinese origin shipping volumes, firms serving the U.S. market may encounter delays and rising costs.<sup>48</sup>

**Shipping delays compound existing supply chain disruptions.** Since the outbreak of the COVID-19 pandemic, freight shipping spot rates around the world<sup>†</sup> have risen to record levels amid container shortages, lagging inventories, and high consumer demand.<sup>49</sup> According to the logistics company Freightos, as a result of the overall rise in global shipping costs which have been exacerbated by the Yantian lockdown, the costs of shipping from Asia to the U.S. east and west coasts have risen by 215 and 178 percent year-on-year, respectively.<sup>50</sup> The cost of shipping goods between Shanghai, the world’s largest port, and China’s commodities suppliers in South America rose by 443 percent.<sup>51</sup> The resulting surge in commodity prices has pushed China’s producer price index to its highest level in 13 years.<sup>52</sup> Since most shipping companies operate on futures contracts that are negotiated annually, current price surges are baked into long-term contracts, which will likely result in long-term price increases for downstream producers and consumers.<sup>53</sup>

**China’s government extends COVID-19 related border closures to second half of 2022, delaying full economic re-opening.** In extending border closures, the Chinese government hopes to guard against emerging COVID-19 variants while maintaining domestic stability for important events like the Chinese Communist Party (CCP) centennial and the 2022 Beijing Winter Olympics.<sup>54</sup> Domestically, the specter of intermittent lockdowns continues to dampen consumption and recovery of the retail and services sectors, thereby perpetuating China’s uneven economic recovery.<sup>55</sup> Because Chinese consumption has not recovered, some Chinese producers have begun passing on higher costs to their international clients due to rising shipping and commodity prices, thus reinforcing global inflation pressures.<sup>56</sup>

## China Cracks Down on Cryptocurrency Mining and Trading

**In June, several Chinese provinces shut down cryptocurrency mining<sup>‡</sup> operation following official calls to halt mining and trading.** On May 21, Chinese Vice Premier Liu He called for “cracking down” on both Bitcoin mining and trading without elaborating on how authorities should implement the crackdown.<sup>57</sup> Vice Premier Liu’s statement, made while presiding over a meeting of the State Council’s Financial Stability and Development Committee, is the first time a Chinese government official has called for ending cryptocurrency mining in the

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\* TEUs are a unit of measure for shipping volumes based on standardized 20-foot long shipping containers. Flexport, “TEU (Twenty-Foot Equivalent Unit).” <https://www.flexport.com/glossary/twenty-foot-equivalent-unit/>.

† Here spot rates indicate prices quoted for the immediate payment of shipping costs, as opposed to prices quoted for future payment. James Chen, “Spot Rate,” *Investopedia*, February 17, 2021. [https://www.investopedia.com/terms/s/spot\\_rate.asp](https://www.investopedia.com/terms/s/spot_rate.asp).

‡ Cryptocurrency networks are maintained by “miners” who validate transactions on the blockchain. Bitcoin miners are rewarded in new Bitcoin that they have “mined.” Validating transactions requires solving complex mathematical puzzles, and therefore requires significant computing power. Arjun Kharpal, “Everything You Need to Know about Blockchain,” *CNBC*, June 18, 2018. <https://www.cnbc.com/2018/06/18/blockchain-what-is-it-and-how-does-it-work.html>.

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country. China accounts for around 65 percent of Bitcoin mining globally,<sup>58</sup> which earned Bitcoin special notice from the Financial Stability and Development Committee, but the crackdown extends to all cryptocurrencies.<sup>59</sup> Several provinces or provincial-level autonomous regions acted swiftly to cease cryptocurrency mining operations. Inner Mongolia released strict draft regulations that would revoke the business licenses of companies involved in mining.<sup>60</sup> In June, Qinghai and Sichuan ordered cryptocurrency miners to shut down operations, while some operations in Xinjiang were ordered to cease.<sup>61</sup>

**The People’s Bank of China (PBOC) also pressured major financial institutions to cease crypto-related services.** On June 21, 2021, the PBOC summoned major Chinese lenders and Alipay, an Alibaba-affiliated payments service, to a meeting to instruct them not to provide transfer services that enable Chinese citizens to exchange renminbi (RMB) for cryptocurrencies.<sup>62</sup> China’s government banned domestic cryptocurrency exchanges in 2017, but Chinese citizens can still access offshore exchanges using a virtual private network to bypass China’s internet restrictions.<sup>63</sup> Peer-to-peer exchanges that match users who want to exchange RMB for cryptocurrencies and vice-versa have been especially difficult for regulators to track because they involve fund transfers between individuals. In these transactions, a person buying cryptocurrency can transfer funds directly to someone selling cryptocurrency via a mobile payment app, such as Alipay, or via an RMB-denominated bank account, and then the seller will authorize the exchange to release the currency to the buyer upon receipt of the RMB.<sup>64</sup> The PBOC’s latest warning intends to curb workarounds to avoid the restrictions on cryptocurrency trading.<sup>65</sup> The reminder follows a separate warning issued by three Chinese financial industry groups in May,\* which warned that regulators would begin cracking down on financial institutions conducting cryptocurrency business or related services in China.<sup>66</sup>

**The Chinese government’s crackdown on mining and trading of cryptocurrencies has environmental, financial, and oversight motivations.** Because cryptocurrency mining requires substantial computing power, it is incredibly energy intensive. Researchers from Cambridge University estimated that global Bitcoin mining consumes more 121.4 terra-watt hours of energy annually, more than the entire country of Argentina, and about 0.32 percent of the global total.<sup>67</sup> Mining has flourished in China due to its abundant low-cost electricity and local innovation in computer chips specially designed for mining.<sup>68</sup> Inner Mongolia accounts for 8 percent of global mining alone, and it missed energy use targets set by Beijing for 2019.<sup>69</sup> Chinese authorities are targeting mining as China pledges to lower carbon emissions and improve energy efficiency. Aside from energy considerations, China’s government claims it is pressuring financial institutions to block transactions in cryptocurrency due to concerns over cryptocurrencies’ volatility as well as their potential to facilitate illicit transactions.<sup>70</sup>

**Steering the direction of blockchain development and digital currency use is a political imperative for Chinese policymakers.** As the PBOC accelerates development of its own central bank digital currency, the Digital Currency Electronic Payment (DCEP), its scrutiny of cryptocurrencies has increased. China’s government has been adamant that while it remains legal to own Bitcoin and other cryptocurrencies in China, it considers them investment assets rather than currency, and no cryptocurrencies should compete with DCEP.<sup>71</sup> The latest efforts to curtail mining and trading come as Chinese policymakers issued a separate plan aiming to steer the development of China’s domestic blockchain industry, and as several Chinese cities, including Shanghai and coastal shipping hub Qingdao, conduct limited trials in DCEP.<sup>†</sup> <sup>72</sup> Demonstrating policymakers’ attempts to control the narrative around cryptocurrency, at least 15 social media accounts related to cryptocurrencies were shut down at the beginning of June, following Vice Premier Liu’s remarks.<sup>73</sup>

**China’s crackdown is having a ripple effect on cryptocurrency values globally.** Following Sichuan’s shutdown of mining operations on June 18, Bitcoin’s value tumbled 16 percent by the morning of June 22, dropping below \$30,000 for the first time since late January 2021 and erasing \$400 billion in market value.<sup>74</sup> As of July 1, 2021, Bitcoin’s value had recovered slightly, exceeding \$33,000.<sup>75</sup> Values of major rival cryptocurrencies Ether, the

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\* The groups are National Internet Finance Association of China, the China Banking Association, and the Payment & Clearing Association of China. Elaine Yu and Chong Koh Ping, “China’s Latest Crackdown on Bitcoin, Other Cryptocurrencies Shakes Market,” *Wall Street Journal*, May 24, 2021. <https://www.wsj.com/articles/chinas-latest-crackdown-on-bitcoin-other-cryptocurrencies-shakes-market-11621853002>.

† For a description of an early DCEP trial in Shenzhen during October 2020, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, November 9, 2020, 7-9. [https://www.uscc.gov/sites/default/files/2020-11/November\\_2020\\_Trade\\_Bulletin.pdf](https://www.uscc.gov/sites/default/files/2020-11/November_2020_Trade_Bulletin.pdf).

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second-largest cryptocurrency by value, and XRP, a cryptocurrency used to facilitate cross-border transactions by the San Francisco-based startup Ripple, both dropped 12 percent on June 21.<sup>76</sup>

**Cryptocurrency mining operations are relocating, and the United States is a top destination.** With the crackdown accelerating, China’s cryptocurrency miners are looking for new locations to establish operations.<sup>77</sup> Because internet access and low energy costs are the main considerations in mining, areas in the United States with plentiful energy sources are among the top destinations for the exodus of cryptocurrency miners from China. In particular, Texas has some of the world’s lowest energy prices.<sup>78</sup> Chinese operations are also moving to neighboring Kazakhstan, where abundant coal also lowers energy costs and lax building standards enable miners to resume operations quickly.<sup>79</sup>

## In Focus: China’s Data Governance Regime

**On June 10, the NPC, China’s top legislative body, passed the Data Security Law, the first comprehensive piece of data security legislation in China.** The Data Security Law, which will take effect on September 1, 2021, contains several important provisions on the handling of data in China:

- *Tiered classification of data:* The Data Security Law applies to all data stored in China by domestic or foreign operators.<sup>80</sup> The law establishes different categories of data, with more important classes of data subject to more stringent regulation. Processors of “important data”<sup>\*</sup> are subject to additional risk assessment requirements and export controls, while companies that transfer “core state data”<sup>†</sup> overseas without obtaining prior approval from Chinese authorities are subject to penalties, including fines of up to \$1.5 million (RMB 10 million) for each violation and the closure of the business.<sup>81</sup> The provisions on “core state data” were relatively late additions to the law, having not appeared in drafts released in October 2020 and April 2021.<sup>82</sup>
- *Increased government access to data:* The Data Security Law requires organizations and individuals to “cooperate” with public security and state bodies collecting data “as necessary to lawfully preserve national security or investigate crimes.”<sup>83</sup> This is the latest in a series of recent Chinese laws that require “cooperation” from Chinese citizens and organizations as well as foreign citizens and organizations in China, including the 2017 National Intelligence Law and the 2017 Cybersecurity Law.<sup>84</sup>
- *Restrictions on transfer of data abroad:* The Data Security Law adds to existing restrictions on transferring data outside of China. The law provides that handlers of “important data” will be subject to forthcoming regulations, and mandates that data stored within China by domestic organizations or individuals not be provided to foreign law enforcement or justice bodies without first receiving permission from the government.<sup>85</sup>
- *Extraterritorial application:* In addition to data processing within China, the Data Security Law applies to all data processing outside of China—regardless of who is handling the data—that could harm China’s national security, the public interest, or the “lawful rights and interests of citizens and organizations.”<sup>86</sup> Extraterritorial application has historically been rare in Chinese laws, but several recent Chinese laws have included provisions with extraterritorial application, creating potential compliance challenges for foreign firms operating in China.

**The Data Security Law is one of three main pieces of Chinese data legislation.** The other two important laws are the Cybersecurity Law, which took effect in 2017, and the personal information protection law, which remains in draft form. The Cybersecurity Law instituted many of the basic data provisions that were subsequently strengthened in the Data Security Law. For instance, the Cybersecurity Law included data localization requirements

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\* The Data Security Law does not define “important data,” providing instead that various regions and sectors will be responsible for publishing individual catalogs of “important data.” In May, the Cyberspace Administration of China published a draft set of regulations, *Several Provisions on the Management of Automobile Data Security*, which categorize several types of automobile data as “important data,” including data on traffic volume on the road and data concerning automobile charging networks. <https://digichina.stanford.edu/news/translation-several-provisions-management-automobile-data-security-draft-comment>.

† The law broadly defines “core state data” as “data related to national security, the lifeline of the national economy, important aspects of people’s livelihoods, and major public interests.”



for companies that are designated “critical information infrastructure,” subject to sweeping restrictions.\*<sup>87</sup> The personal information protection law, which was first introduced in draft form in October 2020, is China’s first law focusing on personal data protection. The draft personal information protection law states that personal data of Chinese citizens generally may only be transferred outside of China after the Chinese government grants permission.† Like the Data Protection Law, the draft personal information protection law contains provisions that apply beyond China’s border. The law contains many of the same protections against collection of individual data by private companies that are in the General Data Protection Regulation (GDPR), the EU’s data protection law.<sup>88</sup> Unlike the GDPR, however, the personal information protection law provides a much broader definition of personal information.<sup>89</sup> China’s draft personal information protection law also includes a potentially more restrictive requirement that organizations transferring personal information collected in China overseas can do so for “business reasons,” which are not defined as in the GDPR, and must pass a security assessment.<sup>90</sup>

**Over the past several years, the CCP has placed increasing emphasis on collecting data, framing it as an economic, national security, and geopolitical issue.** In a press release published on the same day as the passage of the Data Security Law, the Cyberspace Administration of China (CAC) wrote, “Data is a country’s basic strategic resource. Without data security there is no national security.”<sup>91</sup> In April 2020, the government named data as a “factor of production,” on par with land, capital, and labor.<sup>92</sup> The 14th Five-Year Plan, released in March 2021, highlights “big data” as one of the key components of China’s digital economy and sets goals to promote big data collection and analysis as well as improving the standards system for big data.<sup>93</sup> The CCP’s data ambitions have extended to international standards setting as well. In September 2020, Chinese Foreign Minister Wang Yi presented a *Global Initiative on Data Security*, which Foreign Ministry spokesman Zhao Lijian characterized as “contributing China’s wisdom to international rules-making” for data.<sup>94</sup> The document promotes many of Beijing’s preferred data governance policies, including local data storage—a policy that has raised concern among human rights experts as well as U.S. tech firms.<sup>95</sup>

#### **Didi Investigation Highlights Chinese Government Scrutiny of Data Security and Foreign Listings**

On July 2, China’s Cybersecurity Review Office, which is part of CAC, announced that it was conducting a “cybersecurity” review of ride-hailing giant Didi and was temporarily preventing Didi from registering new users. Two days later, CAC ordered Chinese app stores to remove Didi from their platforms and said the company had violated Chinese law by improperly collecting and storing user data.<sup>96</sup> The move came just days after Didi raised \$4.4 billion in an initial public offering on the New York Stock Exchange.<sup>97</sup> Share prices for Didi fell nearly 20 percent, from \$15.53 to \$12.49, on July 6, the first day of trading since the announcement of the investigation.<sup>98</sup> After announcing the Didi investigation, the Cybersecurity Review Office said it was conducting data-security investigations of two other companies that went public in the United States in June, Full Truck Alliance and Kanzhun.<sup>99</sup> Full Truck Alliance operates two ride-share apps that target the trucking industry, while Kanzhun operates Boss Zhipin, an online job recruiting app.<sup>100</sup>

The investigations into these companies mark a new development in the CCP’s crackdown against big tech firms. The Didi investigation was the first time that Chinese regulators cited national security as a reason for investigating a Chinese tech firm; the same reason was given for the investigations into Truck Alliance and Kanzhun.<sup>101</sup> The investigations underline Chinese government’s rising concern over data leaving China. Ahead of Didi’s listing on the New York Stock Exchange, CAC and the China Securities Regulatory Commission held talks with the company regarding listing in Hong Kong instead of the United States.<sup>102</sup> CAC also reportedly recommended the company

\* The Data Security Law clarifies that “critical information infrastructure” operators remain subject to the procedures in the 2017 Cybersecurity Law. The Cybersecurity Law does not define “critical information infrastructure,” but subsequent government documents have provided a nonexhaustive list of sectors likely to fit the definition, including transportation, health, and energy. Todd Liao, “China Publishes New Measure on Cybersecurity Review of Network Products and Services,” *Morgan Lewis*, May 14, 2020. [https://www.jdsupra.com/legalnews/china-publishes-new-measure-on-94241/#\\_ftnref2](https://www.jdsupra.com/legalnews/china-publishes-new-measure-on-94241/#_ftnref2).

† The draft personal information protection law does not specify the approval process, merely noting that the handlers of personal information must pass an assessment organized by a state cybersecurity and informationization department. The law provides several alternatives to passing a security assessment, including receiving a certification in “personal information protection,” but such steps also require government approval. Graham Webster, “Translation: Personal Information Protection Law of the People’s Republic of China (Draft) (Second Review),” *DigiChina Cyber Policy Center*, April 29, 2021. <https://digi.china.stanford.edu/news/translation-personal-information-protection-law-peoples-republic-china-draft-second-review>.

delay its listing and review its data security practices, motivated by concerns that the higher transparency standards in U.S. listings could lead to valuable data being transferred abroad.<sup>103</sup>

On July 6, China's State Council announced it would tighten regulations on a range of securities activities, including listing abroad.<sup>104</sup> While focus on data security is a major driver behind scrutiny of Didi, Beijing has been tightening rules for firms with foreign listings or those seeking to list abroad. Bloomberg reported on July 7 that the China Securities Regulatory Commission was seeking to introduce new rules allowing them to block a Chinese company from listing overseas if it uses a structure called a variable interest entity (VIE).<sup>105</sup> Separately, on July 10, CAC published draft rules requiring any Chinese company with user data of more than one million users to complete a review with the Cybersecurity Review Office before listing abroad.<sup>106</sup>

**The Chinese government's regulatory efforts have increasingly focused on controlling data held by nonstate companies.** The passage of the Data Security Law represents the latest step in Beijing's escalating efforts to rein in nonstate technology firms. CCP policymakers view data collected by China's state and nonstate firms as a national asset that should be available to the government.<sup>107</sup> China's top leaders are also interested in exercising greater oversight of technology firms in general, which they view as a potential source of economic as well as political instability.<sup>†</sup><sup>108</sup> According to a March Bloomberg report, Chinese policymakers are considering the establishment of a government entity, led by the PBOC, that would coordinate and oversee data collected by Chinese tech companies, although the scope of the proposed entity reportedly remains undecided.<sup>109</sup> In July, the Chinese magazine *Caijing* reported the PBOC had issued instructions to online platforms to route all their credit data through credit reporting agencies rather than directly sharing them with financial institutions.<sup>110</sup> According to research consultancy Trivium, the Chinese government owns the largest stake in the only two credit reporting agencies that provide individual credit scores.<sup>111</sup> Chinese government pressure has extended to foreign private firms operating in China as well. In May, Tesla announced that all data from cars sold in China would be stored in a new data center in China, following Chinese government scrutiny over the handling of Chinese drivers' data.<sup>112</sup>

**China's increasing interest in data collection and regulation has raised both compliance and privacy concerns among foreign observers.** U.S. companies operating in China may, for instance, be required to produce documents located in China under legal requirements in the Clarifying Lawful Use of Data (CLOUD) Act, a 2018 U.S. law. Under the Data Security Law, however, the sharing of such data with the United States would be prohibited without approval from the Chinese government.<sup>113</sup> Additionally, Chinese investment in U.S. firms has raised concerns that data on U.S. users could be made accessible to the CCP. In June, former employees of TikTok told CNBC that ByteDance, the Chinese parent company of TikTok, was actively involved in the U.S. subsidiary's decision-making process and had access to U.S. user data.<sup>114</sup> Despite TikTok's statement that they had never shared U.S. user data with the Chinese government, Bryan Cunningham, a U.S. cybersecurity expert, assessed that "if the legal authorities in China or their parent company demands the data, users have already given them the legal right to turn it over."<sup>115</sup>

**Disclaimer:** The U.S.-China Economic and Security Review Commission was created by Congress to report on the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China. For more information, visit [www.uscc.gov](http://www.uscc.gov) or follow the Commission on Twitter @USCC\_GOV.

This report is the product of professional research performed by the staff of the U.S.-China Economic and Security Review Commission, and was prepared at the request of the Commission to support its deliberations. Posting of the report to the Commission's website is intended to promote greater public understanding of the issues addressed by the Commission in its ongoing assessment of U.S.-China economic relations and their implications for U.S. security, as mandated by Public Law 106-398 and Public Law 113-291. However, it does not necessarily imply an endorsement by the Commission, any individual Commissioner, or the Commission's other professional staff, of the views or conclusions expressed in this staff research report.

\* The Chinese government prohibits foreign direct investment in certain industries, including many high-tech sectors, and maintains strict controls on foreign exchange and capital flows. To circumvent these restrictions, many companies list abroad using a VIE structure. For an in-depth explanation of VIEs and associated risks, see U.S.-China Economic and Security Review Commission, 2019 Annual Report to Congress, 176–177. <https://www.uscc.gov/sites/default/files/2019-11/Chapter%203%20Section%201%20-%20U.S.-China%20Commercial%20Relations.pdf>.

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