

Intelligence MEMOS



From: Lawrence Herman
To: Canadian Trade Watchers
Date: November 14, 2022
Re: **INDO-PACIFIC POLICY, CHINA STRATEGY AND SEMICONDUCTORS**

We got an advance outline of Canada's long-awaited Indo-Pacific strategy this week from Global Affairs Minister Melanie Joly, before its full release in weeks to come.

China was the focus of her University of Toronto address and the challenges it poses as a result of "tectonic" geopolitical shifts in the last decade.

The forthcoming policy will cover many other areas, but China is critical and any new Canadian policy will have to take into account three powerful elements.

The first is the primacy of Canada's national security, the core responsibility of any government. Recent events have shown how Canada's national security must transcend other values, Ms. Joly cited recent restrictions on Chinese investment in critical minerals as an example.

A second element in any Indo-Pacific + China strategy is the growing use of export controls as a national security weapon, increasingly employed by Canada and other democratic nations to prohibit transactions in sectors essential to national security. Export controls differ from economic sanctions in that they are prospective and strategic, as opposed to sanctions, which are reactive and tactical, the Ukraine war providing the latest example.

The third strategic factor in economic and trade relations with China involves semiconductors and related technology, including the interconnected web of microprocessor production, distribution and use.

Semiconductors now loom large in strategic importance, displacing traditional commodities such as steel, lumber and even oil.

Canada and its allies will increasingly use export controls to prevent China from gaining access to leading semiconductor technologies. This will result in global trade reconfiguration as supply chains for many chip-embedded products will need to adjust to increased national security actions.

National security will be safeguarded by those countries best able to manage those supply chains and harness the power of that technology. Dominating or controlling trade in advanced semiconductor technology could be the single most important factor in constraining China for decades to come.

The first major salvo in this conflict came last month from Washington with the Commerce Department's Advanced Computing and Semiconductor Rule.

This new set of export controls has extraordinary scope and power, making sweeping changes to trade in semiconductors and micro-processors. Because it hits on business in these high-tech goods and technologies, it has huge ramifications for international business. It also shows the continuing global power of US trade actions that stem from the White House alone.

We saw this revealed full force in the Trump years on aluminum and steel most famously, and Joe Biden has taken it further with China.

Importantly for Canada and other allies, the new rule is extraterritorial, reaching far beyond US borders. It also restricts transactions outside the US that use American inputs or technology, however minimal, destined for Chinese end-use. It covers American persons anywhere in the world and any person and any manufacturing facility, whether in China or elsewhere, that has anything to do with the production or use of listed US items.

The rule also imposes burdensome diligence requirements on the microchip industry to ensure products and services do not end up in China or in the hands of Chinese entities.

All of this has been a broadside hitting the global semiconductor industry full force, already affecting supply chains in a huge way, putting any entity or person in the complex web of commercial relationships at risk of being offside US law. As an example, ASML, the Dutch manufacturer that has a monopoly on many high-end semiconductor manufacturing tools, immediately ordered its US staff to freeze interaction with Chinese customers.

Unfortunately, it appears that very little – if any – prior consultations were held with US allies, including Canada, before the new rule emerged. This is an unwelcome departure from the Biden administration's efforts to pay more attention to collaboration with allies, a stark to the unbridled unilateralism of the Trump years.

It also seems to offend the spirit of collaboration under the Wassenaar Arrangement on Export Controls, established among 41 Western allies in 1996 to ensure consultation and collaboration on export controls over sensitive goods and technologies. Its spirit of transparency should have provided motivation to consult, and at the very least given American allies a heads-up about these measures. Apparently, none was undertaken.

What does all of this mean for Canada and Canadian businesses involved with China in the technology sphere, directly or indirectly?

Some of the answers will come with the unveiling of the new policy and how it stickhandles Canada's strategic interests in Indo-Pacific region, balancing it with the Canada-US bilateral relationship and the Joint Action Plan on Critical Minerals, taking into account the huge impact of the new American controls on semiconductors.

Lawrence Herman, a former Canadian diplomat, is Counsel at Herman & Associates and a Senior Fellow of the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

The views expressed here are those of the author. The C.D. Howe Institute does not take corporate positions on policy matters.