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GEOECONOMICS CENTER

ISSUE BRIEF

Delist or Not Delist: A $2.2-Trillion US-China Auditing Dispute

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Executive Summary

The economic and financial forces set in motion by the COVID-19 pandemic—global recession and ultra-loose monetary policies that have driven a cross-border search for higher yield—have contributed to a slow shift of international capital toward China's markets. Now, intensified US-China tensions—especially the targeting of Chinese companies for delisting from US stock markets—have the potential to heighten that trend.

A longstanding dispute regarding US regulators' access to Chinese companies' books—standard disclosure practice for virtually all other foreign countries listed on US markets—could accentuate that shift. Legislation passed unanimously by both houses of the US Congress in 2020 has started the clock ticking on a process that could result in the delisting of more than two hundred Chinese companies, representing about 6 percent of US stock-market capitalization, in the next three years. It is an issue that was largely separate from the Donald Trump administration's efforts to restrict the commercial activities of Chinese companies with ties to China's military and security services.

While US markets may ultimately take a mass delisting in stride, and investment banks would likely benefit, many US investors could end up facing losses. Moreover, the exodus of companies from Wall Street would lift the profile of China's financial markets, including a Hong Kong market that has lost considerable allure because of Beijing's political crackdown there. The majority of companies threatened with delisting (which fundamentally have no say in the disclosure dispute) are private-sector firms that would lose access to the prestige and lower-cost financing that accompany a US listing. They would also be more vulnerable to shifting political winds in China—most recently underlined by the crackdown on Alibaba, the online retail and fintech giant that would be the most prominent company to face US delisting.

These outcomes still might be avoided: Chinese regulators have signaled a willingness to engage more seriously in negotiations on the disclosure issue, and that suggests an opening for the Joe Biden administration as it comes to grips with Trump administration actions toward Beijing and refines its own China policy.

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Background

In the forty years of China's emergence as a global economic power, the quest for financing and stature has led hundreds of Chinese companies—state-owned enterprises and high-tech startups alike—to seek listings on US stock markets. Billions of dollars have been raised in initial public offerings (IPOs), and many investment banks have reaped handsome fees from the process.[1] As of October 2020, 217 Chinese companies were listed on the New York Stock Exchange (NYSE), Nasdaq, and the US over-the-counter (OTC) market.[2] They had a combined stock-market capitalization of $2.2 trillion, or some 6 percent of the markets' total capitalization. (By comparison, China held about $1.1 trillion of Treasury securities in November 2020, according to US government statistics.[3])

The five largest listed companies—led by e-commerce giant Alibaba Group Holding Ltd.—overwhelmingly dominate investor interest in the Chinese shares. But, over the years, a constantly changing array of smaller companies has attracted the attention of US regulators. It has also generated a bilateral dispute over disclosure practices that, thanks to a law passed unanimously last year by both houses of the US Congress, could result in the delisting of every Chinese company on US exchanges within three years.[4] That, in turn, has the potential to deepen the growing political divide between the US and Chinese economies, while increasing the heft of China's financial markets—including a Hong Kong stock market whose standing in the world of international capital has been damaged by political turmoil over the past few years.

The diplomatic standoff was sparked by a series of accounting scandals that caused billions of dollars in investor losses on Wall Street. While many of those incidents occurred a decade ago, the most recent exploded last April when Luckin Coffee, a Nasdaq darling that sought to unseat Starbucks as China's leading coffee retailer, suddenly announced that its chief financial officer had fabricated $310 million in sales.[5] Within weeks, a company whose May 2019 share issues raised $1.5 billion, and whose market capitalization soon peaked at $12 billion, was delisted from Nasdaq. By year end, Luckin had agreed to pay the US Securities and Exchange Commission (SEC) $180 million in fines for "accounting fraud."[6] The company filed for bankruptcy in February 2021.[7]

While the presence of Chinese companies on Wall Street expanded, China's financial markets have grown from a backwater of international finance into an important destination for international capital. The Shanghai, Shenzhen, and Hong Kong stock markets are all among the ten largest markets in the world, and foreign investments in equities listed on those markets and Chinese bonds have grown rapidly.[8] Despite the COVID-19 pandemic and recession, all Chinese stocks—including those listed in the United States—in aggregate gained 41 percent in value in 2020, representing about one third of the global increase in stock-market capitalization during the year.[9]

This shift has not been lost on the Chinese government, which is eager to boost its markets. Nonetheless, while total foreign holdings of China's A-shares—the category of stocks in Shanghai and Shenzhen open to foreign ownership—rose 65 percent to $354 billion in the year to

1 Dave Michaels and Akane Otane, "U.S. Moves to Audit Chinese Firms. Market Frets over What Comes Next," *Wall Street Journal, May 26, 2020, https://www.wsj.com/articles/u-s-moves-to-audit-chinese-firms-market-frets-over-what-comes-next-11590485401.*

2 "Chinese Companies Listed on Major U.S. Stock Exchanges," US-China Economic and Security Review Commission, October 2, 2020, https://www.uscc.gov/research/chinese-companies-listed-major-us-stock-exchanges.

3 "Major Foreign Holders of U.S. Treasury Securities," US Department of the Treasury, January 19, 2021, https://ticdata.treasury.gov/Publish/mfh.txt.

4 Holding Foreign Companies Accountable Act S.945 of the 116th Congress, https://www.congress.gov/bill/116th-congress/senate-bill/945. Passed by the US Senate on May 20, 2020. Passed by the US House of Representatives on December 8, 2020. Signed by President Trump into Public Law No. 116-222 on December 18, 2020.

5 Selina Wang and Matthew Campbell, "Luckin Scandal is Bad Timing for U.S.-Listed Chinese Companies," Bloomberg, July 29, 2020, https://www.bloomberg.com/news/features/2020-07-29/luckin-coffee-fraud-behind-starbucks-competitor-s-scandal?sref=E0nAM78N.

6 "Luckin Coffee Agrees to Pay $180 Million Penalty to Settle Accounting Fraud Charges," US Securities and Exchange Commission, press release, December 16, 2020, https://www.sec.gov/news/press-release/2020-319.

7 Jordan Valinksky, "Luckin Coffee Files for Bankruptcy in the US," CNN Business, February 5, 2021, https://www.cnn.com/2021/02/05/investing/luckin-coffee-us-bankruptcy-trnd/index.html.

8 While the Hong Kong Stock Exchange operates under a separate legal framework and different market regulations than the Shanghai and Shenzhen stock markets, it is included as a Chinese financial market for purposes of this paper's analysis. "The World's 10 Largest Stock Markets," *Visual Capitalist, October 29, 2020, https://www.visualcapitalist.com/the-worlds-10-largest-stock-markets/.*

9 Quentin Webb, "Chinese Stocks Have Banner Year, Gaining Nearly $5 Trillion," *Wall Street Journal, December 25, 2020, https://www.wsj.com/articles/chinese-stocks-have-banner-year-gaining-nearly-5-trillion-11608892204?st=uevrmn3df4cu8ao&reflink=article_gmail_share.*

A woman leaves a store of the Chinese coffee house chain Luckin Coffee in Beijing, China, July 8, 2020. Picture taken July 8, 2020. REUTERS/Thomas Peter.

November 30, 2020, that still represented only 16 percent of the market capitalization of Chinese company shares listed in the United States.[10]

The Audit Dispute

The issue between Beijing and Washington over Chinese stocks listed in the United States centers on SEC rules put in place in the wake of the 2001 Enron scandal that brought down both the energy company and its accounting firm, Arthur Anderson. Listed companies were subsequently required to allow a newly created regulatory body, the Public Company Accounting Oversight Board (PCAOB), to inspect the "audit work and practices" of their accountants.[11] While foreign companies listed on US exchanges were held to a somewhat lower disclosure standard than US firms, the Chinese government refused to allow PCAOB inspection of accounts audited in China—even though most of the audits are conducted by Chinese and Hong Kong affiliates of the major international accounting firms.

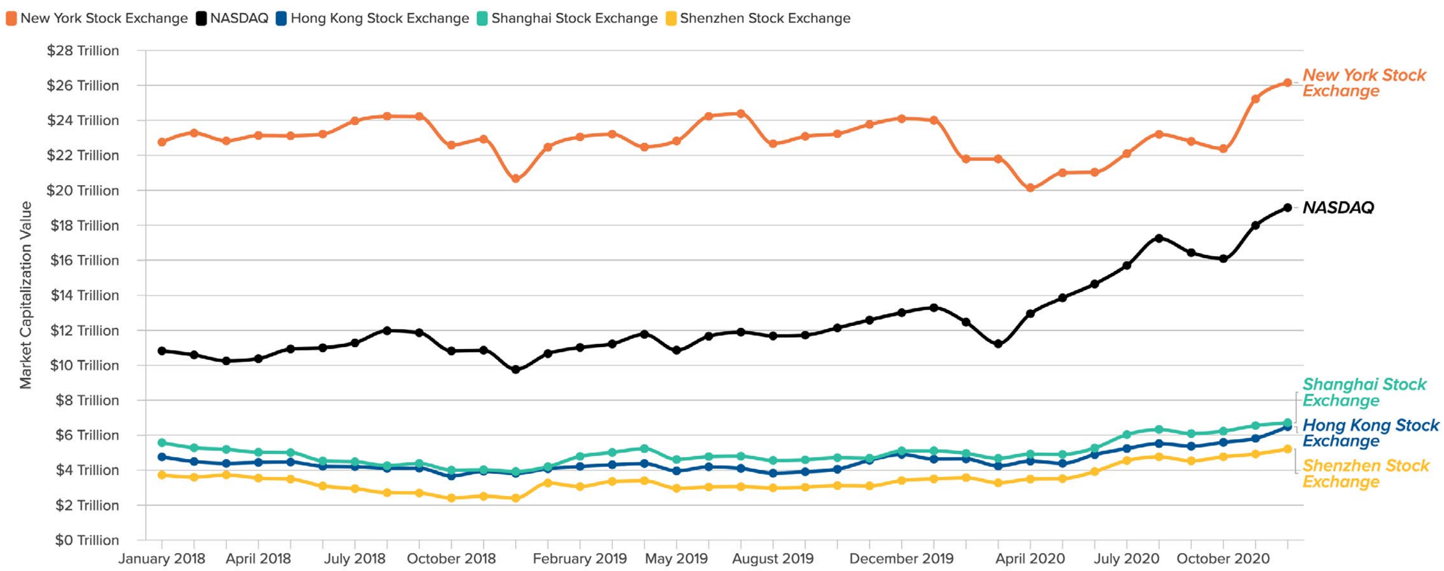
The dispute has dragged on for a decade, during which the SEC says it has "investigated and litigated…dozens of possible violations of the federal securities laws related to China-based issuers, registrants and persons."[12] Extensive negotiations between the PCAOB, the China Securities and Regulatory Commission (CSRC), and the Ministry of Finance have been conducted on the issue. A memorandum of understanding on enforcement was signed in 2013, but Chinese regulators prevented progress—including during 2017 pilot PCAOB inspections

10 Mike Bird, "Delisting Chinese Stocks in the U.S. Won't Sever Their Access to Global Capital," *Wall Street Journal, December 3, 2020, https://www.wsj.com/articles/delisting-chinese-stocks-in-the-u-s-wont-sever-their-access-to-global-capital-11606972489.*

11 Jay Clayton, William D. Duhnke III, and Sagar Teotia, "Statement Regarding Audit Quality in Emerging Markets and Recent Developments," Harvard Law School Forum on Corporate Governance, December 1, 2020, https://corpgov.law.harvard.edu/2020/12/01/statement-regarding-audit-quality-in-emerging-markets-and-recent-developments/.

12 "Report on Protecting United States Investors from Significant Risks from Chinese Companies," President's Working Group on Financial Markets, July 24, 2020, 10, https://home.treasury.gov/system/files/136/PWG-Report-on-Protecting-United-States-Investors-from-Significant-Risks-from-Chinese-Companies.pdf.

Figure 1. Comparison of US and Chinese stock exchanges by market capitalization



Source: Nitya Biyani, Atlantic Council.

in China. The Chinese regulators insisted on the right to block review of, and black out, documents on national security grounds.[13]

Beijing's opposition stands in contrast to broad international acceptance of enforcement cooperation on securities fraud. The SEC has signed more than seventy-five formal arrangements with foreign regulators and law-enforcement agencies, while the PCAOB has twenty-three agreements enabling joint inspections and shared findings, and has conducted inspections in more than fifty "non-U.S. jurisdictions."[14]

In a report issued late last year, the SEC and PCAOB stated that "Chinese cooperation has not been sufficient for the PCAOB to obtain access to relevant documents and testimony" on audit-related matters.[15] The Chinese government's position was summed up in an article in the state-run *China Daily: "China will stick to its own authority over regulatory issues. This is a matter of national sovereignty."*[16]

2020: White House Action and Congressional Legislation

That is where matters stood until last year, when the issue moved back to the front burner. A crucial reason was the fundamental change in the tenor of US-China relations, which deteriorated rapidly after the two governments reached the Phase One trade deal in January 2020. That deal included Beijing's agreement to open a range of sectors in its financial-services industry to US companies.[17]

As the US presidential campaign built momentum, and especially after President Biden's November victory, financial-market issues became points of heated contention. The Chinese government implemented a

13 Public Companies Accounting Oversight Board (PCAOB) letter, in Ibid., Appendix A, 19; see 21–24 for summary of PCAOB interaction with CSRC.

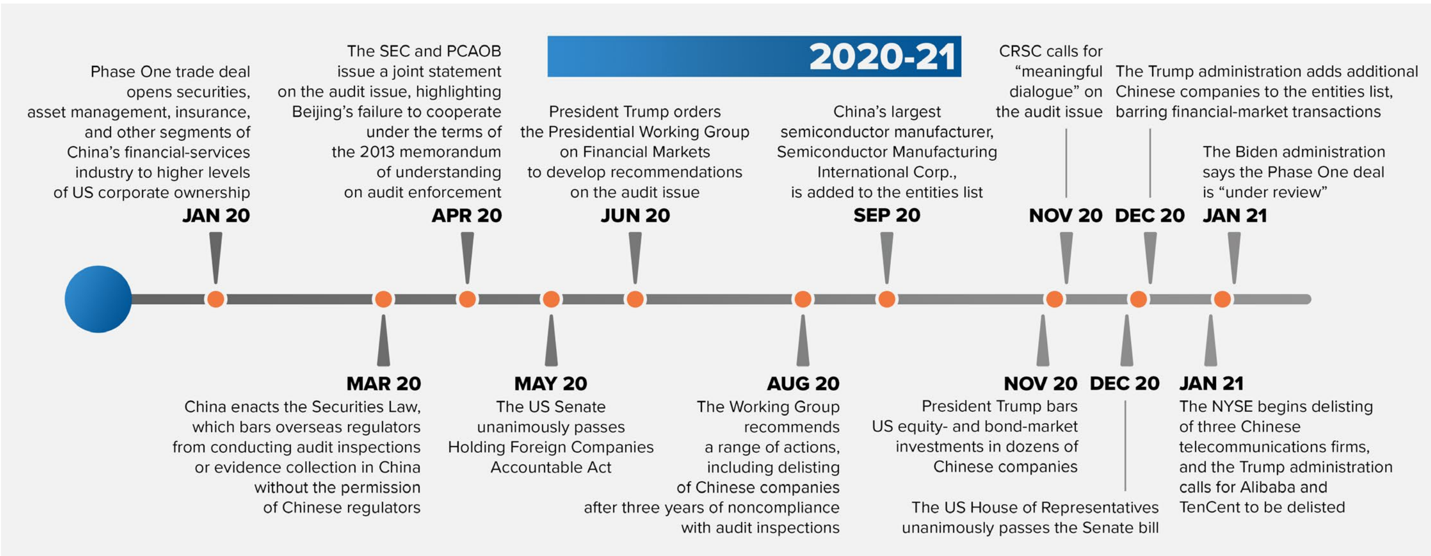
14 "Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China," US Securities and Exchange Commission, December 7, 2018, https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other.

15 SEC and PCAOB "Statement on Relevant SEC and PCAOB Activities Relating to Market Awareness and Enforcement," in "Report on Protecting United States Investors from Significant Risks from Chinese Companies," Appendix C, 40.

16 Pan Yuanyuan, "Idea to Force Chinese Stocks to Delist in US is Bad," *China Daily, June 1, 2020, https://www.chinadaily.com.cn/a/202006/01/WS5ed46bdba310a8b241159d5d.html.*

17 Michelle Price and Sumeet Chatterjee, "Trade Deal Touts Financial Sector Wins; China to Scrap Securities Business Cap Faster," Reuters, January 15, 2020, https://www.reuters.com/article/us-usa-trade-china-finance/trade-deal-touts-financial-sector-wins-china-to-scrap-securities-business-cap-faster-idUSKBN1ZE2OI.

Figure 2. How the year unfolded on the markets front



Source: Stefan De Villiers, Atlantic Council

Securities Law that blocks foreign inspection of audits.[18] Both the Senate and House of Representatives passed the Holding Foreign Companies Accountable Act, which calls for the delisting of companies from countries that the PCAOB certifies have failed to cooperate on audit inspections for three years. The Trump administration ordered a Cabinet-level presidential working group on financial markets to produce recommendations for actions on the matter; that group issued a report in August 2020 that endorsed delisting.[19]

At the same time, the Trump administration moved on a parallel track to punish Chinese companies involved in supporting China's military and security services. Dozens of companies—ranging from aerospace to telecommunications to semiconductors—were placed on the Commerce Department's "entities list," which bars US businesses from conducting commerce with those companies, including investments.[20]

The legislation passed by both Houses of Congress amends the Sarbanes-Oxley Act of 2002, passed in the wake of the Enron collapse, which mandated stricter disclosure rules and established the PCAOB. While it addresses the failure of "foreign jurisdictions" to allow inspection of audits, and mandates the delisting of companies after three years without such access, the law is framed in terms of determining whether the Chinese Communist Party plays a role in the listed companies.[21] SEC documents related to the issue have not dwelled on the role of China's ruling party, focusing instead on the audit matter. It will be interesting to see how future implementing regulations—mandated by the 2020 law—address the matter.

President Trump signed the legislation into law on December 18, 2020.[22] SEC Chairman Jay Clayton failed to have implementing regulations in place before he stepped down at the end of 2020.[23] As with several other

18 "Disclosure Considerations for China-Based Issuers," US Securities and Exchange Commission, CF Disclosure Guidance: Topic No. 10, November 23, 2020, https://www.sec.gov/corpfin/disclosure-considerations-china-based-issuers.

19 "President's Working Group on Financial Markets Releases Report and Recommendations on Protecting Investors from Significant Risks from Chinese Companies," US Department of the Treasury, press release, August 6, 2020, https://home.treasury.gov/news/press-releases/sm1086.

20 "Addition of Entities to the Entity List, Revision of Entry on the Entity List, and Removal of Entities from the Entity List," US Department of Commerce Federal Register, *December 22, 2020, https://www.federalregister.gov/documents/2020/12/22/2020-28031/addition-of-entities-to-the-entity-list-revision-of-entry-on-the-entity-list-and-removal-of-entities.*

21 "Holding Foreign Companies Accountable Act," US Senate, https://www.congress.gov/bill/116th-congress/senate-bill/945/text.

22 Jordan Fabian, "Trump Signs Bill that Could Remove Chinese Stocks from U.S.," Bloomberg, December 18, 2020, https://www.bloomberg.com/news/articles/2020-12-18/trump-signs-bill-that-could-remove-china-stock-listings-in-u-s?sref=E0nAM78N.

23 Robert Schmidt and Benjamin Bain, "SEC Pushes Urgent Plan that Could Delist Chinese Companies," Bloomberg, November 17, 2020, https://www.bloomberg.com/news/articles/2020-11-17/sec-pushes-urgent-plan-that-could-delist-chinese-companies?sref=E0nAM78N.

Trump administration initiatives targeting China, many key decisions on rules and regulations will be left to President Biden.[24] That includes various edicts related to the entities list.

Potential Implications of Delisting

Global capital markets link the US and Chinese economies in a fashion no less consequential than the supply chains that bind the two countries' manufacturing and retail sectors. The web of financial ties—encompassing commercial and investment banks, stocks and bonds, derivatives and cash transactions—are increasingly important to the stability and fortunes of the global economy. Any actions that raise uncertainty about those ties need to be taken very seriously.

In a worst-case scenario, measure that threatens to undermine the value of a sector representing a non-trivial portion of the capitalization of the world's largest stock market cannot be taken lightly. The delisting of more than two hundred listed companies could cause losses, but the prospect that it would turn into a destabilizing event is distant. As one analyst told investment weekly *Barron's, "The three-year time horizon (for delisting) creates a framework for the U.S. and China to negotiate. They will have three years to develop an off-ramp for companies that can't meet compliance."*[25]

However, the January 2021 experience with the delisting of three major Chinese telecommunications companies targeted by the Trump administration for their ties to China's military suggests that a mass action against listed companies could cause investor pain. In the space of a few days, the NYSE clumsily directed that the companies be delisted, reversed itself, and then reinstituted the ban. Many investors suffered losses as the stocks plummeted, rose sharply, and fell again.[26] The episode underlines the importance of hedging strategies to address the possibility of a delisting endgame in the audit dispute—although that is largely an option for institutional, rather than individual, investors.

Another trend will be the shift of companies to listings in Hong Kong, Shanghai, and Shenzhen, which will allow some investors to maintain their investments outside the United States. Some of the largest Chinese companies listed on Wall Street—including Alibaba, e-commerce company JD.com, and mobile gaming giant NetEase—already have cross-listings in Hong Kong, and other companies will likely follow suit in advance of possible Wall Street delistings. But, that raises the prospect of investor losses in a delisting buyout. Analysts (and no doubt Chinese executives and their investment bankers) are mindful of the 2016 experience when an Internet security firm named Qihoo 360 offered its shareholders in the United States a "depressed buyout price" before relisting in a Shanghai stock IPO at a "much loftier valuation"; Qihoo's chairman netted a reported $12-billion profit.[27]

There are also potential downsides for Chinese companies. A US listing carries considerable prestige and offers many intangible branding benefits. It can also reduce the cost of capital—both debt and equity—and a cross-listing between the United States and Hong Kong has been shown to increase the market value of a stock. So, these companies may face higher financing costs going forward, especially on access to dollars.[28] In addition, US markets, which are dominated by institutional investors, offer much less price volatility than China's markets, where fickle retail investors are king.[29]

Delisting could also result in much tighter Chinese bureaucratic control of several hundred companies whose presence on Wall Street had earned them a measure of freedom from China's political winds. Many companies originally turned to the United States because Chinese

24 Jeremy Mark, *US Investors Face Half-Baked Trump Restrictions on Chinese Securities, Atlantic Council, December 7, 2020, https://www.atlanticcouncil.org/blogs/new-atlanticist/us-investors-face-half-baked-trump-restrictions-on-chinese-securities/.*

25 Reshma Kapadia, "House Passes China Delisting Bill, Sending to Trump for Approval. What that Means for Investors," *Barron's, December 2, 2020, https://www.barrons.com/articles/china-delisting-bill-could-pass-this-week-in-u-s-what-that-means-for-investors-51606903200.*

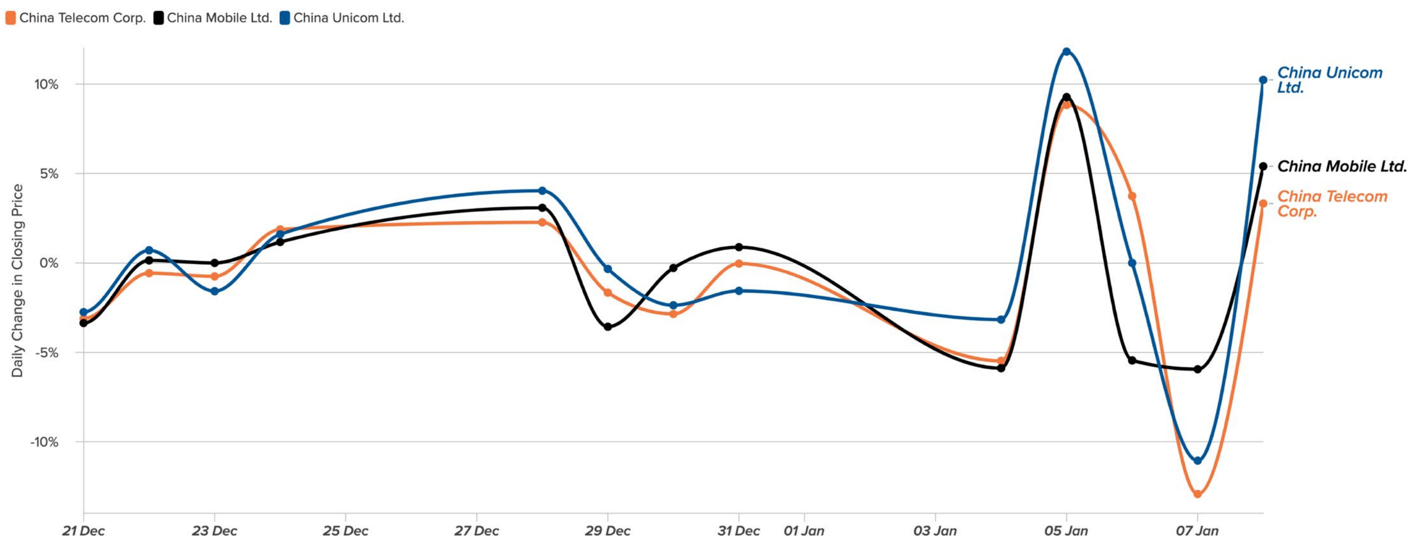
26 Alexander Osipovich and Chong Koh Ping, "Trump's Ban on Chinese Stocks Roils Investors," *Wall Street Journal, January 10, 2021, https://www.wsj.com/articles/trumps-ban-on-chinese-stocks-roils-investors-11610274600.*

27 Jesse Fried and Matthew J. Schoenfeld, "Delisting Chinese Firms: a Cure Likely Worse than the Disease," Harvard Law School Forum on Corporate Governance, June 9, 2020, https://corpgov.law.harvard.edu/2020/06/09/delisting-chinese-firms-a-cure-likely-worse-than-the-disease/. The authors also describe losses that investors have incurred when Chinese stocks have delisted and gone private.

28 George Calhoun, "What Happens if Chinese Stocks are Kicked Out of the U.S. Stock Market," *Forbes, August 11, 2020, https://www.forbes.com/sites/georgecalhoun/2020/08/11/what-happens-if-chinese-firms-are-kicked-out-of-the-us-stock-market/?sh=1f1c1699287e. The author cites several academic studies on the impact of cross-listing and delisting.*

29 Yuan Tian, "Case Studies on Companies that Delisted US and Relisted in China," thesis for MIT Sloan School of Management, May 2020, https://dspace.mit.edu/handle/1721.1/127009. This study contains detailed background on Chinese companies' listing and delisting experiences over a twenty-year period.

Figure 3. Volatility in stock price of the delisted entities



Source: Nitya Biyani, Atlantic Council.

and Hong Kong regulators made listing difficult, especially for technology startups. And, the offshore legal vehicle they used to list abroad—called the variable-interest entity structure—had placed them beyond the supervisory purview of the CSRC.[30] Given Beijing's current policy of tightening control over private-sector companies, as demonstrated by the recent crackdown on Alibaba and its fintech subsidiary Ant Group, returning companies can probably expect more intrusive—and arbitrary—scrutiny than PCAOB oversight of their books.[31]

But, for the Chinese government, the return of Chinese companies from Wall Street would be a prize, not least as it would boost the standing of its financial markets. There is also a hunger among Chinese investors for shares that have been largely out of reach in New York. It would be a political coup to bring these companies back, along with the institutional investors who would follow them to Shanghai or Shenzhen, something that many Chinese economists are eager to see.[32] Ironically, relistings in Hong Kong could have the opposite effect: long dominated by institutional investors, that market is already seeing a flood of retail investors from China attracted by the US delistings of China's telecommunications companies.[33]

There is a view that Beijing has a long-term goal of strengthening its role in the global financial system at the expense of the United States, though that perspective has focused more on policies to encourage the use of the renminbi as a reserve currency, and efforts to attract foreign investment in Chinese government bonds.[34] Foreign investment in Chinese stocks and bonds has risen sharply over the past year, totaling $212 billion through November 2020.[35]

30 "2020 Annual Report to Congress," US-China Economic and Security Review Commission, 269–271, https://www.uscc.gov/annual-report/2020-annual-report-congress.

31 Tim Culpan, "Beijing Just Tore Up China's Giant Internet Playbook," Bloomberg, November 10, 2020, https://www.bloomberg.com/opinion/articles/2020-11-11/china-s-antitrust-rules-will-threaten-alibaba-tencent-rivals?sref=E0nAM78N.

32 Ren Chunsheng, "Seize the Golden Period of China's Capital Market Development and Cultivate Long-Term Investment Practice," China Finance 40 Forum, December 28, 2020, http://www.cf40.com/en/news_detail/11519.html.

33 Shuli Ren, "Elliott Management Flees the Amateurs at the Gates," Bloomberg, January 20, 2021, https://www.bloomberg.com/opinion/articles/2021-01-20/a-new-wave-of-investors-invades-hong-kong-as-elliott-decamps-for-japan?sref=E0nAM78N.

34 Kevin Warsh, "Beijing's Bid for Financial Supremacy," *Wall Street Journal, January 4, 2020, https://www.wsj.com/articles/beijings-bid-for-financial-supremacy-11609785257; Hung Tran and Nitya Biyani, Confidence in Chinese Sovereign Debt Shows Decoupling is a Long Way Off, Atlantic Council, October 23, 2020, https://www.atlanticcouncil.org/blogs/econographics/confidence-in-chinese-sovereign-debt-shows-decoupling-is-a-long-way-off/.*

35 "Wall Street Keeps Pushing into China as Washington Balks," Bloomberg, December 3, 2020, https://www.bloomberg.com/news/articles/2020-12-03/wall-street-keeps-pushing-into-china-as-washington-balks?sref=E0nAM78N.

Officials from the Chinese Ministry of Commerce attend a news conference in Beijing, China January 29, 2021. REUTERS/Tingshu Wang.

Beyond boosting China's stock markets, delisting from the United States would serve a political purpose at a time of trade tensions. "From Beijing's perspective, there is little doubt that the leadership would prefer to see its most high profile companies listed at home instead of remaining at the mercy of US lawmakers, especially in the present political environment," writes Hong Kong-based fund manager JK Capital Management, which called the delisting law "a bonanza for Hong Kong."[36]

Another political benefit from the delisting imbroglio would be the impact on Hong Kong, where Beijing's crackdown on pro-democracy protestors over the past year has significantly damaged the city's once-favored status as a regional financial center. The Hong Kong Security Law imposed last June has shaken confidence in the protections once offered by Hong Kong's legal system and market regulations—particularly in the case of disputes with Chinese companies.[37] Many financial institutions are reported to be quietly shifting some operations to Singapore.[38]

A Way Forward?

And yet, despite the acrimony surrounding the issue, Chinese regulators most closely involved in the audit dispute appear serious about avoiding a rupture over the issue.[39] As the United States hardened its position during the course of 2020, the CSRC sent several signals that it was willing to reengage in "meaningful dialogue," including an April 3, 2020, letter to the PCAOB

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36 "The Forced Delisting of Chinese ADRs: a Bonanza for Hong Kong," JK Capital Management, June 24, 2020, https://jkcapitalmanagement.com/the-forced-delisting-of-chinese-adrs/.

37 John Lyons and Frances Yoon, "Hong Kong Security Law Stuns International Business: 'It Turns out It is Really Bad,'" *Wall Street Journal, July 2, 2020, https://www.wsj.com/articles/hong-kong-security-law-jolts-international-business-11593715471?mod=article_inline.*

38 Mercedes Ruehl and Primrose Riordan, "Global Banks Boost Singapore Hiring to Mitigate Hong Kong Risk," *Financial Times, December 20, 2020, https://www.ft.com/content/c3478b85-2be5-449b-90b1-c4ffe78150d8.*

39 "Bill to Delist China Firm Marks New High in U.S. Anti-China Hysteria," China Global Television Network, December 3, 2020, https://news.cgtn.com/news/2020-12-03/Bill-to-delist-Chinese-firm-marks-new-high-in-U-S-anti-China-hysteria-VV91jMk8Wk/index.html.

containing a "proposal of joint inspection."[40] The PCAOB subsequently rejected the CSRC position as "materially deficient in myriad ways," including proposals that are "contrary to the international norms for cooperation."[41]

The United States also has offered the solution of "co-audits," in which a second auditor based in a country where there is compliance with PCAOB oversight would review the audits conducted by the listed Chinese company's accountants.[42] PCAOB inspectors would then gain access to those reviews. In practice, this would likely mean that teams from the major international accounting firms would review the work conducted by their own subsidiaries, a procedure that is already standard practice.[43] So far, Beijing has rejected that proposal.

This is essentially where the issue stood as the Biden administration took office facing a range of economic issues in the US-China relationship, including punitive tariffs, restrictions on technology sales and other commercial interactions with a large number of Chinese companies, and the looming delistings.

There is a range of views in the United States on how the issue should be addressed. Jesse Fried, a professor at Harvard Law School, maintains that delisting will "enrich Chinese insiders and investors at Americans' expense" and recommends that the United States stop short of delisting the Chinese companies. Instead, he advocates a ban on future Chinese IPOs or new share issues by existing listed companies.[44] Meanwhile, Scott Kennedy, a senior adviser at the Center for Strategic and International Studies, groups the audit dispute alongside China's harsh policies toward Xinjiang and Hong Kong as issues that are "beyond the pale and violate basic principles of human rights, threaten intellectual freedom, or flout the law." He calls for the Biden administration to move forward "without delay" on delisting companies that refuse PCAOB oversight.[45]

The question is how important the audit issue is to China. The US position is in line with international agreements and practice that aim to level the playing field for listed companies and protect investors. Delisting the Chinese companies would be consistent with SEC disclosure policy. While Beijing insists that there are national security reasons for resisting audit inspections, most of the companies listed on Wall Street do not appear to have significant connections to China's military and intelligence organizations—and those that do have already been singled out through the use of the Commerce Department's entities list.

One longtime US observer of the audit issue who specializes in Chinese accounting practices believes that the ban on Chinese listings on Wall Street will not come into effect, asserting that Beijing "has indicated it is willing to deal. I expect the issue will be settled by China agreeing to inspections."[46] He foresees an agreement involving joint inspections "with adequate controls to protect state secrets."[47]

This sort of agreement will require continued negotiations with the Biden administration, most likely in the context of wide-ranging discussions of outstanding trade issues. Chinese officials have signaled a desire to move beyond the escalating confrontations of the past year, but they have offered little of substance—preferring to fall back on the time-worn call for "win-win" solutions. But, the CSRC's démarches suggest a willingness to solve the audit issue.

The Biden administration so far has not signaled changes in China policy as it sorts through the actions toward China taken during the Trump administration, especially

40 "CSRC Seeks 'Meaningful Dialogue' with PCAOB on Audit Issues," *Regulation Asia, November 24, 2020, https://www.regulationasia.com/csrc-seeks-meaningful-dialogue-with-pcaob-on-audit-issues/; CSRC letter of April 3, 2020, to PCAOB, "Report on Protecting United States Investors from Significant Risks from Chinese Companies," Exhibit A, 26–28.*

41 PCAOB letter to PWG in "Report on Protecting United States Investors from Significant Risks from Chinese Companies," Appendix A, 22.

42 Dave Michaels and Alexander Osipovich, "SEC Pursues Plan Requiring Chinese Firms to Use Auditors Overseen by U.S.," *Wall Street Journal, November 17, 2020, https://www.wsj.com/articles/sec-pursues-plan-requiring-chinese-firms-to-use-auditors-overseen-by-u-s-11605614403.*

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45 Scott Kennedy, "A Complex Inheritance: Transitioning to a New Approach on China," Center for Strategic and International Studies, January 19, 2021, https://www.csis.org/analysis/complex-inheritance-transitioning-new-approach-china.

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47 Paul Gillis, "China Blinks on PCAOB," *China Accounting Blog, June 20, 2020, https://www.chinaaccountingblog.com/weblog/china-blinks-on-pcaob.html.*

Chinese and U.S. flags flutter outside the building of an American company in Beijing, China, January 21, 2021. REUTERS/Tingshu Wang.

the flurry of punitive measures announced during its final, chaotic months. But, there has been a consistent message of the need to address China's "abusive, unfair and illegal practices" in trade policy.[48] The audit issue is not likely to be an immediate priority, given the three-year timeline for delisting contained in the new law.

Some observers believe the new administration will have a "strong hand" toward Beijing on economic issues.[49] In large measure, this is because it has acquired leverage over Trump administration policies without any ownership, while also pursuing a multilateral approach to many of the outstanding bilateral issues. In addition, unlike many of the initiatives undertaken by executive fiat during that administration's final months, the audit issue has the force of law backed by international agreement. That puts the Chinese government in the position of having to refuse to take steps expected under the norms of international governance that it has spent the past four years claiming to defend.[50]

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49 Peter Martin and Saleha Mohsin, "Biden Will Inherit a Strong Hand Against Xi, Thanks to Trump," Bloomberg, December 20, 2020, https://www.bloomberg.com/news/articles/2020-12-20/biden-will-inherit-a-strong-hand-against-xi-thanks-to-trump?sref=E0nAM78N.

50 Xi Jinping, keynote speech to the World Economic Forum, Davos, Switzerland, January 25, 2021, http://www.xinhuanet.com/english/2021-01/25/c_139696610.htm; "Full Text of Xi Jinping Keynote at the World Economic Forum," CGTN, January 17, 2017, https://america.cgtn.com/2017/01/17/full-text-of-xi-jinping-keynote-at-the-world-economic-forum.

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