U.S.-CHINA TRACK II DIALOGUE ON THE DIGITAL ECONOMY

CONSENSUS AGREEMENT

DECEMBER 2023
Suzhou, China

The **National Committee on U.S.-China Relations** and the **China-U.S. Green Fund** convened the sixth iteration of the Track II Dialogue on the Digital Economy on December 9-10, 2023, in Suzhou, China. The dialogue brought together American and Chinese former officials and experts from academia, think tanks, and industry for non-governmental, off-the-record, in-depth, and frank discussions on digital economy issues of concern to both countries. (See the list of delegates from both countries below.)

The two sides discussed artificial intelligence, data and financial services, and semiconductors, and have developed key recommendations for their respective governments.

THE CURRENT STATE OF THE DIGITAL ECONOMY IN CHINA AND THE UNITED STATES

China and the United States are the two largest digital economies in the world, with the United States leading in basic technology and original innovation capability, and China having its own advantages in use case and business process innovation. The two countries have great potential for mutually beneficial cooperation and should become joint partners and an important driving force to promote the development of the global economy.

However, the increasingly weak foundation of mutual trust has led both countries to prioritize national security and increasingly equate economic security with national security. As the United States continues to introduce restrictive legislation and sanctions, China has been forced to push forward technological autonomy in more and more areas. As a result, the United States and China are working to strengthen their own domestic capabilities in semiconductors, artificial intelligence, and other related ICT (information and communications technology) areas. Both countries also aim to reduce their dependency on the other in these same ICT areas.

A policy of pursuing higher levels of technology self-sufficiency will have diminishing gains from a security point of view, is impractical from an economic point of view, and comes with significant collateral damage to industries and companies. Policy makers from both countries have a responsibility to reduce policy uncertainty, provide clear and transparent regulation, and identify areas and modes of U.S.-China industry collaboration that threaten neither national nor economic security.

ARTIFICIAL INTELLIGENCE

Artificial intelligence (AI) offers great promise for economic and social benefit in both the United States and China. Potential areas for cooperation include developing regulatory frameworks to regulate the risks posed by certain AI-driven applications, including advanced or “frontier” AI models, and sharing innovation around new models and applications in relatively non-sensitive sectors.

In both countries, companies are rapidly developing new models and algorithms that will raise policy and regulatory issues in the future. In contrast to the more top down and comprehensive regulatory environment that the European Union has adopted via the General Data Protection Regulation and the newly passed EU AI Act, the United States and China should balance encouraging AI innovation and development with the need to formulate new frameworks for regulation around existing and future risks related to AI. This approach will promote creativity and sustainable innovation and avoid overregulating a technology, such as AI, which is in an early stage of development in both countries. For example, in general, most Chinese companies and government officials favor open sourcing some AI models, whereas in the United States there is a growing divide between companies that are at the forefront of the development of foundational models and a growing number of firms that believe open sourcing models bring significant benefits, including around AI safety. While there are advantages and disadvantages to both open and proprietary approaches, currently, we judge that it is advisable to avoid making a hard policy choice that would either prohibit or require the open sourcing of new models.

The most favorable and least controversial areas for U.S.-China cooperation are those with low national security sensitivity and high societal benefit. Healthcare, food and agriculture, climate change, and scientific research are promising sectors, along with non-critical business-to-business applications, for example software coding, sales targeting, staff hiring, financial services, and predictive maintenance. (While the COVID-19 pandemic has shown that these areas can become politically sensitive, bilateral cooperation should nonetheless be pursued for mutual benefit.)

As part of an incipient effort begun in 2023 to develop a framework for international standards and norms, both countries are participating in the UK AI Safety Summit, or Bletchley Park Process, and both signed the landmark Bletchley Declaration in November 2023. The China-sponsored Global AI Governance Initiative, released in October 2023, is basically aligned with the "human-centric" emphasis of the Bletchley Declaration. Both sides agree that identifying and promoting the benefits of AI applications within countries in the Global South should be a crucial part of these processes.

Also in November 2023, Presidents Biden and Xi agreed to develop a Track I discussion on AI issues. The details, such as leadership, private sector role, and the full scope of the agenda, are yet to be made public. Members of our Dialogue agree that it would be valuable to begin this Track I dialogue between China and the United States before the next AI Safety Summit, which will be hosted virtually by South Korea in May 2024. This type of official engagement comes in addition to important discussions among AI developers in private sector consultations and Track II settings.

The Chinese side believes that achieving the most fruitful level of cooperation between the United States and China on AI will also require reaching agreements on critical adjacent issues, such as on handling cross-border data flows for access to the large data sets on which models are trained, as well as on the scope of export restrictions on advanced GPUs, which are currently sourced exclusively from U.S.-headquartered firms, also required for training large models. In addition, common understanding of the terms used to discuss AI issues is important, as many of them are new and defined differently in the United States and China, or even used inconsistently within the English and Chinese languages.

Recommendations:

1. Linguists and subject matter experts in both countries should work together to create a glossary to be updated regularly of key and evolving AI-related terms in English and Chinese. Basic terms such as "generative AI" and "frontier AI" should be used as consistently as possible to reflect a common understanding of how they are used in both countries.

2. Establish a Track 1.5 consultation and negotiation process between government officials, academics, and enterprise experts in the United States and China that includes relevant ministries/departments, as well as private company representatives. This Track 1.5 process should promote security protocols and technical guidelines and explore AI applications from a collaborative global lens. It should also align and be informed by or be consistent with other current global efforts such as the Bletchley Park Process and elements of the EU AI Act.
3. As part of the Track 1.5 consultations, both countries should share best practices and approaches to AI regulation. On the Chinese side, this should include development of regulations on generative AI and standards related to AI applications such as watermarking; on the U.S. side, this should include informing the development process of cutting-edge AI models. Both sides should also consider discussing risk-based approaches to regulating the open sourcing of frontier models. These discussions would also be useful for broader international engagement as part of the Bletchley Park Process.
4. In the Track I process, both countries should identify "whitelists," or "green lanes," within which Chinese and U.S. companies can cooperate to develop models, algorithms, and applications that can be used in both countries.
    a. This effort should begin with the areas of healthcare, climate change, and non-sensitive business applications.
    b. Both countries should agree on the scope of permissible data flows (size, security, anonymization) so as to form a sharing mechanism for public data.
    c. Avoid making national-security-based export restrictions on AI chips.
    d. Both countries should agree to "AI model review" processes which would ensure that the models are not posing unacceptable safety, economic, or social risks.
    e. Both countries should also work with private sector companies leading the development of generative AI to gain agreement on a code of conduct, building on similar efforts already underway as part of the G7 Hiroshima Process and the White House Voluntary Commitments.
5. Monitor the progress of approved cooperation in order to adjust policies and identify new areas for consensus.

DATA AND FINANCIAL SERVICES

The United States and China have both implemented or considered policies that limit the flow of data between the two countries for national security reasons. However, both sides agree that there are areas that are promising for easing data flows outside of national security, privacy, and critical information infrastructure considerations. Similar to AI, the most favorable areas to ease data flows between the United States and China include healthcare data (after anonymization), climate change research and mitigation, economic and financial data, and other mundane data related to cross-border business services.

Both sides agree that a realistic objective is *reasonable, sensible flow of data* between the United States and China, based on reciprocal, clear, and transparent standards in both countries. Both nations should consult and specify mutually recognized standards for data that requires special handling, such as data involving national security and personal information.

Recommendations:

1. The United States and China should establish Track I negotiations, perhaps using the recently established Commercial Issues Working Group between the United States and China, with the objective of establishing a new "reasonable, sensible and transparent cross-border flow of data" regulatory framework.

a. In these negotiations, both countries should establish clear and transparent standards for regulating data transfers out of the country, as well as clear and transparent definitions for data that must be stored locally.
b. These negotiations should establish "whitelists," or "green lanes," for areas that do not involve national security or personal data, such as some aspects of healthcare, climate change, and business operations. For data in these areas, there should be no restrictions on data flows as long as they do not involve national security or personal data.

2. Both countries should establish a principle that data which is not designated sensitive or restricted should remain open and unrestricted for cross-border transfer. However, relevant catalogs or lists may be established for "sensitive or restricted" data.
3. The two nations may form an expert group to discuss how to jointly establish a credible and interoperable technical architecture for data flows to support the above-mentioned data sharing.

In light of the practical problems faced by the companies operating in China, the U.S. team of this Dialogue believes that China should make a statement committing to ending exit bans and detainments of foreign businesspeople from leaving the country, especially when they are doing market research in China using openly available data. This will help strengthen the safety of the digital economy security system.

SEMICONDUCTORS

U.S. policies restricting exports of certain cutting-edge semiconductors useful for high performance computing and AI applications to China, and key tools used to manufacture semiconductors at advanced nodes are still in development. A second round of restrictions was issued in October 2023 and industry partners are still navigating the many policy implications. In China, there are growing concerns within the semiconductor industries in both countries that the United States intends to impose restrictions that go well beyond the "small yard and high fence" policies developed by the Biden administration. Despite this friction, in non-restricted product classes, Chinese imports of U.S. semiconductors remain strong and are an area of mutual benefit.

The first step required for this dialogue between the two governments will be transparency. The U.S. team believes that nearly all of the insight required to understand U.S. semiconductor policy is available at chips.gov; there is relatively little public information on the objectives, contents, or decision-making processes for Chinese semiconductor policy. The Chinese team believes that the information asymmetry is due to a number of factors directly related to the lack of mutual trust and the continued increase in sanctions. Both governments must increase transparency on their semiconductor policies, because without it, productive dialogue is impossible.

Recommendations:

1. China and the United States should re-start Track I dialogues on semiconductors, in which both sides transparently share their policy goals and tools, and both sides agree on a goal of *reasonable mutual dependence based on economic and technological reality.* Both sides must recognize that, under the current legal and policy constraints, China faces daunting challenges and risks and significant costs in independently developing and scaling comprehensive semiconductor technologies that replace U.S.-sourced technology, and it is hard for U.S. companies to exit the Chinese market without substantial economic cost. Both countries should avoid becoming embroiled in a tit-for-tat spiral of restrictions that further disrupts supply chains in the semiconductor and related industries such as EV batteries.
2. The United States and China should continue discussions on broader, non-semiconductor specific issues of concern to both countries. For example, China is concerned that U.S. digital economy policies are expanding

in scope and stringency, and the United States is concerned that the China's civil-military fusion initiatives are enabling the diversion of U.S. technology exports to military end uses. In particular, both countries would benefit from a full and nuanced discussion on what civil-military fusion means in the Chinese context, given that this is frequently used as a justification for export and investment-related controls implemented by the United States.

3. China and the United States should encourage trade in chips used in consumer electronics, green energy, and medical care that are not related to national security, ease restrictions on the export of scientific research equipment for non-military academic research, and support enhanced cooperation in these areas. Both countries should also encourage enhanced exchanges and dialogues between industries and businesses and promote the exploration of better cooperation mechanisms between the United States and Chinese scientific and technological communities and industries.
4. Both countries should consider discussions around China's production capacity for mature semiconductors, given recent U.S. concerns about the potential for overcapacity in this sector to create adverse impact on the industry supply chain and undercut western producers.

CONCLUSION

Collaborative development of an interrelated set of advanced and complex technologies has become a major driver of the global economy, offering tremendous opportunities for U.S.-China cooperation in such areas as healthcare, climate change mitigation, business development, and more. Given that companies in the two countries are currently among the global leaders in developing AI technologies and applications, both countries should discuss the optimal balance between allowing development of the AI sector and erecting national and global frameworks for mitigating current and future risks posed by the technology.

At the same time, there is growing concern that uncoordinated global efforts to develop binding and enforceable regulatory frameworks around the development of new technologies – particularly advanced or "frontier" AI – could potentially pose substantial political, financial, and social risks, as well as opportunity costs. For these reasons, it is critical that China and the United States, as the world's two largest economies, work together to ensure that such development and regulation is done in an informed, collaborative, and human-centric way. To this end, the two governments should establish regular working meetings to move forward jointly on these key issues and respond to the recommendations outlined in this agreement accordingly.

CHINESE DELEGATION

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