Prepared Testimony of Michael R. Wessel
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U.S.-China Relations: Improving U.S. Competitiveness Through Trade
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Chairman Wyden. Ranking Member Crapo. Members of the Committee. It is an honor to appear before you today to address this important topic.

My name is Michael Wessel and I am a Commissioner on the U.S.-China Economic and Security Review Commission. I also serve as the staff chair of the Labor Advisory Committee to the USTR and Secretary of Labor. While my testimony is informed by these positions, my service in Congress for more than two decades as a Congressional staffer and other work, my testimony reflects my personal views and are not on behalf of any other entities.

The Commission was created by Congress in 2001 in conjunction with the debate about the grant of Permanent Normal Trade Relations (PNTR) to China, paving the way for its accession to the World Trade Organization. The Commission was tasked with monitoring, investigating and submitting to Congress an annual report on the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China, and to provide recommendations, where appropriate, to Congress for legislative and administrative action.

The grant of PNTR ended the annual debate about whether to extend most favored nation status to China. But as it passed PNTR, Congress created the Commission because it did not want to forego the annual review of our relationship with China. Since the creation of the Commission, Congress has extended and altered our mandate as the U.S.-China relationship evolved.

The Commission is a somewhat unique body: We report to and support Congress. Each of the four Congressional leaders appoint 3 members to the Commission for 2-year terms. In 7 of the last 10 years, we have issued unanimous reports. In the 3 years where it was not unanimous, there was only one dissenting vote. In many ways, the evolving challenges and opportunities posed by the relationship with China have united us in our analysis. Our bipartisanship is a reflection of the broader political support in this country for addressing the challenges posed by the Chinese Communist Party's (CCP's) approach.

This hearing occurs at a critical time. Tensions with China have risen as a result of its continued predatory trade policies, its rampant human rights abuses in Xinjiang, Tibet and other parts of the country, its illegitimate territorial claims and militarization in the South and East China seas, its corroding of democratic rights and freedoms in Hong Kong, its increased pressures on Taiwan, its Belt and Road Initiative, its use of economic leverage and outright coercion against U.S. allies like Australia, its efforts to direct and dominate standards setting bodies, and its expansive political, economic, security and diplomatic actions across the globe.

China is pursuing its own interests. It is not interested in abiding by international norms. In fact China seeks to minimize these norms and the universal values that underpin them by attempting to recast them as "Western". We should stop hoping and waiting for change in the CCP's outlook or policies. Rather, we need to accept the reality of China's approach and adopt the policies and responses that are in *our* long-term best interest.

Let me start by making clear that in debating and addressing the challenges posed by the policies of the CCP, we are not disparaging the people of China. Rising anger and aggression targeted at people of Asian descent here in the U.S. or around the globe is unacceptable. We must be careful in our debates. But we must not allow the CCP efforts to coopt these important discussions to advance its influence.

The Trump Administration challenged China on many fronts. Now the question is how to respond to China's plans and policies and what will be the architecture underlying our approach for the future. The Biden Administration is engaged in a top-to-bottom review assessing past actions, identifying its preferred path forward and, importantly, what cooperation and coordination with our allies is possible.

A multilateral approach is important. But it is not the only approach. For years we sought multilateral cooperation on issues ranging from China's overcapacity in steel, aluminum and other sectors to China's efforts to dominate the global roll-out of 5G with Huawei and ZTE equipment at its core, and in many other areas. To paraphrase an old saying, our allies were willing to hold our coat while we bloodied our nose.

Our allies now appreciate, to a greater extent, the challenge posed by China's predatory and protectionist policies though they may still hesitate to act or may have a different sense of urgency when it comes to addressing these challenges. Our producers and our workers cannot wait for our allies to fully appreciate the impact of China's policies and develop the will to act—for their own interests and for their own people.

The outsourcing and offshoring of U.S. jobs and productive capacity to China has created some unacceptable vulnerabilities. Americans experienced head-on the impact of this outsourcing last year with too many unable to obtain critical personal protective equipment (PPE) to protect themselves and those around them as COVID-19 ravaged our country.

In 2019, before the pandemic, the U.S.-China Commission held a hearing on the challenges posed by our growing reliance on China's biotech and pharmaceutical products. Our reliance was built up over many years as China's industrial policies created incentives, market barriers and market access requirements that expanded their capabilities often with the support of our own companies. We are, in my view, unacceptably reliant on China for our active pharmaceutical ingredients (APIs), which are some of the building blocks for the life-saving and life-sustaining drugs our people take. The United States sources 80 percent of its APIs from overseas, and a substantial portion of U.S. generic drug imports come either directly from China or from third countries like India that use APIs sourced from China.[1]

We no longer make penicillin in this country, as we abandoned the fermentation capacity for this drug years ago. We are dependent on China for many other critical drugs.

China's government has shown its willingness to politicize and indeed, weaponize, its supplies of critical products. It threatened to withhold rare earth products from Japan many years ago and did so against the U.S. recently. As the world was grappling with devastating effects of the global pandemic, China's government engaged in the so-called "mask diplomacy,"[2] offering scarce PPE products to countries in return for recognition and support of its policy objectives. It is doing this again with regard to its supplies of COVID-19 vaccines.[3]

We need to treat supply chains as integral components of our national and economic security as well as vital to our critical infrastructure. The past years have seen multiple warning shots across the bow of our country ranging from inadequate supplies of PPE to rare earth minerals and magnets to products like grain oriented electrical steel vital to power transmission. Globalization has shown its limits and its risks and it's time to act.

We must confront the policies of the CCP. But we must not naively expect them to change. We must compete. We must reduce our dependence on China for vital supplies and technologies.

This is a critical time because many of our multinational firms, which were essentially sidelined during the COVID-19 pandemic, are beginning to plan for the future. Data from the Financial Accounts of the U.S. (formerly the Flow of Funds report) indicate that at the end of 2020, U.S. corporations were sitting on more than $5.5 trillion in cash and liquid assets.[4] Many of these companies are now making plans for how to deploy those funds.

My view is that they should be investing in production and job creation here in the U.S. The allure of accessing China's market has waned in significant ways, but companies are looking for a signal from Congress and the Administration as to the direction of future policy. Congress has acted on a number of fronts in past years, including in passing FIRRMA and the CHIPS Act, to make clear that we will respond to predatory practices, we will preserve our key technologies and we will promote American competitiveness. That must be the path forward.

We need to send stronger signals that we want them to invest those funds ***here*** to expand production and create jobs.

China recently adopted its 14th Five Year Plan.[5] Along with supporting policies from the past, the CCP wants to for the future by capturing leadership in technologies that will be foundational for the next wave of innovation and growth. It wants to increase support for indigenous innovation to meet the China's domestic needs while continuing to have an expansive export strategy. General Secretary Xi has termed this China's "dual circulation" strategy.

For the U.S. this means that China will continue to advance the development of key sectors such as new materials, quantum computing, biomedicine, artificial intelligence, electric vehicles and others. It will support these sectors and technologies with massive subsidies, protectionist and predatory practices and through legal and illegal means. It will use an "all of the above" strategy to achieve its goals.

U.S. goods trade with China continues to show a significant imbalance. While the size of the U.S. goods trade deficit with China is deeply troubling to me, more important has been the composition of that trade deficit. The year 2020, of course, was an aberration. In 2019 the U.S.

ran a trade deficit in advanced technology products (ATP) with China of $134.4 billion. That should be an issue of considerable concern.

China continues to build up massive productive capacity that has resulted in significant overcapacity in a growing number of sectors beyond the steel and aluminum sectors that have, appropriately, garnered attention. Chemicals, fiber optics, and other sectors are also in overcapacity as a result of CCP policies. This overcapacity has undermined the efforts of market-based companies in other countries to compete and survive. In some sectors, such as steel, the CCP has made repeated promises to reign in overcapacity, to dismantle operations and to limit production. Each of those promises has been broken.

There have been international dialogues to try to address the problem in steel fostered primarily at the Organization for Economic Cooperation and Development (OECD). China, however, never really engaged in a good faith effort to reduce overcapacity; rather, it used the forum to delay action. This is similar to how it approached many of the talks within the Strategic and Economic Dialogue where engagement was used by the CCP as an alternative to action.

The CCP is seeking to advance research and development (R&D) indigenously, with the support of foreign firms and through a variety of programs including the so-called “Thousand Talents” program. Many foreign firms have dramatically expanded their R&D investments and activities in China to respond to CCP policies and incentives, to improve potential market access in China and to support their China-based operations. The connection between R&D and production is well known with operations often being located in proximity to each other.

The pace of R&D expenditures by U.S. affiliates in China has grown at a faster pace than domestic investments by their U.S. parents. According to a report issued by the U.S.-China Commission, expenditures by U.S. multinational enterprises is China grew an average of 13.6 percent year-on-year since 2003, compared with 7.1 percent for all U.S. multinational foreign affiliates and just 5 percent for multinational parents in the U.S. in the same period.[6] This acceleration of the pace of investment in China, as opposed to in the U.S. by American-headquartered companies must be addressed.

Efforts by the CCP to promote “cooperation” should be viewed with skepticism. The CCP is more interested in winning than in the proverbial “win-win”

At the same time, China’s leaders are desperate for capital and for foreign investment. China’s debt-to-GDP ratio has increased at one of the fastest paces of any major country, now estimated at 288 percent at the end of Q3 2020.[7] Although shadow banking has been somewhat reigned in since 2016, massive debt is still out of control.

China has pressured international benchmark index developers like Morgan Stanley Capital International (MSCI) to include Chinese equities in its emerging market index and increase the weighting of Chinese issues. MSCI succumbed to the pressure. Unless the trendline changes, the inclusion of Chinese securities by major international index providers like MSCI, FTSE Russell, and others could lead an estimated $400 billion or more of foreign capital to flow into Chinese equities.[8] Changes in bond indices may result in another $200 billion of foreign capital flowing into China to purchase bond issues.

The *South China Morning Post* earlier this week reported that Citigroup is planning to apply for permission to "open a new wholly-domestic securities business in China…The American bank plans to apply by the second half of this year for licenses that would allow it to underwrite domestic securities, engage in advisory services on local deals and conduct trading for clients, as well as engage in stock futures."[9]

Yet the CCP still refuses to allow the Public Company Accounting Oversight Board (PCAOB) access to the work papers of major U.S. accounting firms to ensure that the books and records accurately reflect the facts. While any investment in a major Chinese company bears additional risks due to the power of the CCP the fact that there is no transparency should severely limit the scope of foreign investment.

It is not just the issue of "buyer beware," although some observers argue that investors assume responsibility for their investment and must bear that losses that may result. It is also the potential risks to the U.S. taxpayer posed by these investments and possible federal exposure. For example, capital losses can offset capital gains under our tax laws—meaning that tax revenues would essentially support losses on these equities and bonds. The Pension Benefit Guaranty Corporation (PBGC) could potentially have to play a role if investments in these kinds of issues degraded the economic viability of a pension plan covered by the agency.

The Federal Thrift Savings Plan (TSP) had considered utilizing the MSCI index that would open up investments in Chinese securities to federal employees and our men and women in uniform. These investments may directly challenge our national and economic security interests. Over the last several years, increasing numbers of Chinese companies have been placed on the Entities List[10] as well as on the Department of Defense's list of companies supporting the People's Liberation Army.[11] Many of these companies are still included in some international indexes and U.S. funds are still flowing to these companies. Indeed, U.S. investors reportedly continued to invest in these entity list and DOD-identified companies *after* they were publicly identified as being on these lists.

CONCLUSION:

In the 1980s, America faced competitive challenges from Japan. While those challenges, in retrospect, pale in comparison to those posed by China, there are lessons to be learned. Japan was dominating the automotive sector. Japan was dramatically expanding its leadership in semiconductors. Japan had closed its market to U.S. products in key sectors, including telecommunications, electronics, pharmaceutical and medical equipment, and forest products. The Reagan Administration initiated the Market-Oriented Sector Selective (MOSS) talks to address Japan's anticompetitive practices. Voluntary restraint agreements were adopted.

In 1987 Congress and the Administration worked together to create SEMATECH to reclaim America's momentum in the semiconductor sector. SEMATECH was a non-profit consortium of 14 U.S.-based semiconductor firms that pooled resources and revitalized U.S. R&D in advanced chip manufacturing.

Following these and other initiatives, Congress considered and passed the Omnibus Foreign Trade and Competitiveness Act of 1988 (PL 100-418) that included a broad array of provisions to advance America's ability to compete. It was an Act that updated existing authorities, and created new ones, to give America the tools needed to compete in new sectors and to address new challenges.

Now is the time to consider what steps America should take to protect our interests and prepare for the future. Too much of the focus of our China discussions has been about containing, confronting or decoupling. Many of the actions and policies of the CCP directly challenge U.S. interests. We need to send a strong signal to the CCP, to our companies, to our people and the world that we will stand up for our interests, we will compete, we will invest and we will win.

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[5] Karen M. Sutter, Michael D. Sutherland, "China's 14th Five-Year Plan: A First Look," Congressional Research Service, January 5, 2021, https://bit.ly/3dvpItg.

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