Testimony before the

United States Senate Committee on Finance

Hearing on

"U.S.-China Relations: Improving U.S. Competitiveness Through Trade"

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Chairman Wyden, Ranking Member Crapo, distinguished Members of the Committee,

Thank you for the opportunity to appear before you today to discuss how to improve U.S. competitiveness vis-à-vis China. The U.S. – China competition will define the trajectory of the global economy for generations to come. The Government of China's efforts to dominate today's industries and those of the future with unfair trade practices pose a serious threat to long-term U.S. competitiveness and leadership. Likewise, the Government of China's efforts to export its non-democratic model of censorship, propaganda, and surveillance around the world pose a serious threat to our values and way of life. Democrats and Republicans must work together to counter this threat and ensure the United States remains more economically competitive and globally influential than China for years to come.

During today's hearing, I will offer suggestions on how to best achieve this objective based on my experience negotiating with China on the Phase One Deal and in persuading U.S. allies to adopt robust policy responses on China in multilateral fora, including the World Trade Organization (WTO) and Group of Seven (G7). Some of my ideas are derived from the China strategy that I helped develop as part of the National Security Council (NSC) and National Economic Council (NEC). I will also draw on my experience helping companies navigate China's market and adjust to recent U.S. policy on China, although the comments I provide are solely my own.

Ultimately, Congress – along with the Administration, the private sector, and key U.S. allies and trading partners – will all play a critical role in determining the outcome of the U.S. – China competition. I hope my suggestions today help provide elements of a roadmap that leads to success.

"Run Faster" with Domestic Innovation Incentives <u>AND</u> Trade Agreements

<u>First</u>, winning this competition undoubtedly requires the United States to "run faster". In particular, the United States should adopt policies to encourage domestic innovation, especially in critical areas that China is targeting due to their strategic importance, such as artificial intelligence, semiconductors, synthetic biology, 5G and 6G, among others.[1] I share the concerns of some policymakers about overall government spending levels, but misdirected spending in certain areas should not deter us from well-directed spending in other areas critical to continued U.S. innovation leadership.

Appropriately directed government spending should enhance the strengths of the U.S. market-led economic system and strengthen the U.S. private sector instead of attempting to replace it. The *Endless Frontiers Act* and other legislation that focuses on research and development, public-private partnerships, collaboration with universities, and narrowly tailored grant programs are a

[1] The *Endless Frontiers Act* and *Executive Order on America's Supply Chains* (EO14017) target many of the appropriate sectors.

good start. Congress should also fully fund the *USA Telecommunications Act* and *CHIPS for America Act* as well as consider tax incentives to spur innovation for critical industries.[2]

Such policies will help us "run faster", but we are unlikely to run "fast enough" if we only focus at home. Much of the revenue our companies use to fund innovation is derived from sales overseas, and the United States should negotiate trade agreements that break down barriers to American goods and services. The United States cannot afford to sit on the sidelines while China implements the Regional Comprehensive Economic Partnership (RCEP) and considers the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP). Our inaction puts U.S. companies at a disadvantage, depriving them of revenue that could be used to fund greater innovation. We also miss the chance to set standards in key areas like technology transfer, subsidies, state-owned enterprises (SOEs), and digital trade that promote our economic model over China's.

Congress should renew Trade Promotion Authority, encourage the Administration to finalize the U.S.-U.K. trade agreement, and plot a path to new agreements in the Indo-Pacific region. If a comprehensive agreement with our former TPP partners is not viable, we should consider targeted sectoral agreements with TPP countries in areas like digital trade and build on that approach over time.[3] Concurrently, we should robustly implement the U.S.-Mexico-Canada agreement, which was enacted by Congress with historic bipartisan support.

Better Coordinate with Allies

Second, any effective China policy requires better coordination with U.S. allies. In addition to negotiating and implementing bilateral and regional trade agreements, we should coordinate on WTO reform and other efforts to set global rules and standards for emerging technologies and critical industries.

The United States has used the WTO to address harmful Chinese policies, including export restraints on rare earth metals[4] and licensing of intellectual property on non-market terms, among others.[5] But despite successes like these, the WTO has not effectively constrained many of China's practices and is falling short of its mandate to widely promote market-oriented free and fair trade. The WTO does not include agreements governing forced technology transfer or SOEs, it allows China to claim "developing country status" and gain a negotiating advantage despite its global stature, and dispute settlement proceedings take too long and have undermined our ability to use trade remedies to counter China's massive industrial subsidies.

Congress should encourage the Biden Administration to make ambitious proposals to fix the WTO's problems as soon as possible, including through its trilateral initiative with the EU and

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[2] This includes the tax components of the *CHIPS for America Act* (S. 3933 in the 116th Congress). The tax components of this package could also be broadened to include design.

[3] See, e.g., Wendy Cutler and Joshua P. Meltzer, "Digital trade deal ripe for the Indo-Pacific", available at: https://www.brookings.edu/opinions/digital-trade-deal-ripe-for-the-indo-pacific/.

[4] *China – Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum (United States)*, WT/DS431.

[5] *China – Certain Measures Concerning the Protection of Intellectual Property Rights (United States)*, WT/DS542.

Japan,[6] plurilateral agreements on E-Commerce and other issues, and robust dispute settlement reform proposals that would restore the system's functionality in exchange for meaningful changes. My paper "Revitalizing the WTO" lays out potential reform proposals in detail.[7]

The United States must also better coordinate with allies on defensive measures taken in relation to China. Many recent export control actions are justified, but due to a lack of multilateral coordination there are reports of production shifting to other countries without similar measures in place.[8] In the future, such controls should be coordinated to maximize impact and avoid putting U.S. industry at a disadvantage to foreign competitors. Such measures should also be narrowly tailored to allow exports for non-sensitive items to ensure American goods and services can compete globally and support jobs at home. To the extent that Chinese companies continue to purchase such non-sensitive items from U.S. technology companies, this puts China in the position of subsidizing U.S. innovation leadership.

The United States should also prioritize resolving disputes with allies, such as the longstanding WTO disputes related to *Large Civil Aircraft*,[9] Section 232 tariffs on steel and aluminum, and digital services taxes. Resolving these disputes will require flexibility on both sides, but such flexibility is worthwhile if it allows us to avoid wasting time and energy fighting each other that is better spent on building trust and coordinating on China.

Importantly, this does not mean the United States should not leverage existing measures or give countries a free pass on policies that harm U.S. interests. For example, in exchange for lifting its Section 232 tariffs on steel and aluminum, the United States should ask partners to commit to actions to reduce the impact of Chinese excess capacity on global markets, track transshipment, and limit import surges into the United States. Likewise, on digital services taxes, the United States should continue to move forward with its Section 301 investigations until others agree to drop unilateral measures that unfairly target U.S. companies for revenue while exempting domestic competitors. The United States should also not tolerate policies like the EU's proposed Digital Marketing Act, which is both discriminatory and includes elements would force U.S. companies to turn over their technology.[10] Mechanisms like the proposed U.S.-E.U. Trade and Technology Council could be used to resolve differences on digital-related issues and set standards for future technologies.

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[6] Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States, and the European Union, Jan. 14, 2020, available at: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/joint-statement-trilateral-meeting-trade-ministers-japan-united-states-and-european-union.

[7] See, e.g., Clete Willems, "Revitalizing the WTO", available at: https://www.atlanticcouncil.org/wp-content/uploads/2020/11/Revitalizing-the-WTO-Report_Version-11.6.pdf.

[8] See, e.g., Stu Woo, "The U.S. vs. China: The High Cost of the Technology Cold War", Wall Street Journal, Oct. 22, 2020, available at: https://www.wsj.com/articles/the-u-s-vs-china-the-high-cost-of-the-technology-cold-war-11603397438.

[9] *European Communities and Certain member States – Measures Affecting Trade in Large Civil Aircraft (United States)*, WT/DS316; *United States – Measures Affecting Trade in Large Civil Aircraft – Second Complaint (European Union)*, WT/DS353.

[10] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on contestable and fair markets in the digital sector (Digital Markets Act), available at: https://eur-lex.europa.eu/legal-content/en/TXT/?qid=1608116887159&uri=COM%3A2020%3A842%3AFIN.

Further Engage with China Bilaterally

Third, the United States should engage directly with China to press for additional market access openings and modifications to China's policies. Sales to China support American farmers, businesses, and workers. Just as China harnessed U.S. consumption and growth to grow its economy, so too the United States should benefit from increased consumption and a level playing field in the second largest economy in the world.

The Phase One deal did not fix all of our problems with China, but it helped achieve important structural reforms to China's intellectual property laws, substantially reduced barriers to U.S. agricultural exports, begun to pry open the financial services sector, and condemned the policy of forced technology transfer. According to the Trump and Biden Administrations, China has met the majority of its structural commitments[11] and U.S. agricultural exports to China are at record levels.[12] The Phase One deal is also one of the only bilateral dialogues currently in place and thus one of few existing mechanisms to discuss and potentially solve problems. For these reasons, it is in the strong U.S. interest to maintain the deal.

In addition to continuing with Phase One, the United States should consider whether there is a viable path to Phase Two. China is admittedly unlikely to fully address issues like industrial subsidies or state-owned enterprises (SOEs) in a bilateral context, but we can make additional progress that benefits U.S. industry and workers. As a starting point, I recommend harvesting the text on services, non-tariff barriers, and forced technology transfer[13] on which the U.S. and China were making progress before negotiations on a more comprehensive deal broke down in May 2019.

Any Phase Two deal should also focus on structural issues instead of purchases. Although the Phase One agricultural purchasing commitments helped spawn record sales to China, this is because the purchasing commitments are coupled with a robust underlying structural chapter that requires China to actually change its laws. The purchasing commitments on manufacturing, services, and energy have not fared as well because of the lack of a corresponding structural chapter. As this illustrates, it is the structural commitments that matter, not the purchasing ones.

Another benefit to a Phase Two deal is that it could lead to a tariff reduction on certain Chinese imports and U.S. exports. To be clear, I supported the initial imposition of the 301 tariffs on China to create leverage to persuade China to drop its unfair trade practices. But there is no question that existing U.S. tariffs – and China's corresponding retaliation – are having an adverse impact on U.S. businesses, farmers, and workers. This is especially true with respect to those that obtain production inputs from China that cannot be sourced elsewhere or who have lost

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[11] Interim Report on the Economic and Trade Agreement between the United States of America and the People's Republic of China: Agricultural Trade, U.S. Department of Agriculture, Oct. 2020, available at: https://ustr.gov/sites/default/files/assets/files/interim-report-on-agricultural-trade-between-the-united-states-and-china-final.pdf; See also 2021 National Trade Estimate Report on Foreign Trade Barriers, Mar. 31, 2021 (discussing China's implementation of the Phase One Deal at length), available at: https://ustr.gov/sites/default/files/files/reports/2021/2021NTE.pdf.

[12] See, e.g., USDA China data: https://www.fas.usda.gov/regions/china.

[13] The Forced Technology Transfer chapter of the Phase One deal does not include all of the components that the United States and China were originally negotiating.

market share in China to international competitors. Therefore, it is in our interest to seek additional changes in China's policy (and Chinese tariff relief) in exchange for U.S. tariff relief. In this regard, it is important to recall that Section 301 statute indicates that tariffs imposed pursuant to it are not intended to be permanent, but to temporarily provide the United States leverage to achieve negotiated outcomes.[14]

At the same time, the Biden Administration should also consider reinstating a tariff exclusion process to provide relief for products that cannot be sourced elsewhere and are not core to China's Made in China 2025 ambitions. This will make a policy that maintains leverage over China more economically sustainable over the long-term.

Don't Become China to Beat China

Fourth, the United States must avoid the impulse to "become China to beat China." More specifically, we must not adopt policies that replicate the same Chinese practices we are condemning. Such policies will be inefficient at best, and at worst will harm our economy and credibility to rally an international coalition in our favor. The strength of the U.S. economy and the core of our innovation leadership comes from our market-based system and rules-based trade that rewards entrepreneurialism, fair competition, and the rule of law. This should not be sacrificed.

For example, in an attempt to respond to supply chain challenges, we should not seek to source all products domestically. We should also not double-down on procurement policies that discriminate against foreign products and services. These evoke core elements of the Made in China 2025 plan. Supply chain efforts should instead focus on positive incentives like increased spending and tax credits combined with efforts to improve supply diversity, flexibility, redundancy, and partnership with trusted partners and allies. Similarly, access to our procurement markets should not be restricted for all foreign actors, but instead traded for reciprocal access to foreign markets. This can help promote the same levels of economic growth as Buy American while saving taxpayer dollars in the process.

The United States should also resist invoking "national security" to support broad trade barriers unless it is truly justified. Indeed, China's expansive view of national security as it applies to its economy underpins many of the policies the United States finds most problematic and was a common excuse as to why China could not meet U.S. demands during negotiations on the Phase One deal. Invoking national security in questionable circumstances and against key allies gives China *carte blanche* to justify a whole range of policies with questionable national security claims while at the same time undermining the WTO legal architecture.

Congress should also tread carefully when considering novel policies like outbound investment screening regimes that would significantly expand the role of government in company investment decisions.[15] Broad interventions into how U.S. companies operate and invest abroad risk mirroring the distortive role the Government of China often plays in the allocation of

[14] 19 U.S.C. § 2411(b) specifies that action under the statute is taken "to obtain the elimination of [the] act, policy, or practice" that "is unreasonable or discriminatory and burdens or restricts United States commerce."

[15] America LEADS Act, S. 4629, 116th Congress, as introduced, Sec. 411.

resources by its companies. Such a regime could also impair the ability of U.S. businesses and workers to compete globally from the United States and advantage their competitors in foreign countries not subject to similar restrictions and reviews.

Consult Closely and Continuously with the Private Sector on Policy Choices

Fifth, the U.S. Government and private sector should closely align on efforts to address the challenges posed by China. It is entirely reasonable for the U.S. Government to set standards about U.S. company behavior in China, including that U.S. companies not utilize forced labor in their supply chains or directly support companies affiliated with China's military. However, U.S. policymakers should consult closely with industry on such action to receive input on how to best design any measures and provide businesses with time to adjust to changes in U.S. policy. The Biden Administration's efforts to reach out to numerous U.S. companies during its 100-day supply chain review is a welcome development, and hopefully the policies derived from that effort fully reflect industry input.

The U.S. Government should also be willing to back U.S. companies facing particularly difficult Chinese government policies, such as Chinese government censorship, an issue I had the opportunity to testify on before this Committee last year.[16] Some of the ideas that I shared at that time remain relevant, but I would also endorse other ideas, such as a Special 301 on censorship activities.[17] This is a good example of the U.S. Government adopting a core role in pushing back on a policy that is so embedded in the current Chinese Government's philosophy that no company could navigate it sufficiently on its own.

Be Clear-Eyed About the China Threat and the Risks From Certain Policy Choices

Finally, we must be clear-eyed about the extent of the threat posed by China and the risk that certain policy choices entail. If we over-legislate on this issue in a way that undermines our long successful market economy principles and view every single Chinese action and Chinese company as a threat, we could unintentionally undermine our greatest strengths and even bring ourselves to the brink of conflict.

Yes, China's Made in China 2025 plan and subsequent five year plans threaten U.S. innovation leadership in critical industries of the future, but the health of China's economy as a whole appears more tenuous. As numerous analysts have pointed out, China's economic growth data is unreliable and China remains heavily reliant on inefficient SOEs.[18]

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[16] Clete R. Willems, Testimony before the Senate Committee on Finance, Subcommittee on International Trade, Customs, and Global Competitiveness, Hearing on "Censorship as a Non-Tariff Barrier to Trade", June 30, 2020, available at: https://www.finance.senate.gov/imo/media/doc/30JUN2020WILLEMSSTMNT1.pdf.

[17] America LEADS Act, S. 4629, 116th Congress, as introduced, Sec. 415.

[18] See, e.g., Shehazd H. Qazi, "The Great Chinese Rebound? Not So Fast", Barron's, Jan. 26, 2021, available at: https://www.barrons.com/articles/the-great-chinese-rebound-not-so-fast-51611622798.

Further, while China's plans for Military-Civil Fusion are truly concerning,[19] not every company in China is a Communist Chinese Military Company (CCMC). Indeed, some very prominent Chinese companies appear to be quite out of alignment with their government at the moment.

As a result of factors like these, U.S. policymakers should adopt nuanced policy responses that are calibrated to the threat posed and intended to achieve clear objectives instead of overly-broad approaches that may do more harm than good. Indeed, if we seek to fully sever ties with China and blindly demagogue all Chinese entities and people, including the many that share our concerns about their own government's policies, we could find ourselves on a dangerous path.

One important lesson that I learned as a negotiator on the Phase One deal with China and witnessed Chinese government officials openly arguing with each other in front of our delegation is that China is not a monolithic country. Much like the United States, China is composed of individuals with very different perspectives and companies with very different relationships with their government. To ensure that our policies lead to our desired outcomes, we need to develop clear standards to help discern between different groups of individuals and companies in China so we can continue to engage with and to build up those who share our values and can help promote long-term peace, prosperity, and a level playing field between our countries. That is better than many of the alternatives.

I look forward to continuing to work with the Committee on all of these important objectives.

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[19] See "Military-Civil Fusion and the People's Republic of China", U.S. Department of State, available at: https://www.state.gov/wp-content/uploads/2020/05/What-is-MCF-One-Pager.pdf.