HEARING ON CHALLENGING CHINA'S TRADE PRACTICES: PROMOTING INTERESTS OF U.S. WORKERS, FARMERS, PRODUCERS, AND INNOVATORS

HEARING

BEFORE THE

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

ONE HUNDRED SEVENTEENTH CONGRESS
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THURSDAY, APRIL 14, 2022

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UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

WASHINGTON: 2022

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THURSDAY, APRIL 14, 2022

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Washington, D.C.

The Commission met in Room 419 of Dirksen Senate Office Building, Washington, DC and via videoconference at 9:30 a.m., Commissioner Robin Cleveland and Commissioner Michael Wessel (Hearing Co-Chairs) presiding.

OPENING STATEMENT OF COMMISSIONER ROBIN CLEVELAND HEARING CO-CHAIR

COMMISSIONER CLEVELAND: Welcome to my colleagues and our witnesses today. We have a long day ahead of us.

Our hearing today will focus on a key aspect of the U.S China relationship and this Commission's mandate: trade. U.S. policymakers have long been dedicated to expanding market access and commercial opportunities. The United States has prioritized alignment with global trading rules and the formation of new rules to protect innovation and promote competition.

As this Commission has observed in the last two decades, China's policies and practices run contrary to the U.S. approach. China has repeatedly flouted its commitments to reciprocal access, protection of intellectual property, and equal treatment.

The Chinese Communist Party has strengthened the hand of the state rather than the market, creating a cascade of negative effects around the globe. Chinese state and non-state producers have drowned global markets with over capacity to eliminate competition and hollow out entire industries.

In the aftermath of the COVID 19 pandemic and Beijing's failure to live up to its obligations under the Phase One Deal, it is clear that the United States and many of its allies must craft a more resilient approach to trade policy.

Our witnesses today have a deep bench of expertise and will focus on how to address a range of China's distortive practices, from subsidies to IP theft. As China is reinforcing rather than retreating from its stated approach, this hearing seeks to answer key questions about U.S. bilateral, regional, and multilateral trade policies.

As current and past administrations have recognized, an accurate assessment of China's strategy in the Indo Pacific and globally is necessary to correctly calibrate U.S. economic engagement. Our challenge in this hearing is not only consideration of trade remedies, but also trade agreements, new structures, and new rules to mitigate the effect of Beijing's distortions.

I welcome the fact that 9 of our 12 witnesses have not appeared before the Commission and bring forward valuable new perspectives. We are also pleased to hear from three experts

who have previously helped to shape the Commission's views and welcome them back today. Thank you all for your knowledge and insight into this complex set of issues.

I'll now turn to my colleague Commissioner Wessel.

PREPARED STATEMENT OF COMMISSIONER ROBIN CLEVELAND
HEARING CO-CHAIR

Hearing on "Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators"

Opening Statement of Commissioner Robin Cleveland

April 14, 2022

Washington, DC

Our hearing today will focus on a key aspect of the U.S-China relationship and this Commission's mandate: trade. U.S. policymakers have long been dedicated to expanding market access and commercial opportunities. The United States has prioritized alignment with global trading rules and the formation of new rules to protect innovation and promote competition. As this Commission has observed in the last two decades, China's policies and practices run contrary to the U.S. approach. China has repeatedly flouted its commitments to reciprocal access, protection of intellectual property, and equal treatment. The Chinese Communist Party has strengthened the hand of the state rather than the market, creating a cascade of negative effects around the globe. Chinese state and nonstate producers have drowned global markets with over capacity to eliminate competition and hollow out entire industries. In the aftermath of the COVID-19 pandemic and Beijing's failure to live up to its obligations under the Phase One Deal, it is clear that the United States and many of its allies must craft a more resilient approach to trade policy.

Our witnesses today have a deep bench of expertise and will focus on how to address a range of China's distortive practices, from subsidies to IP theft. As China is reinforcing rather than retreating from its state-led approach, this hearing seeks to answer key questions about U.S. bilateral, regional, and multilateral trade policies. As current and past administrations have recognized, an accurate assessment of China's strategy in the Indo-Pacific is necessary to correctly calibrate U.S. economic engagement in the region. Our challenge in this hearing is not only consideration of trade remedies, but also trade agreements, new structures, and new rules to mitigate the effect of Beijing's distortions. I welcome the fact that 9 of our 12 witnesses have not appeared before the Commission and bring forward valuable new perspectives. We are also pleased to hear from three experts who have previously helped to shape the Commission's views and welcome them back today. Thank you all for your knowledge and insight into this complex set of issues.

OPENING STATEMENT OF COMMISSIONER MICHAEL WESSEL
HEARING CO-CHAIR

COMMISSIONER WESSEL: Thank you, Commissioner Cleveland and good morning, everyone. I want to thank our witnesses for joining us today, and for the thought and consideration that they have given their testimonies. I also want to thank my co-chair. I believe this is our seventh hearing over the years that we have co-chaired together and it's been a productive partnership so thank you.

Today's hearing will start by exploring not only how the United States can more effectively utilize existing trade tools to address China's predatory and protectionist trade practices, but what new tools might be needed. The current suite of tools is often limited in scope and there are questions about the tools' utility in addressing the structural trade problems we have with China. Our discussion is taking place as the administration is also reportedly looking at what new tools may be needed.

There has been a growing but still tenuous consensus among many of our allies that coordinated action to address China's predatory economic approach is needed. We need to look not only at what we can do on our own, but what actions and approaches we might want to take with friends and allies.

Since the Commission's last hearing on China's trade practices in 2018, many changes have impacted the global trading system, including the Phase One Trade Agreement, COVID 19, a broken WTO dispute settlement mechanism, regional trade agreements including RCEP and CPTPP, the initiation of the U.S. Trade and Technology Council, and the intention of the Biden Administration to develop an Indo Pacific Economic Framework.

Of course, as we discuss these issues, we can't ignore Russia's invasion of Ukraine and China's diplomatic and economic approach. Updated foreign policy, economic and security assessments are necessary.

My co chair has highlighted China's long standing distorting trade practices. The size, ferocity, and the impact of those practices have only gotten worse. No sector is immune from China's predatory policies.

The impact of these policies is evident not only with last year's $355.3 billion bi-lateral trade deficit in goods, but with its composition. Last year's bi-lateral trade deficit in advanced technology products with China of more than $113 billion was 11 percent higher than in 2020.

This hearing will also assess the future of U.S. economic strategy in the region, particularly as the Administration's Indo Pacific Economic Framework (IPEF) develops. For me the issue is not whether to engage in the region. We already have. The question is what should America's future role be and how do we gauge success.

In my personal view, we can't afford another diplomatic failure in the region like the trans-Pacific partnership. The architecture for America's future role in the region must be built on a sound foundation that yields economic benefits for producers and workers here at home and fosters broadly-shared prosperity in all the signatory countries.

We will close with an assessment of whether the WTO is capable of addressing the challenges raised by China's trade practices and its non market model.

To our distinguished witnesses, thank you for joining us to discuss these important questions. Thank you as well to the Senate Foreign Relations Committee for lending us their space for today's event.

Before we begin, I would like to remind you that the testimonies and transcript from today's hearing will be posted on our website, www.uscc.gov. Also, please mark your calendars for the Commission's upcoming hearing on China's influence and activities in South and Central Asia, which will take place on May 12.

PREPARED STATEMENT OF COMMISSIONER MICHAEL WESSEL
HEARING CO-CHAIR

Hearing on "Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators"

Opening Statement of Commissioner Michael Wessel

April 14, 2022

Washington, DC

Thank you, Commissioner Cleveland and good morning, everyone. I want to thank our witnesses for joining us today, and for the thought and consideration that they have given their testimonies.

- Today's hearing will explore how the United States can leverage its trade tools to adopt a more resilient trade policy, not only to challenge China's distortive practices, but to engage more effectively in the broader Indo-Pacific in a way that can promote the interests of U.S. workers, farmers, producers, and innovators.
    - The Commission last held a hearing examining China's trade practices in June 2018. Since then, many changes have impacted the global trading system, including: the United States and China's Phase One Trade Agreement, COVID-19, a broken WTO dispute settlement mechanism, regional trade agreements including RCEP and CPTPP, and the development by this Administration of an Indo-Pacific Economic Framework. One thing has unfortunately failed to change since our last trade hearing: the Chinese Communist Party's predatory and mercantilist approach to trade.
- My co-chair has highlighted China's long-standing distorting trade practices.
    - These remain unchanged two decades after its WTO accession: hundreds of billions of dollars worth of state-subsidies, heavy-handed industrial policy, and non-tariff trade barriers that include discriminatory procurement policies and an investment black list.
    - Perhaps most pressing, China is leveraging all the nonmarket tools at its disposal to race ahead in Fourth Industrial Revolution technologies. In industry after industry—from telecommunications to high-speed rail to semiconductors to biopharmaceuticals--China's heavy-handed state intervention is undermining free and fair trade, hurting U.S. workers and producers and undermining U.S. and global innovation.
    - The impact of these practices is evident in current bilateral trade relations, as the U.S. goods trade deficit with China in 2021 was $355.3 billion, the highest in several years. But the impact is not just felt by the United States: in 2021 China registered its largest trade overall surplus in history at $676 billion.

- This hearing will contemplate the future of U.S. economic strategy in the region, particularly as the Administration's Indo-Pacific Economic Framework (IPEF) develops and seeks to further engage the region on digital trade, supply chain management and security, climate, and labor issues.
    - China's moves to further enmesh itself in Indo-Pacific trade raises serious concerns about the potential loss of U.S. influence and key questions about balancing U.S. security and economic interests.
    - While recognizing the need for consistent engagement, we also know that the United States has both broad and deep ties to this region. The question is how we achieve this without potentially creating back doors to Chinese overcapacity and outlets for its subsidized goods. Furthermore, how can we achieve trade that is sustainable?
    - Augmenting America's influence in the Indo-Pacific must offer economic opportunity both ways to benefit workers in the region as well as workers at home.
- Today's hearing will close with an assessment of whether the WTO is capable of addressing the challenges raised by China's trade practices and its non-market model.
    - Since acceding to the WTO in 2001, China has consistently failed to fulfill its commitments under the WTO. The WTO has failed to hold China accountable for its subsidies, lack of transparency, and favoritism for SOEs and state banks.

To our distinguished witnesses, thank you for joining us to discuss these important questions. Thank you as well to the Senate Foreign Relations Committee for lending us their space for today's event. We look forward to hearing from each of you.

Before we begin, I would like to remind you that the testimonies and transcript from today's hearing will be posted on our website, www.uscc.gov. Also, please mark your calendars for the Commission's upcoming hearing on China's influence and activities in South and Central Asia, which will take place on May 12.

PANEL I INTRODUCTION BY COMMISSIONER MICHAEL WESSEL

COMMISSIONER WESSEL: Our first panel today will examine China's long-standing nonmarket practices and in particular subsidies, excess capacity, and non-tariff barriers. The panel will consider how the array of U.S. trade tools can best be leveraged to mitigate the harmful effects on the U.S. and global trading system from China's non-market practices.

We will hear from a phenomenal set of experts. We will begin with Clyde Prestowitz, founder and president of the Economic Strategy Institute. Mr. Prestowitz' testimony will consider how the U.S. can leverage new or under-utilized tools to challenge China's trade practices. We are welcoming Mr. Prestowitz to the Commission for the first time.

Next we will hear from Nazak Nikakhtar, partner at Wiley Law where she co-chairs Wiley's National Security Practice. Mr. Nikakhtar will offer her views on reshaping the U.S./China trade relationship. We welcome Ms. Nikakhtar back to the Commission after testimony for us last year.

We will then hear from Dr. Alicia Garcia-Herrero, Senior Research Fellow at Bruegel. Dr. Garcia-Herrero's testimony will consider the evolving role of China's state sector and its economy and how to create a level playing field. This is also her first time with the Commission.

Thank you all very much for your testimony. Please keep your remarks to seven minutes to leave time for the question and answer session. We'll go in the order in which I introduced you so, Mr. Prestowitz, we'll start with you

OPENING STATEMENT OF CLYDE PRESTOWITZ, FOUNDER AND PRESIDENT, ECONOMIC STRATEGY INSTITUTE

MR. PRESTOWITZ: Thank you very much, Mr. Chairman. It's an honor and a pleasure to be invited to testify this morning. I think the fundamental key concept that we need to keep in mind in dealing with China is it's not simply a trade policy or trade policy issue or a trade policy solution.

China has adopted a policy of total economic development and catch-up. We've seen catch-up policies in the past. Japan had catch-up policies in the 1970s and 1980s. Korea, Taiwan, others. In the case of China, it's even beyond the industrial policies and catch-up policies that we've seen in the past.

The Chinese Communist Party is aiming to requite what it calls 150 years of humiliation. It's aiming to displace the United States as the world's leading power. To do so not only in terms of political or military power, but particularly in terms of economic and technological power.

China has a complete strategy. This is very different from the approach that the U.S. and other democratic free market countries have taken. We think in terms of trade policy and foreign policy and military policy being somewhat separate.

We think in terms of trade remedies; antidumping or other trade remedies as specific steps that can be taken to address particular infractions or disruptions of what we think of as the proper trade rules and trade modeling.

China doesn't accept our concept of free trade. It doesn't accept our concept of rule of law so we have to respond to China in a full-court full-strategy way in order to deal with all of the issues that it raises.

I think that a major element here is that it's not just trade that we're talking about. It's also investment. It's also technological transfer so that requires a complete strategy that subsumes in the U.S. policy achieving and maintaining leadership in technology, maintaining leadership in key areas of production.

It also involves investment. We're not just talking trade. We're talking where are lead-cutting edge corporations investing, where are they producing, what is it that leads them into the decisions they make.

For example, let me use Apple as a key example. Everything that Apple sells at some point came out of U.S. government-funded research. It came out of the Defense Advanced Research Project Agency. Everything that Apple sells had a high degree of U.S. taxpayer money behind it in the beginning.

Everything that Apple makes is made in China. Apple in Washington is a powerful player. Tim Cook has instant entrée to the members of Congress, to the White House, to the major agencies of the U.S. government.

In Beijing he has no political influence at all. Let me give you two examples. In 2015 a shooting took place in California and an Apple phone was dropped at the location. The Apple phone was picked up by the FBI and the FBI requested that Apple open the phone. Apple refused, the case went to court, was never settled in the U.S. courts.

Fast forward to four years, 2019. Demonstrators are demonstrating in Hong Kong and in the Apple App store is a thing called Hong Kong Map Live. It means that if you have the app, you can see Hong Kong in real time.

So the kids could see where the police were and they could see where the police weren't.

The demonstrators, of course, went to where the police were not. This infuriated Beijing. It infuriated the Chinese Communist Party.

People's Daily began inveighing against Apple and within two days the app was out of the app store. This power of Chinese to capture foreign and U.S. corporations is very important and something that we need to respond to.

I think another element of this is that when we conduct trade, of course we conduct it typically in dollars. The dollar tends to be chronically over valued because it is the world's major reserve currency.

You know, it's interesting. We have a trade deficit but there is one product that is only made in America that everybody in the world wants. It's the U.S. dollar.

Other countries, China being a major one of them, manipulate their currencies. They do not have free currency markets. They set their currencies to support their trade. We need to counter this kind of activity, and one way to do it would be to introduce what we call a market access charge. Three or four percent charge on incoming investment that is not green field investment.

The final point I would like to make is that there are a lot of costs that are never included in the trade calculations. For example, let's take steel. Chinese steel typically sells in the world market at prices below U.S. steel. Yet, Chinese steel is largely made with coal, U.S. steel is largely made with energy fired by natural gas or nuclear power. The carriage of Chinese steel to foreign markets is done by ship and airplanes which contribute 14 percent of greenhouse gases. Those costs are not included in the prices of Chinese steel coming into the U.S. and other foreign markets. They should be included.

Let me conclude my remarks there. I look forward to your questions.

COMMISSIONER WESSEL: Thank you.

PREPARED STATEMENT OF CLYDE PRESTOWITZ, FOUNDER AND PRESIDENT, ECONOMIC STRATEGY INSTITUTE

April 6, 2022

Clyde Prestowitz

Founder and President, Economic Strategy Institute

Testimony before the U.S.-China Economic and Security Review Commission

Hearing on "Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators"

A. How would an Economic NATO Work REGARDING CHINA

An Economic NATO presumes a common policy among its members on trade with, investment in and from, and transfer of technology to China. As has become apparent in the case of the Russian-Ukraine war, even though NATO is not directly involved, most of the major corporations of the NATO countries have decided to halt or suspend their operations in Russia. Further, the NATO countries are drastically curtailing their imports from Russia and are aiming effectively to achieve a state of minimal dependence on the Russian economy.

In the case of China, an ENATO might not be much concerned by the operations of say a Starbucks or a Nestle in China or of an Alibaba in the free world. But all the ENATO members would have to refrain from any significant dependence on China for things like advanced telecommunications equipment, semiconductors, robotics, and essentially all advanced technology products and services. Nor would members be allowed to sell advanced products and technological know how to China. A corporation like Apple, which makes everything it sells in China, would have to be forced to move most of its production out of China and to halt transfer of any advanced technology to China. This may sound draconian, but it is important to remember that China's Dual Circulation and Made in China 2025 and 2035 policies are aimed at achieving Chinese autonomy across the board in the short to medium term.

By the same token, just as NATO members are not allowing their banks and equity funds to invest in Russia today, so ENATO members would have to have very strict rules limiting free world investment fund activity in China and Chinese investment in the ENATO countries. Black Rock hedge fund manager Larry Fink recently declared globalization to be over as a result of the Russia-Ukraine War and of China's backing of Russia. Thus, even without and ENATO, major U.S. investors are dramatically changing their investment tune.

China uses economic dependence upon it as a coercive weapon. We have seen that in the cases of Australia, South Korea, Norway, Lithuania, Germany, and even of the U.S. in the case of Beijing's cancellation of the broadcasting of National Basketball Association games in China as punishment for a U.S. team manager's tweet in support of protestors in

Hong Kong. To avoid coercion, ENATO members would have to monitor constantly the degree of their dependence on China and would have to coordinate counter measures among themselves. For example, recently, China barred imports of wine from Australia. An ENATO would have a common fund aimed at deterring such Chinese action. The fund would buy the wine rejected by the Chinese and redistribute it in other world markets.

Were an ENATO to come into existence, it would supersede the WTO and effectively divide the global economy into one free world economy and one mercantilist economy that would engage with each other on strictly reciprocal terms.

B. WHAT IS SUCCESS IN DEALING WITH CHINA'S TRADE PRACTICES?

What we refer to as "China's trade practices" really go far beyond mere trade. China aims as a matter of its quasi-quasi-religious socialism with Chinese characteristics doctrine to develop the world's largest, most technologically advanced economy with leadership and autonomy in all the cutting- edge technologies and with

Purely trade practices are only a relatively small part of the problem and could be reasonably well handled by aggressive use of existing remedies. Dumping by Chinese exporters is endemic and yet the number of anti-dumping cases being processed by the U.S. government is relatively small. The reason for this is that the government typically waits to act until there is a complaint from private industry. But private industry hesitates to complain because it is subject to retaliation by China. The solution to this is readily available. Under U.S. trade law, the Secretary of Commerce has the authority to self-initiate anti-dumping cases. It has only been done once. That was by Secretary Malcolm Baldrige of the Reagan administration against the Japanese for dumping of semiconductors. It worked extremely well. Not only did the Japanese stop the dumping. They also took concrete steps to open the Japanese market. Henceforth, the Secretary of Commerce should become aggressive in identifying and combating Chinese dumping.

However, trade per se is only a small part of the problem which is broad and inclusive a broad variety of elements. For instance,

the Chinese Renminbi is kept chronically undervalued by the Chinese government. The U.S. Secretary of the Treasury should be constantly monitoring exchange rates and should declare China to be a currency manipulator and make China subject to retaliation for that malpractice.

Indeed, China has been operating a full-fledged, mercantilist, catch-up economic/industrial development program while U.S. leaders have clung to the view that China will become a "responsible stakeholder in the liberal, rules based, global order." China's comprehensive development policy has been and is more about enticing and forcing foreign investment into China, transfer of production from previous locations to China, compulsory exportation of products from China, and comprehensive transfer of

technology to China. More recently, Beijing has encouraged the acquisition of foreign high- tech organizations and the transfer of their technology by Chinese corporations. Thus, the game is not so much trade as technology acquisition, and establishment of dominant manufacturing capacity in China.

Heretofore, American policy has almost perfectly complemented Chinese policy. It has encouraged transfer of technology from America and the free world to China while at the same time reducing funding and promotion of new technology development at home. It has privileged Chinese state- owned corporations by allowing them to list on U.S. stock exchanges without meeting the same listing standards as those required of American corporations. By not strictly enforcing trade agreements and by, in effect, encouraging the offshoring of production, technology, and jobs to a country in which labor unions are outlawed, environmental standards are lax to non-existent, taxes are suspended for several years for new investments, land is provided at no cost, and investment incentives can amount to a large percent of the total cost, Washington, Wall Street, the American press and academic institutions along with the Business Roundtable and Chamber of Commerce have been consistently and steadily undermining U.S. competitiveness and manufacturing and technological leadership.

Both the Trump and now the Biden administrations have taken some baby steps away from this historical pattern, but much more needs to be done. Any Chinese investment in U.S. corporations or technology should be subject to U.S. government approval. China based production is inexpensive because labor unions are banned, safety and environmental rules are lax to non-existent, much of the investment in land and equipment in China is subsidized, and the costs of greenhouse gas emissions resulting from production and shipment are completely ignored. Carbon border taxes, environmental equalization charges, and a market access charge (MAC) on other than green field investment in the U.S. should be imposed. These would be meaningful steps toward success. A further step would be reduction in corporate taxes on profits generated by U.S. based production as opposed to production abroad.

In short, the United States must stop trying to convince China to stop playing football and adopt baseball in its place. China will never do so. Success will come when America starts playing football too.

C. UNDER-UTILIZED TOOLS

There are several tools not much used that potentially could have a significant impact on trade and investment with China. One is the Market Access Charge (MAC) mentioned above. Many countries operate their economies in ways to keep their currencies undervalued versus the U.S. Dollar. These include such as Switzerland, Japan, South Korea, Taiwan, Singapore, and Germany. This tends to drive U.S. based production abroad. A flexible charge of 1-5 percent on non-productive incoming investment into the U.S. would do much to level the playing field. The proceeds could be used to fund infra-structure improvement.

I have already mentioned self-initiation of anti-dumping cases by the Secretary of Commerce.

The U.S. government could declare a balance of payments emergency. U.S. trade has been in constant and enormous deficit for the better part of fifty years. This is only possible because of the floating exchange rate system and the reserve currency role of the U.S. dollar. Of all the countries in the world, only the U.S. dollar could remain viable in this situation. Under World Trade Organization rules, Washington could declare a balance of payments crisis, temporarily suspend WTO tariff commitments, and impose tariffs as needed to correct the balance.

The Defense Production Act of 1950 broadly enables the President to direct industry to make and distribute products and services necessary to the well being of the United States. This act could be used to ensure that various products such as medicines, semiconductors, smart phones, and artificial intelligence devices are made in the United States. For instance, under this act the White House could compel products like smart phones to be made in the United States. In view of the recently revealed vulnerability of global supply chains, this act should be used to ensure that the United States is not vulnerable to fragile, far flung, global supply chains.

D. MARKET ACCESS CHARGE (MAC)

The concept of a MAC is simple, easily possible, and quite necessary. When the global financial system was first established in 1948, it was based on a gold/dollar standard with the dollar valued at $35 per Troy ounce of gold and all other currencies fixed to the dollar (360 Japanese yen, 4 Swiss francs, etc.). The objective was a trade system in which the trade of each country would be in medium and long- term balance. No one imagined that major economies would or could accumulate eternal trade deficits.

Indeed, by 1972, the system was demonstrating this to be a fact. America was experiencing successive trade deficits and many countries found they were holding more dollars than they needed or wanted. They began to exchange those for gold. A yellow river began to flow from Fort Knox to London, Paris, Frankfurt, and Tokyo as U.S. trading partners turned in their dollars for gold. With the U.S. gold supply literally melting away, President Nixon simply and unilaterally announced that the U.S. would no longer exchange gold for dollars. Treasury Secretary John Connally famously told the Europeans that “the dollar is our currency but now it’s your problem.”

That may have been true at that moment, but by making the dollar the main global reserve currency, Connally and Nixon also inadvertently made it subject to chronic overvaluation and a target for manipulation by mercantilist countries pursuing export led growth strategies.

The MAC could be a key tool for properly valuing the dollar in international trade and bringing U.S. trade into something approaching balance and thereby creating more jobs and wealth in the United States

E. HOW CAN THE U.S. COUNTER CHINA'S INDUSTRIAL POLICIES

An old saying advises that "if you can't lick em join em." A huge fallacy of post WWII American economics and trade doctrine is that industrial policies don't work and that the United States should avoid them even if they appear to be helpful to other countries.

The fact is that industrial policy often works exceedingly well. Moreover, the United States has been a major beneficiary of industrial policy. American producers have long been leaders in global aviation markets. This was not the result only of entrepreneurial genius on the part of American business leaders. The U.S. government has subsidized and promoted the aviation industry from the time of the Wright brothers. After WWII, Japan and Germany were banned from producing airplanes for many years. The first major, civilian jet liner was the Boeing 707 which was a civilian copy of the KC-135 U.S. Air Force jet tanker. Sometimes I ask audiences who invented the Internet. They often reply: Steve Jobs, Bill Gates, or Jeff Bezos. No. It was DARPA- the Defense Advanced Research Projects Agency.

For years as a U.S. trade negotiator and as an economist and trade analyst, I argued that the United States should not allow its industries like the semiconductor industry to lose global leadership because of the impact of the industrial policies of countries like Taiwan, Japan, and South Korea. For years, conventional wisdom -oriented economists said I was wrong and that if foreign producers could produce semiconductor chips more inexpensively and advance the technology more rapidly, we should take advantage of their chips and not worry about it if the U.S. industry went down. But now, faced the fact that by dint of industrial policy Taiwan and South Korea are more advanced in chip production than America and the fact that China is committed to achieving global semiconductor leadership, American leaders have finally turned a deaf ear to outdated economists and are pouring $50 billion into support of the U.S. semiconductor industry.

The answer to China's industrial policy is a thorough going American industrial policy aimed at dramatically reducing American dependence on fragile, far-flung supply chains anchored in hostile countries.

F. HOW TO DEAL WITH CHINA'S SUBSIDIES

A Section 301 investigation of China's trade practices will inevitably discover substantial government subsidization of investment, production, and delivery. One way to deal with this is the self-initiated dumping investigations I mentioned above. Another way is to impose counter-vailing duties. But the best way is to make the stuff in America or in countries like Mexico that are not seeking to overturn America's global leadership and ideals. De-coupling from China should be the number one goal of American trade policy.

In this regard, another target of U.S. trade policy must be American companies like Apple and Goldman Sachs. Everything that Apple makes and sells originated in some U.S. government financed research program. Everything that Apple sells is made in China. In Washington, Apple is a power political player. It has armies of lawyers and lobbyists and writes a lot of legislation itself. The CEO of Apple has instant entrée into the highest levels of the U.S. government and his company makes major political donations. In short, in Washington, he is extremely powerful.

But, you know what. In Beijing, he kowtows. He has no influence and is subject to constant potential coercion because there is no rule of law to protect him and his company against a sudden "power shortage", or unscheduled inspection, or any number of things that might constitute the death of a thousand cuts. The truth is that the CEO of Apple is more afraid of and more responsive to Beijing than to Washington. He will lobby the U.S. congress on behalf of Beijing. Nor is it just Apple. Think Goldman Sachs, Ray Dalio, Fedex, and many, many more.

A major target of this Commission should be U.S. industry. It is chartered in America. It is given the huge gift of limited liability that goes with corporation status. The state grants that gift because it expects the corporation to do something good for the whole society. We must start asking U.S. CEOs how moving production and R&D to China is good for America. When they testify before the U.S. Congress they always present themselves as American CEOs. But are they really? Is the head of Apple thinking about what is good for America or about how many subsidies he can get from Beijing that will result in profits that he can hold in Bermuda or Singapore without being subject to American taxation?

G. AFFECT OF REPEALING PERMANENT NORMAL TRADE RELATIONS

Permanent Normal Trade Relations is an awkward term developed to replace and offset the implications of the traditional and more accurate – Most Favored Nation Relations - known as MFN.

Traditionally, nations did not maintain the same terms of trade with all nations. Rather some received more favored treatment than others for a variety of reasons. Perhaps they were allies or neighbors or offered something that no one else offered. MFN were the terms of trade offered to the country or countries with which one wanted to have a particularly friendly and prosperous relationship. When the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organization (WTO) were established, the members agreed to offer MFN to all other members. It is important to note that this was not an offer of normal trade relations. It could not be because there never was any such thing as normal trade relations.

The verbal creativity arose when trade with China began to grow rapidly. The U.S. granted MFN to China beginning in the early 1980s, but it did so only on an annual basis because of the hangover of old national security concerns. One reason China wanted to

join the WTO was because joining would automatically require that it be granted permanent MFN like all other WTO members. But in the discussions of welcoming China into the WTO, the term Most Favored Nation seemed to some to be a political obstacle. How could a communist country be among our most favored nations? So proponents of China's WTO membership came up with the Permanent Normal Trade Relations (PNTR) moniker as a more politically palatable formulation.

The problem is that so called PNRT with China is not normal at all. China's very state led economic system makes PNTR meaningless. No matter what trade relations we offer China we will never receive the same in return. But China is now a member of the WTO. If we were to withdraw the PNTR status unilaterally, we might also be expected to withdraw from the WTO. That probably would not be the wisest move.

The results we need can be achieved by means of some of the suggestions I have made above.

H. HOW ABOUT A MULTILATERAL PATHWAY OUTSIDE THE WTO

This idea deserves more attention. The U.S., EU, and Japan account for well over half of global GDP. If we add the GDP of other democracies, we will arrive at about 85 percent of global gdp. This could easily be democratic world trade organization. The fact is that a marriage of the economies of democratic countries with those of autocratic countries is not made in heaven. It was dreamed at the time of the entry of China into the WTO that free trade would democratize the country. Clearly it has not. If anything it has enabled China to become more powerful and more threatening to democratic countries.

A Democratic Trade Organization (DTO) is a good idea that should be pursued.

I. BALANCING SECURITY WITH FAIR ECONOMIC COMPETITION

A fallacy of free world economic policy over the past seventy years has been to assume that economic globalization would inevitably lead to global democratization and rule of law. No risks or costs were attached to the establishment of complex, far flung supply chains, to carbon gas emissions, to theft of intellectual property, to potential loss of critical skills in the work force, to worker displacement, or to the effective capture of global CEOs by authoritarian systems aiming to undermine the free world.

In the future, it will be essential to do the math comprehensively. For instance, shipping by air and sea accounts for about 14 percent of global greenhouse gas emissions. There is a known cost of those emissions. It should be included in the transport bill when items are shipped. The result would inevitably be less shipping and more production closer to population centers. Similar calculations should be made and applied to all of the unincluded costs noted above.

OPENING STATEMENT OF NAZAK NIKAKHTAR, PARTNER, WILEY REIN

MS. NIKAKHTAR: Good morning, members of the Commission. Thank you for the opportunity to speak about the growing challenges of the distorted and predatory economic practices of China and the appropriate U.S. Government response.

The views and opinions expressed today are mine only, and do not represent the views of Wiley Rein or any of the firm's clients.

I've been on the front lines of the U.S.-China economic challenge for decades. The global -- and this is, it's from this context that I offer my testimony. Globally, China has captured extensive market share and wiped out critical industries in the United States and the countries of our allies, including semiconductors, high-capacity batteries, essential medicines, for example.

We don't process critical minerals domestically because we've given up since it's just cheaper to import them from China rather than making then cleanly at home. We've not only lost industries as a result of China's predatory practices, we've lost jobs and much of our incentive to innovate.

If China is manufacturing items, we've defaulted to buying them rather than making them. Taiwan owns the IP to make leading edge chips. And China owns much of the IP for making lithium ion battery cells. That's just the start.

First, what I describe here are not incidental consequences of open and free trade, but the very perverse and adverse consequences of one country exploiting open borders to cripple other nations' economies. Without access to secure and critical supply chains -- semiconductors, lithium ion batteries, critical minerals -- we are unable to sustain our economy and we're unable to develop weapons systems necessary for national defense.

The result is that our military will have a one strike capability. This is also true for our allies and for the rest of the world.

Second, the economic facts before us should make abundantly clear that the Chinese Government has waged an economic war against the rest of the world aimed at eroding non-Chinese supply chains so that no country is able to depend on itself or its allies for the essential items that it needs. The Chinese Government's end game is to render the rest of the world dependent on it. And today this plan is succeeding.

At present, we depend on China for 80 percent of our critical minerals, 20 to 23 percent of our semiconductor chips, that is increasing rapidly, 92 percent of Taiwan for our most advanced chips, 60 percent of our consumer electronics, including telecom equipment, 75 percent of our lithium ion battery cells, and 100 percent of many of our pharmaceutical and medical supplies.

The greater our dependence grows, the more vulnerable and fragile we become. This is not a sound strategy.

To be clear, we have not yet felt the full adverse effect of China's control over our supply chain and economies yet, not because control doesn't exist but, rather, because the Chinese Government has chosen not to exercise it yet.

When will that time come? When the Chinese Government knows that we're too weak to respond. Perhaps when it displaces the U.S. dollar from the global currency market, or when it fully indigenizes leading edge semiconductor development such that it no longer needs U.S. technology. This time horizon is only a few years away. This threat is becoming immediate.

As a nation, we tend to downplay these risks because we hold steadfastly to the belief that the United States' economy is strong and resilient, and so it will just be immune from external threats.

The prevailing argument is that U.S. purchasing power will keep, will continue to keep the Chinese economy dependent on the United States and prevent it from harming the U.S. interests is terribly misinformed. We source from China not because we choose to, but because we have very little option for most goods, for many goods.

Our trade deficit with China, $355.3 billion in 2021, underscores this point. The coronavirus pandemic highlighted our supply chain reality. And the farther our supply chains migrate into the PRC, the greater our dependence will become.

As our import dependence on Chinese-origin goods expands, the PRC Government will not guarantee to the rest of the world fair and equitable access to its supply chain.

We've already witnessed instances of the PRC's stranglehold over trading partners: for example, the debt trap diplomacy created by the PRC's one belt/one road scheme where countries are now at the PRC Government's mercy and have given up critical national assets to the Chinese Government in repayment.

We, the United States, our North American allies, European and Asian partners, are all nearing this dangerous tipping point as well. For those of us who have studied China in depth for decades, this is precisely the PRC Government's end game: to deplete other nations of the resources necessary for self-defense by creating supply chain weaknesses and economic dependence.

This Chinese Government strategy, coupled with reports of the PRC Government's endless intimidation of the United States and our allies makes clear that the Chinese Government is a real threat.

Both the Trump and Biden administrations designated the PRC as a foreign adversary. This means something.

In my testimony I offer several recommendations to begin slowing our vulnerabilities and curing them. And I'll explain them briefly here. The recommendations I provide may not all be easy. They will require sacrifices. But if we, as a nation, are resolute we may be able to solve our weaknesses before it's too late.

For the United States, the economic impact of moving our supply chains out of China is approximately 1 percent of GDP in the short term. If we do this in concert with Europe, Japan, and our South Korean allies, the economic impact is significantly lessened. After 3 to 5 years, any negative impact will turn to substantial gains for the United States, and those gains will grow significantly. Overall, the benefits to the Free World of disentangling from a predatory actor will be immeasurable.

As to the recommendations, first we need an export control system that allows us to run faster but also block China's ability to benefit from our technology. I'll give you an example through our hypersonic weapons system.

We freely divulge our technology to China because we think that we need the revenue stream. But hypersonics is a great example. It was facilitated by the U.S. transfer of semiconductor technology to the PRC. And one company's tech transfer allowed the Chinese military to race ahead of the United States. And that company's realized short-term profits now threatens our national security and the world's security.

Second, we need controls on emerging technologies. We need to do them broadly but restrict application to the high-threat actors.

Third, we have a problem with our end use checks in the government. We cannot make sure that the Chinese are adhering to the terms and conditions of our export licenses because our ability to check compliance is restricted.

I have provided in my testimony recommendations on looking to unilateral export controls, giving our allies cover to follow suit. And I discuss some CFIUS reforms.

And I wanted to make one final point. China's a non-market economy and it leverages its command control type economic system to manipulate the land, energy, labor, raw material crisis, currency to weaken its competitors. The more we invest in a non-market economy, the more we move production into China to avail ourselves of its cheap prices, forced labor, and other non-market dispersions, the more we buy cheap Chinese products rather than goods from market economies, the more we allow non-market forces to capture a greater share of the global market. And this way we're accelerating the demise of capitalism and the market-based system.

I look forward to your questions.

COMMISSIONER WESSEL: Thank you.

Dr. Garcia-Herrero.

PREPARED STATEMENT OF NAZAK NIKAKHTAR, PARTNER, WILEY REIN

April 14, 2022

Statement of Hon. Nazak Nikakhtar

Partner, International Trade and National Security Practice, Wiley Rein LLP
Former Assistant Secretary for Industry & Analysis and Under Secretary for Industry & Security
U.S. Department of Commerce

Testimony Before the United States-China Economic and Security Review Commission*

Challenging China's Trade Practices:
Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators

Chairman Wong and Vice-Chair Glas, hearing Co-Chairs Commissioner Cleveland and Commissioner Wessel, thank you for the opportunity to speak about the growing challenges posed by the distortive and predatory economic practices of the People's Republic of China ("PRC") and the appropriate U.S. Government response.

My name is Nazak Nikakhtar, and it is an honor to appear before you today. I am an international trade attorney and Chair of the National Security practice at the Washington, DC, law firm of Wiley Rein LLP. I am also a trade and industry economist, a former Georgetown University adjunct law professor, and recently completed my second tour of duty in the U.S. Government. Twenty years ago, I began my career as an analyst at the Department of Commerce's Bureau of Industry and Security and subsequently at the International Trade Administration, where my colleagues and I witnessed from the frontlines the predatory economic tactics used by our trading partners to erode our industries. In 2004, I helped establish and lead the Commerce Department's China/Non-Market Economy Office and, for several years thereafter, I audited numerous foreign (including Chinese) companies and their affiliates for the Department. In 2018, I returned to the Commerce Department to serve as Assistant Secretary for Industry & Analysis and, in 2019, I simultaneously served, performing the non-exclusive functions and duties, as the

**The views and opinions expressed in this testimony are mine only and do not represent the views of Wiley Rein LLP or any of the firm's clients.*

Under Secretary for the Bureau of Industry and Security. It is from all of these vantage points that I offer my testimony and observations today.

I. THE EROSION OF SUPPLY CHAINS AND THE RESULTING ECONOMIC AND NATIONAL SECURITY THREATS

Only recently, in 2017, the U.S. Government began to aggressively confront the challenges posed by the PRC's predatory economic practices. These challenges had been ignored for decades and, as a result, over the course of the past 40-plus years, the United States continuously lost capabilities in sector after sector in manufacturing, technology, and services that are essential to our national security. In goods alone, the offshoring of manufacturing has created supply chain vulnerabilities across hundreds of critical products, ranging from semiconductor and electronics manufacturing to the development of active pharmaceutical ingredients. This has led to job losses of between 3.4 to 3.7 million between 2001 to 2018.[1] In key sectors such as communications equipment, electronics, and computer technology, we ceded up to 40% to 60% of the domestic market share to Chinese imports, and globally the PRC has captured extensive market shares in those sectors as well.

Let me be clear on two key points. First, these are not incidental consequences of open and free trade. These are the very perverse and adverse consequences of one country exploiting open borders to cripple other nations' economies. Our economic losses have resulted from the PRC's deliberate attempts to hollow out our industries in order to create dependency on their own distorted market. The weaker our industries become – semiconductors, telecommunications, critical minerals and rare earth elements, high-capacity batteries, and pharmaceuticals and medical

[1] Robert Scott and Zane Mokhiber, *Growing China Trade Deficit Cost 3.7 Million American Jobs Between 2001 and 2018*, Economic Policy Institute (Jan. 30, 2020), available at https://www.epi.org/publication/growing-china-trade-deficits-costs-us-jobs/.

equipment – the more our national security is at risk.[2] Without access to secure supply chains, we are unable to sustain our economies, and we are unable to develop the weapon systems necessary for national defense. The result is that our military will have a "one strike" capability. This is also true for our allies and the rest of the world.

Second, the economic facts before us should make abundantly clear that the PRC government has waged an economic war against the rest of the world aimed at eroding non-Chinese supply chains so that no country is able to depend on itself or its allies for the essential items it needs. The PRC's end game is to render the rest of the world dependent on it, and today this plan is succeeding. At present, we depend on the PRC for 80% of our critical minerals,[3] 20-23% of our semiconductor chips (92% on Taiwan for our most advanced chips),[4] 60% of our consumer electronics including telecommunications equipment,[5] 75% of our lithium-ion battery cells,[6] and 100% for many of our pharmaceuticals and medical supplies. The greater our dependence grows, the more vulnerable and fragile we become. This is not a sound strategy.

To be clear, we have not yet felt the full adverse effect the PRC's control over our supply chains and economies yet. Not because control does not exist, but rather because the PRC

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[2] President Biden's 2021 supply chain Executive Order lists these critical sectors. *Executive Order on America's Supply Chains*, The White House (Feb. 24, 2021), available at https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-americas-supply-chains/.

[3] *A Federal Strategy to Ensure Secure and Reliable Supplies of Critical Minerals*, U.S. Department of Commerce (2019), available at https://www.commerce.gov/sites/default/files/2020-01/Critical_Minerals_Strategy_Final.pdf.

[4] *Strengthening the Global Semiconductor Supply Chain in an Uncertain Era*, Boston Consulting Group and Semiconductor Industry Association (Apr. 2021) at 5, 35, available at https://www.semiconductors.org/wp-content/uploads/2021/05/BCG-x-SIA-Strengthening-the-Global-Semiconductor-Value-Chain-April-2021_1.pdf ("BCG/SIA 2021 Report"); *Taking Stock of China's Semiconductor Industry*, Semiconductor Industry Association (July 13, 2021), available at https://www.semiconductors.org/taking-stock-of-chinas-semiconductor-industry/.

[5] BCG/SIA 2021 Report at 28.

[6] Gavin Thompson, *Batteries with Chinese Characteristics*, Wood Mackenzie (Feb. 10, 2021), available at https://www.woodmac.com/news/opinion/batteries-with-chinese-characteristics/; *Protecting Americans' Sensitive Data From Foreign Adversaries, Exec. Order No. 14034 of June 9, 2021*, 86 Fed. Reg. 31,423 (June 11, 2021), available at https://www.govinfo.gov/content/pkg/FR-2021-06-11/pdf/2021-12506.pdf.

government has chosen not to exercise it yet. When will that time come? When the PRC knows that we are too weak to respond – perhaps when it displaces the U.S. dollar from the global currency market, or when it fully indigenizes leading-edge semiconductor development such that it no longer needs U.S. technology. This time horizon is only a few years away. This is becoming an immediate threat.

As a nation, we tend to downplay these risks because we steadfastly hold onto the belief that the United States' economy is strong and resilient, and so it will be immune from external threats. The prevailing argument – that U.S. purchasing power will continue to keep the PRC dependent on the United States and prevent it from harming U.S. interests – is terribly misinformed. We source from the PRC not because we choose to but because we have little other option. Today's economic reality is that United States and the rest of the world have absolutely no choice but to import heavily from the PRC because this is where supply chains for the most critical products reside. The current trade deficit with the PRC, which stood at $355.3 billion in 2021, underscores this point.[7] The coronavirus pandemic highlighted supply chain reality. And the farther our supply chains migrate into the PRC, the greater our dependence will become.

As our import dependence on PRC-origin goods expands, we need consider the following question: Will the PRC government guarantee to the rest of the world fair and equitable access to its supply chains? The answer is a definitive "NO." We have already witnessed instances of the PRC's stranglehold over its trading partners. For example, the debt-trap deliberately created by the PRC's One Belt One Road scheme where African and South American countries, who were once lured by the PRC government's promises for substantial investment, have now been forced

[7] The deficit with China increased $45.0 billion to $355.3 billion in 2021. Exports increased $26.6 billion to $151.1 billion and imports increased $71.6 billion to $506.4 billion. *U.S. International Trade in Goods and Services, December 2021*, U.S. Department of Commerce Bureau of Economic Analysis (Feb. 8, 2022), available at https://www.bea.gov/news/2022/us-international-trade-goods-and-services-december-2021.

to give up their most valuable national assets (*e.g.*, mines, roads, and ports) in repayment.[8] These countries are now at the PRC government's mercy and, so far, their only recourse is to ask the United States and other countries for assistance. We – the United States, our North America allies, European and Asian partners – are all nearing this dangerous tipping point as well.

For those of us who have studied the PRC in-depth for decades, this is precisely the PRC government's end game: to deplete other nations of the resources necessary for self-defense by creating supply chain weaknesses and economic dependence. This PRC strategy, coupled with reports of the PRC government's endless intimidation of Taiwan, Japan, Australia, South Korea, and Lithuania, and the government's repeated threats of military attacks against the United States and its allies must make absolutely clear that we are not dealing with a friendly nation. The PRC government is a threat, and both the Trump and Biden Administrations have designated the PRC government as a "foreign adversary" along with the governments of the Republic of Cuba, the Islamic Republic of Iran, the Democratic People's Republic of Korea, the Russian Federation, and Venezuela's Nicolás Maduro Regime.[9] This designation means something.

To be clear, the United States, Europe, and the rest of the world are already in a very vulnerable position with respect to critical minerals and semiconductors supply chains. Without access to these goods, we have very little leverage over the PRC government, and our military capabilities are severely limited. This, then, leads to the obvious question: if the PRC government were to restrict global access to its critical mineral exports, as well as its own and Taiwan's semiconductor supply chains, what would be the economic impact and how would we respond?

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[8] Jeremy Mark, *China's Real 'Debt Trap' Threat*, Atlantic Council (Dec. 13, 2021), available at https://www.atlanticcouncil.org/blogs/new-atlanticist/chinas-real-debt-trap-threat/.

[9] *Securing the Information and Communications Technology and Services Supply Chain*, 86 Fed. Reg. 4,909, 4,911 (Dep't Commerce Jan. 12, 2021), available at https://www.govinfo.gov/content/pkg/FR-2021-01-19/pdf/2021-01234.pdf.

The economic impact to the United States will be in the trillions. Compounded by the economic impact across the rest of the world – the result will be catastrophic. Almost everything we manufacture or consume today, and all of our technological advancements, depend in some way on Chinese-processed critical minerals or Chinese and Taiwanese semiconductor supply chains. Without access to these materials, the global economy will come to an abrupt halt.

As to how we would respond, our response would be ineffective. Realistically, it will take a minimum of three to five years to scale production of critical minerals mining, extraction, and processing capabilities to wean dependence off the PRC. Additionally, it will take at least 10 to 20 years to recreate the vast semiconductor ecosystem that currently exists in the PRC and Taiwan, including the development of upstream raw material and chemical supply chains, as well as the back end assembly/testing/packaging capabilities, which are presently concentrated in the PRC and Taiwan.[10] During this transition period, our countries are vulnerable.

This is the point that most policymakers fail to realize. The PRC is leveraging its near monopoly over critical global supply chains to secure its ambitions for economic and military hegemony. We need to quickly reverse our vulnerabilities, and I urge the Commission and Congress to act before it becomes too late.

II. THE UNITED STATES MUST RETHINK ITS APPROACH TO NATIONAL SECURITY AND TRADE LAWS

For years, I have described the predatory economic tactics that the PRC government has systematically used to weaken our industries and economy, and I have often stressed that we do not adequately leverage our laws to counter these security threats. Appended hereto is my prior testimony on this topic. Today, however, my goal is to offer perspectives on how to cure our

[10] BCG/SIA 2021 Report at 19.

vulnerabilities in order to better protect our economies and technologies. The recommendations I provide may not all be easy. They will require sacrifices. But if we, as a nation, are resolute, we may be able to solve our weaknesses before it is too late.

Success will depend on open trade and reliance on the comparative advantages of the United States and our allies. Success will depend on our ability to work together to reconfigure supply chains out of the PRC. And success will depend on forging greater economic ties between like-minded partner countries. For the United States, the economic impact of moving our supply chains out of the PRC is approximately 1% of U.S. gross domestic product in the short-run. If we do this in concert with our European, Japanese, and South Korean allies, the economic impact is significantly lessened. After three to five years, any negative economic impact will turn into substantial gains for the United States and those gains will grow significantly. Overall, the benefit to the free world of disentangling from a predatory actor will be immeasurable.

A. Deterring Invasion of Taiwan

At the outset, one of the most immediate threats to global security is the PRC government's potential move on Taiwan, whether by military force, legal decree, or another mechanism. The PRC government's objective in obtaining control over Taiwan is to gain control over the island's semiconductor and electronics industries, and thereby gain almost absolute control over the global economy. In other words, control over Taiwan will allow the PRC government to bring the global economy to its knees.

Importantly, however, the United States still controls one of the most powerful weapons of the global economic order – the U.S. dollar. The dollar's special status as the global currency gives our nation unrivaled sanctioning power. Given that access to dollars is a near-necessity for multinational businesses and global financial institutions, the United States is able to impose significant economic damage by denying certain entities or governments access to the dollar.

Indeed, the sanctions that are currently pummeling the Russian currency, banks, and the internal economy are a vivid demonstration of the power of the U.S. dollar. Coupled with sweeping European sanctions, the United States and its allies are capable of imposing significant costs to the PRC economy through comprehensive financial sanctions on PRC banks should it take control of Taiwan.

It should be noted that the PRC government is now hastening efforts to reduce reliance on the U.S. dollar to protect itself from potential U.S. sanctions. It is simultaneously working to displace the dollar from serving as the global currency in favor of the Yuan. But it will take years for the Yuan to gain any significant foothold in the global economy. Until then, and while the dollar still maintains substantial influence, the U.S. Government should be prepared to use this economic lever as deterrence.

B. The U.S. Government Needs A Legal Mechanism to Recognize PRC Entities' Ties to the Central Government

Over the course of the past 10 years, the PRC government has steadily increased its control over Chinese companies. And by doing so, it has coerced companies to aid the central government in growing its military base, technological capabilities, and surveillance activities. It is well documented that the PRC government mandates and coerces – through law, administrative guidelines, and regulations – entities to transfer sensitive information, trade secrets, and intelligence information to the central government. In addition, PRC laws require that entities conform their practices to advance the Chinese Communist Party's ("CCP") military and surveillance interests.[11] Moreover, the PRC's Military-Civil Fusion strategy demands that entities

[11] USCBC, *Fact Sheet: Communist Party Groups in Foreign Companies in China*, China Business Review (May 31, 2018), available at https://www.chinabusinessreview.com/fact-sheet-communist-party-groups-in-foreign-companies-in-china/.

cooperate with the People's Liberation Army ("PLA") to advance the military strength and ambitions of the PRC government for global power. All Chinese entities, even those enterprises that still remain ostensibly private and civilian, are legally obligated to serve the state and the leadership of the central government such that Chinese entities have limited autonomy over their business decisions. The PRC government's routine installation of CCP officials inside private firms ensures compliance with the party's mandates.

The reality today is that Chinese entities operate in a military-driven ecosystem that is centrally coordinated by the CCP to advance the country's weapons capabilities, intelligence operations, and security apparatuses. The legal framework through which the PRC government forces entities to contribute to the modernization and expansion of the CCP's military industrial complex continues to expand rapidly and, therefore, poses a significant threat to the national security, foreign policy, and economy of the United States.

In light of the foregoing, it is surprising that the U.S. Government does not have a consistent legal framework across all federal agencies for finding affiliation between Chinese commercial entities and the PRC central government. In fact, it never has. Crippled by this lack of comprehensive legal framework, the U.S. intelligence community has been hampered in both its offensive and defensive capabilities, the U.S. Department of Defense is limited in the types of companies it can eliminate from supply contracts, and U.S. Government agencies are unable to legally prohibit procurement from CCP affiliates or prohibit U.S. investments in PLA affiliates.[12] However, if the U.S. Government had an actual legal framework to determine whether companies

[12] *E.g.*, through the U.S. Department of the Treasury's Chinese Military Industrial Complex companies. *See Non-SDN Chinese Military-Industrial Complex Companies List (NS-CMIC List)*, U.S. Department of the Treasury (Dec. 16, 2021), available at https://home.treasury.gov/policy-issues/financial-sanctions/consolidated-sanctions-list/ns-cmic-list.

are (1) controlled by the PRC government, or (2) affiliated with the PRC government, it could do more to protect U.S. industries, economy, and national security from their malign activities.

Accordingly, U.S. Government should develop a comprehensive, consistent, and complementary legal standard for evaluating the extent to which commercial and non-commercial PRC entities are controlled by or affiliated with their provincial or central governments. The lack of framework has, to date, significantly impeded the U.S. Government's analysis in export controls, foreign direct investment screenings (discussed further below), intelligence community risk assessments, federal government acquisitions, and supply chain vulnerability analyses. This shortcoming ought to be remedied, and the solution is quite simple. Congress should, by legislation, adopt the longstanding legal definitions of affiliation that exist in U.S. trade laws, through statute, regulations, and case precedent, and apply these definitions to augment the legal authorities currently existing across all federal agencies. The trade laws extend the definition of affiliation beyond ownership interests to the broad range of ways in which foreign governments are able to exercise influence over corporate entities' business operations such that the entities lose autonomy over key decisions. These trade laws have been upheld by U.S. courts for decades, are consistent with the United States' obligations under the World Trade Organization ("WTO") agreements, and will therefore withstand judicial scrutiny. It is axiomatic that the application of a comprehensive legal standard such as this would improve each federal agency's ability to maximize the use of its own existing authorities where a determination of affiliation is needed. Further, a consistent legal approach such as this would promote uniformity and predictability across the U.S. Government agencies' legal authorities and provide better clarity to businesses seeking regulatory approvals from various agencies.

C. The United States and Its Allies Should Rely More Heavily on Export Controls

The PRC's growth has been driven in significant part by U.S. companies as well as firms in allied nations racing to transfer technology to Chinese counterparts – many of which are controlled by the PRC government – in exchange for temporary access to the PRC market. The fact that the PRC government restricts access to its domestic market in exchange for technology transfer to individual companies confirms the extensive collusion and connection between PRC companies and their central government.

This technology-transfer trend has accelerated over the course of the past two decades and has resulted in so much technology transfer to the PRC that the PRC is now technologically neck-in-neck with the United States in many important sectors (*e.g.*, telecommunications and computers), and vastly ahead in others (*e.g.*, hypersonic weapons, artificial intelligence, genomics, and robotics). This is incredibly alarming. In order to solve this problem, we need to revise our current strategy.

1. The Need for a "Block" and "Run Faster" Approach

At the outset, the United States' export control community has traditionally pursued a competition strategy of "run faster" when it comes to developing export control policies.[13] The theory behind this strategy is that, by permitting exports of critical technologies to PRC entities, U.S. firms will gain access to the revenue needed in order to invest in next-generation technologies and stay ahead in the technology race. But this strategy has failed over the years. Although it takes our firms years, even decades, to develop new technologies, we are handing over these technologies to the PRC virtually overnight, allowing them to bypass the extended technology-development lead times and costs (including trial-and-error) that innovators endure. In other

[13] It is important to emphasize that export controls are not prohibitions on exports per se. They simply subject exports to a license review process.

words, our strategy has been to place the painstaking technology development burden on our own businesses, and then allow the rapid transfer of the resulting technology to adversaries enabling them to "run faster" than us. Two examples demonstrate the danger of the 'tech transfer for revenue' approach.

ASML is the Dutch photolithography company that developed the highly-advanced and one-of-a-kind extreme ultraviolet ("EUV") lithography tool that produces the most leading edge semiconductors in existence today. This tool was developed, in part, using U.S.-controlled technology. ASML is the only firm in the world that is capable of making these sophisticated machines,[14] and it has taken ASML 20 years to develop this tool with billions of dollars in investments.[15] If the PRC semiconductor industry were to acquire this machine, it would be able to reverse engineer it in three years, giving it a substantial boost in semiconductor development and solidify its position as a global leader. Indeed, the PRC semiconductor industry in 2020 surpassed Taiwan for the second year in a row in global semiconductor chip sales.[16] With this added EUV capability, along with the downstream assembly/packaging/testing ecosystem that the PRC government has developed, the PRC will be positioned to dominate the global chip industry likely by 2025.[17]

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[14] Sam Shead, *Investors are Going Wild Over a Dutch Chip Firm, And You've Probably Never Heard of It*, CNBC (Nov. 24, 2021), available at https://www.cnbc.com/2021/11/24/asml-the-biggest-company-in-europe-youve-probably-never-heard-of.html.

[15] Matthew Gooding, *ASML Might Be The Most Successful Tech Company You've Never Heard Of*, Tech Monitor (Aug. 6, 2021), available at https://techmonitor.ai/technology/future-of-asml-photolithography-semiconductor-chip-euv.

[16] *China's Share of Global Chip Sales Now Surpasses Taiwan's, Closing In on Europe's and Japan's*, Semiconductor Industry Association (Jan. 10, 2022), available at https://www.semiconductors.org/chinas-share-of-global-chip-sales-now-surpasses-taiwan-closing-in-on-europe-and-japan/.

[17] Tim De Chant, *The Chip Choke Point*, The Wire China (Feb. 7, 2021), available at https://www.euvlitho.com/Blogs/The%20Chip%20Choke%20Point%20-%20The%20Wire%20China.pdf; Robert Castellano, *3 Headwinds Facing ASML's Non-EUV Business in China*, Seeking Alpha (Mar. 22, 2021), available at https://seekingalpha.com/article/4415477-three-headwinds-facing-asml-s-non-euv-business-in-china, Misha Lu, *Is*

In comparison, the United States is lagging behind; we do not have the capability to produce all of the semiconductors required for our defense capabilities, let alone a substantial portion of our economy. We produce neither all of the upstream raw materials necessary to manufacture the chips, nor do we maintain an assembly/packaging/testing ecosystem to operationalize the chips. This is the fundamental problem. It will take 10 to 20 years to rebuild an on-shore and complementary near-shore semiconductor ecosystem to cure the United States' and our allies' dependence on the PRC and Taiwan. The PRC, by contrast, is only a few years away from independence.

The second example is the well documented PLA's advancements in hypersonic weapons, which was facilitated by the transfer of U.S. semiconductor technology to the PRC. To be clear, one U.S. company's technology transfer allowed the PRC military to race ahead of the United States, and that company's realized short-term profits now threatens our national security and the world's security.

Clearly, we need a different strategy – one that both blocks technology transfer and allows us to run faster. This means that we need more aggressive export controls on transfers of critical technology through the denial of export licenses to adversaries in the PRC. We also need to augment investments in U.S. innovation, as discussed further below.

2. Controls on Emerging Technologies

Although the Export Control Reform Act of 2018 ("ECRA") legislated the protection of "emerging technologies" through the use of export controls,[18] the debate continues in the U.S. Government as to the most effective way to implement ECRA's mandates and restrict such

Huawei Making its Own Lithography Equipment, Tech Taiwan (June 9, 2021), available at https://techtaiwan.com/20210609/huawei-duv/.

[18] Export Control Reform Act, H.R. 5040, 115th Cong. § 106 (2018).

exports. At the outset, there is widespread recognition that emerging technologies are most vulnerable to foreign acquisition when they are at the nascent stages of development. Congress recognized this reality when it used the term "emerging" in ECRA. Indeed, at the nascent stage of development, the full range of applications that may arise from new technologies are seldom identified. Because Congress recognized this uncertainty, it instituted regulatory controls over their exports given that the same technologies that wield the power to drive significant advancements in the commercial sector may also be exploited for both known and yet-to-be known dangerous uses by foreign adversaries. Artificial Intelligence is a perfect example of this intersection.

My understanding is that the U.S. Government appreciates the enormous difficulty associated with the task of identifying "emerging technologies" for export controls when those technologies and their applications are constantly evolving. The Government further recognizes that, in order to move forward with controls, it must decide between two very different types of regulatory approaches. The first option is to wait until "emerging" technologies develop into somewhat better understood, more "mature" technologies in order to be more precisely defined for controls (in much the same way that most technologies are identified on export control lists). Alternatively, the U.S. Government has the option of acting more swiftly by delineating and controlling broader categories of technologies as "emerging technologies" under ECRA.

I do not believe that the U.S. Government has abandoned either option to date, even though there are downsides associated with each. The former approach, whereby "emerging technologies" are narrowly defined, risks additional delay in instituting controls that are presently needed. Moreover, by attempting to define technologies that are not yet fully understood with a high degree of specificity, the Government may inadvertently omit necessary technologies from

control. A too-narrow definition also increases the likelihood of circumvention by technology developers who may be able to reconfigure their technologies in minor ways in order "design out" from the scope of controls. On the other hand, the alternative approach of adopting a broader definition of "emerging technologies" – while it allows for the more expeditious implementation of licensing requirements – runs the risk of regulating more exports than necessary to protect national security. To the extent the U.S. Government adopts either option, it should consider imposing licensing requirements for only exports of emerging technologies to entities and/or countries that pose the most significant national security risks. To the extent that the acquisition of emerging technologies by U.S. allies does not pose risks, allies could be exempt from licensing requirements. This approach additionally eases the licensing burden on federal agencies and U.S. businesses.

3. Exports to Countries that Do Not Permit Adequate End-Use Checks

The U.S. Government also needs to better control technology transfers to countries with inadequate "End-Use Checks," like the PRC. End-use checks are mechanisms by which U.S. Government officials conduct on-site audits of foreign recipients' ("end users") use of controlled items to determine whether the items are being used in accordance with the terms and conditions associated with the U.S. Government's export authorization.

Today, in order for the U.S. Government to conduct an end-use check of any PRC entity, it must notify the PRC government of its intent and seek the government's authorization in advance of the actual check. Often, end-use checks are not permitted for weeks. This affords the PRC government ample time to tamper with the end user's records in order to obfuscate any evidence of export control violations. The PRC government and its companies are notorious for falsifying records and diverting exports of controlled items to unauthorized end users within the PRC (*e.g.*,

the PLA, military end users) and countries abroad (*e.g.*, Iran). The U.S. Government needs to take this reality into account.

If the U.S. Government does not have full confidence in its ability to conduct thorough and transparent end-use checks in the PRC, then it should not authorize exports of sensitive items to the PRC at all. At a minimum, the Government ought to adjudicate export licenses to the PRC under a "presumption of denial" evaluation criteria rather than the current "case-by-case" criteria, which is normally enjoyed by firms in nations that authorize end-use checks by U.S. officials and otherwise fully comply with U.S. export laws. The PRC should not be subject to the same license review criteria as fully-cooperating partners. This policy needs to change.

4. Entity List License Review Criteria

The U.S. Government should also update its Entity List policy. The Entity List (found in Supplement No. 4 to Part 744 of the Export Administration Regulations ("EAR")[19]) "identifies entities for which there is reasonable cause to believe, based on specific and articulable facts, that the entities have been involved, are involved, or pose a significant risk of being or becoming involved in activities contrary to the national security or foreign policy interests of the United States."[20] Where the U.S. Government determines that reasonable cause exists, it may include a parent company, as well as its affiliates, on the Entity List.[21]

For items subject to the EAR, the entity listed companies are generally prohibited from receiving U.S. exports absence a license from the U.S. Commerce Department, and the majority

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[19] 15 C.F.R. § 744.16, available at https://www.ecfr.gov/current/title-15/subtitle-B/chapter-VII/subchapter-C/part-744/appendix-Supplement%20No.%204%20to%20Part%20744.

[20] *Clarification of Entity List Requirements for Listed Entities When Acting as a Party to the Transaction Under the Export Administration Regulations (EAR)*, 85 Fed. Reg. 51,335 (Bureau of Indus. and Sec. Aug. 20, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-08-20/pdf/2020-17908.pdf.

[21] 15 C.F.R. § 744.11(b).

of export licenses to Entity List companies are subject to a "presumption of denial" license review policy. The legal threshold for including entities on the Entity List is by design a flexible standard so that the U.S. Government has improved ability to curtail these entities' harmful actions through export licenses.[22]

Today, there are a number of entities on the Entity List where U.S. exports are subject to an export license review policy of "case-by-case" or "presumption of approval," rather than the "presumption of denial" policy. These more lenient license review criteria obviate the punitive impact of a company's designation on the Entity List. It makes no sense to place a PRC entity on the Entity List for having engaged in malign activities if, through the designation, the entity is able to benefit from the same or better export-license adjudication procedures than non-harmful actors.

Congress has, in the past, requested license review and approval statistics for PRC companies on the Entity List and has been surprised by the large number of export licenses approvals to Entity Listed companies. This is the reason.

5. Unilateral Versus Multilateral Controls

It is also worth pointing out that the notion of consistently favoring a multilateral approach for export controls over a unilateral approach may not always be justified and may ultimately impede the implementation of much-needed controls to safeguard national security. The reality is that not all countries are able to move in lock-step with the United States by imposing controls at the same speed, same scope, same manner, and at the exact same time.

[22] Company-specific Entity Listings are not a substitute for item-specific export controls. An Entity Listing regulates exports of many items to a specific entity (*e.g.*, SMIC, Huawei), whereas the control list designation regulates exports of a particular item to all entities in various countries. These authorities are not substitutes and should not be used interchangeably.

Most countries' economic exposure to the PRC and geopolitical vulnerabilities are far greater than the United States', and these exposures necessitate a different approach to controls. For example, Europe is far more economically entangled with the PRC, and South Korea and Japan are far more geographically vulnerable. In light of this reality, it makes little sense for the U.S. Government to continuously demand multilateral export restrictions and expect allies to consistently act in unison in order for it (the U.S. Government) to act. Again, this delays the implementation of controls to protect U.S. national security.

Where the United States has the will and ability to impose controls in advance of its allies, it should do so and with faith that our allies will likely follow our lead. This is exactly what happened when the United States imposed restrictions on U.S. exports to Chinese telecom giant Huawei Technologies Co., Ltd. ("Huawei") several years ago. Had the U.S. Government pursued export restrictions multilaterally, the restrictions would never have been imposed.

For reference, in May 2019, the United States placed Huawei on the Entity List for its violation of U.S. financial sanctions against Iran.[23] The U.S. business community responded with outrage because it argued that foreign countries would increase sales to Huawei and displace U.S. business opportunities. Businesses, in effect, complained that America's allies would work against U.S. interests. But that is not what happened. In fact, the exact opposite occurred.

Soon after the U.S. Government placed Huawei on the Entity List and restricted exports to Huawei under a "presumption of denial" export license review policy,[24] America's allies began pulling back sales to Huawei. Not because they were legally obligated to do so, but because it was

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[23] *Addition of Entities to the Entity List*, 84 Fed. Reg. 22,961 (Bureau of Indus. and Sec. May 21, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-05-21/pdf/2019-10616.pdf.

[24] The license review policy was subsequently changed in August 2020 to a "case-by-case" license review criteria for most exports.

the correct course of action. Yet they did not pull back publicly. Each country, given its own unique economic and political circumstance, retreated from Huawei in its own manner, most often quietly and without any public fanfare. In fact, the United States' unilateral action caused a multilateral ripple effect among our allies, and by our giving them "top cover," our allies followed suit. The result, of course, was the crushing defeat of Huawei's smartphone business.[25]

This example illustrates that, when coordinating export controls with allies, we need not always move in in perfect synchronicity. The United States should, whenever necessary, act to protect its national security interests and be assured that our allies will follow, albeit at their own pace and through their own legal mechanisms.

6. Secondary Sanctions as a Tool

Secondary sanctions should also be leveraged as a viable economic tool. The U.S. Government and Congress receive substantial information on a regular basis – whether through intelligence reporting or public news outlets – of sanctions violations by PRC entities. Under U.S. laws, violations of U.S. sanctions are punishable by the imposition of secondary sanctions. Yet, the U.S. Government has, to date, been reluctant to punish PRC companies for such violations. Presumably, the reason for this is the extent of American companies' financial exposure to the PRC.

Therein lies the irony of the U.S. Government's policies. The U.S. Government, on one hand, is unable to hold PRC entities accountable for undermining U.S. national security interests and, on the other hand, permits businesses to transact with harmful entities even though doing so

[25] Rob Thubron, *Huawei experiences largest-ever revenue fall as sanctions crush its consumer division*, Tech Spot (Aug. 6, 2021), available at https://www.techspot.com/news/90696-huawei-sees-largest-ever-revenue-fall-sanctions-crush.html.

fuels the PRC's growth. Further, our refusal to impose secondary sanctions also emboldens PRC entities to continue undermining U.S. interests.

Our policies need to change. Secondary sanctions need to be used to address activities that undermine U.S. national security interests.

7. Revenue Substitution – Away from the PRC and Towards Allies

Finally, we should dispel the prevailing notion that U.S. businesses need revenue from sales to the PRC in order to invest in next-generation technologies and survive economic competition. Indeed, any revenue lost from sales to the PRC may be replaced (and even augmented) by increasing sales within the United States and to nations of allies. It makes no sense to invest in the supply chains of an adversary instead of our own. We must build our own supply chains, as well as our allies', in order to achieve much-needed redundancies in our most critical supply lines. Furthermore, redundancy is essential where supply chains are most vulnerable. The U.S. Government should support investments to build supply chains domestically and with allies.

D. Regulating Foreign Direct Investment ("FDI") Flows

The U.S. Government needs to better regulate FDI flows that harm U.S. economic and national security interests.

1. Delayed Reviews of FDI in Existing Critical Technology Businesses

The Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") represented a major milestone in protecting national security by providing the Committee on Foreign Investment in the United States ("CFIUS") with enhanced authority to protect "critical technologies" from foreign acquisition through FDIs. However, nearly four years into its enactment, the U.S. Government has not yet been able to fully utilize this new authority. This is because FIRRMA's definition of "critical technologies" rests in large part on ECRA's

identification of "emerging technologies," and until the U.S. Government makes progress on this issue, gaps in our national security laws persist.

Here too, the question of whether to narrowly or broadly define "emerging technologies" (as explained above) has important implications in the context of reviews of FDI transactions. On one hand, a broader definition would subject a wider range of transactions to FIRRMA authority, thereby giving the U.S. Government increased visibility into U.S. FDI activities and greater authority to restrict those that threaten national security. On the other hand, it is argued that increased regulatory oversight will deter FDI flows into the United States. To address this latter concern, the U.S. Government could consider limiting mandatory filing requirements to only those entities and/or countries that pose the most significant threats to U.S. national security. This would decrease regulatory burdens on U.S. businesses and ultimately reduce the volume of transactions subject to review by federal agencies. A broader definition applied to a narrow set of countries is the most effective and efficient national security approach.

Whichever option the U.S. Government pursues has serious implications. But the ultimate point here is that the U.S. Government needs to make substantial progress in its identification of "emerging technologies" under ECRA and "critical technologies" under FIRRMA. Movement on these fronts will give businesses some clarity going forward and enable the U.S. Government to better exercise the legal authorities it possesses to protect national security. The exercise of those authorities has, for nearly four years, languished.

2. Merits of Outbound Investment Reviews

In much the same way that FIRRMA and its predecessor, the Foreign Investment and National Security Act of 2007, imposed national security reviews on inbound FDI transactions, Congress seems to be considering similar legislation for outbound investments to high-risk countries. New legislation could call for CFIUS-type reviews of U.S. capital flows to foreign

markets – whether through public exchanges or private equity – for national security risks. Again, to lessen the burden on U.S. businesses in filing notices of such transactions for federal agency review and to ease the workload for U.S. Government agencies adjudicating such transactions, the scope of reviews could be limited to outbound transactions involving only foreign entities and/or countries that pose the most significant national security threats.

To the extent there is any question as to whether such investment review restrictions are warranted, we should be clear about how urgent the situation has become. At the end of 2020, U.S. investments in in PRC companies totaled, by investment type:

- U.S. Entity List Companies: $48.6 Billion
- PRC State-Owned Enterprises: $152 Billion
- PRC Military End User and Chinese Military Companies: $54 Billion
- Telecommunications: $43 Billion
- Robotics: $1.3 Billion
- Biotechnology: $50.4 Billion
- Artificial Intelligence: $221 Billion
- Surveillance: $3.8 Billion
- Aerospace and Defense: $1.3 Billion
- Semiconductors: $21 Billion
- Pharmaceuticals: $31 Billion

In total, U.S. public and private equity investments in Chinese domiciled companies totaled over $2.3 trillion dollars in market value of holdings at the end of 2020.

Obviously, the flow of U.S. capital to the PRC is continuing to fund the PRC government's malign activities globally and aiding the PLA's military buildup. Furthermore, to the extent that these transactions are enabling the development of technology that is beyond U.S. export control jurisdiction – *e.g.*, American companies developing technologies abroad through joint ventures with the PRC – restrictions on dangerous activities may be necessary to protect U.S. national

security interests. To quote Senator Casey, "As China becomes increasingly aggressive in its willingness to manipulate supply chains for its own gain, the United States must take steps to protect our national and economic security interests."[26] Indeed, it is not U.S. corporations' responsibility to protect U.S. national security, it is the Government's. Hence, Congress should pass this legislation to protect critical national capabilities.

3. Reconsidering CFIUS Mitigation Agreements with the PRC

The U.S. Government's CFIUS "mitigation agreement" policy also warrants reconsideration in light of the PRC government's laws mandating that Chinese and foreign companies transfer sensitive intellectual property, proprietary commercial secrets, and personal data to the central government and the PLA. Among the relevant PRC laws are:

- **National Security/Intelligence Laws:** mandating the transfer of data, information, and technology to the PRC authorities.[27]
- **Cybersecurity Law:** mandating that network operators cooperate with public security organs. [28]
- **Cryptography Law:** eliminating "core function exemption" for products with encryption as general features. [29]
- **Data Security Law:** empowering CCP authorities to demand data from companies and requires companies to "favor economic and social development in line with the CCP's social morality and ethics." [30]

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[26] Senator Bob Casey, *China Commission Report Includes Recommendation to Implement Casey-Cornyn Outbound Investment Policy*, Bob Casey U.S. Senator for Pennsylvania (Nov. 17, 2021), available at https://www.casey.senate.gov/news/releases/china-commission-report-includes-recommendation-to-implement-casey-cornyn-outbound-investment-policy.

[27] *Data Security Business Advisory: Risks and Considerations for Business Using Data Services and Equipment from Firms Linked to the People's Republic of China*, U.S. Department of Homeland Security (Dec. 22, 2020) at 6-7 ("DHS Advisory"), available at https://www.dhs.gov/sites/default/files/publications/20_1222_data-security-business-advisory.pdf.

[28] Lauren Maranto, *Who Benefits from China's Cybersecurity Laws?*, Center for Strategic & International Studies (June 25, 2020), available at https://www.csis.org/blogs/new-perspectives-asia/who-benefits-chinas-cybersecurity-laws.

[29] DHS Advisory at 8-9.

[30] *Id.* at 7-8.

- **Export Control Law:** prohibiting exports of "important data," essentially any information outside of China, even if that data originated from a foreign country, including a U.S. business.[31]

These laws appear to apply to all companies operating in the PRC, regardless of nationality and, in some instances, they also appear to have extraterritorial application, reaching to corporate operations abroad. In the CFIUS context, these laws likely trump the U.S. Government's mitigation agreements.

In reviewing transactions for national security risks, CFIUS commonly enters into agreements with parties in order to mitigate any national security risk resulting from the transfer of information, data, or technologies from the United States to the foreign acquirer. However, when the foreign acquiror is a PRC entity that is also subject to its own governments' data transfer requirements, that entity cannot logically be expected to abide by both the U.S. mitigation agreement and the conflicting PRC government laws. In other words, when a conflict exists between CFIUS's prohibitions on information transfer and the PRC's mandate for data transfer, there is simply no way to adhere to both requirements.

Of course, the PRC government has levers to compel cooperation with its own laws instead of the United States' requirements. One example is the PRC government's nationwide social credit rating system that applies to all corporations for the purposes of detecting misconduct and non-compliance with PRC government rules.[32] The "Corporate Social Credit System" has implications for companies with respect to proprietary technical information, sensitive personal data, and

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[31] Ck Tan, *China's Export Control Law to Become 'Key Dynamic' in U.S. Relations*, Nikkei Asia (Dec. 1, 2020), available at https://asia.nikkei.com/Economy/China-s-export-control-law-to-become-key-dynamic-in-US-relations.

[32] *See, e.g.*, *China's Corporate Social Credit System*, Congressional Research Service (Jan. 17, 2020), available at https://crsreports.congress.gov/product/pdf/IF/IF11342; Kendra Schaefer, *China's Corporate Social Credit System: Context, Competition, Technology and Geopolitics*, Trivium China (Nov. 16, 2020), available at https://www.uscc.gov/sites/default/files/2020-12/Chinas_Corporate_Social_Credit_System.pdf.

surveillance information. Companies may be given low scores if they fail to transfer their data to the PRC government as part of their obligations. Failing to score well, by non-compliance with the PRC government's policies or demands, may subject companies to myriad sanctions, including higher taxes or permit difficulties, or a blacklisting which could mean financial ruin for that entity. The European Chamber of Commerce describes this credit rating system as potentially amounting to "life or death" for companies.[33]

The U.S. Government and Congress must account for the PRC's enormous control over companies and evaluate the effectiveness of the CFIUS agreements. Until the U.S. Government is able to resolve the conflicts described above, it should not permit mitigation agreements for any PRC transactions.

4. The Need for National Security Reviews of Greenfield Investments

Unregulated greenfield investments in the United States also pose very real risks to our national security interests. While CFIUS jurisdiction currently extends to certain real estate transactions that are located within certain geographical areas, for example, certain pre-defined military installations,[34] "greenfield" investments are not broadly subject to CFIUS jurisdiction. This is an enormous gap in our regulations.

Today, malign actors are able to acquire real estate in the United States and use this asset to harm the U.S. interests in a variety of significant ways. Examples include (1) the disruption of regional economic commerce by interfering with critical supply chains (*e.g.*, agriculture, transportation, telecommunication); (2) the displacement of U.S. manufacturers through economic

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[33] *European Chamber Report on China's Corporate Social Credit System, A Wake-Up Call for European Businesses in China*, European Chamber of Commerce (Aug. 28, 2019), available at https://www.europeanchamber.com.cn/en/press-releases/3045/european_chamber_report_on_china_s_corporate_social_credit_system_a_wake_up_call_for_european_business_in_chin.

[34] 31 C.F.R. §§ 800.213, 802.212.

distortive trade activities (underpricing or overproduction to eliminate competition); (3) the acquisition of sensitive personally identifiable information about the general population (*e.g.*, genetic, biometric data); (4) the use of soft power and political propaganda to undermine U.S. democracy (*e.g.*, political promotion programs and media); (5) mass surveillance of U.S. populations (through the establishment of hotels, medical, and service oriented businesses); and (6) the disruption of the energy grid through the transmission of malicious code (*e.g.*, through malicious software in electric vehicle charging stations or smart homes that connect to the grid). These are just a few examples.

President Biden has already warned the American public that the PRC government has been conducting large-scale cyberattacks against the United States.[35] Indeed, some of these threat vectors are coming from within our own boarders. In 2014, the China Rail Rolling Stock Corp. ("CRRC"), a PRC state-owned enterprise, built a passenger rail assembly plant in Springfield, Massachusetts. Over time, this investment destroyed U.S. competition in the rail car market. The CRRC now has passenger rail cars in the U.S. North East, Midwest, and West Coast and it is able to leverage these assets to conduct massive surveillance operations over major U.S. populations and control the movement of the public. Presently, the CRRC controls more than 83% of the global rail market, and the company has publicized its aim to dominate the remainder of the world market as well.[36]

Of course, FDI is capable of delivering enormous benefits to an economy. But the U.S. Government must be aware of the risks posed by malign investors as well. The time is ripe to

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[35] Sean Keene, *Biden Administration Blames China For Microsoft Exchange Email Hack*, C Net News (July 19, 2021), available at https://www.cnet.com/news/privacy/biden-administration-blames-china-for-microsoft-server-hack/.

[36] David C. Lester, *Rail Security Alliance Expresses Concern about CRRC to U.S. Dept. of Defense*, RT&S (June 9, 2021), available at https://www.rtands.com/passenger/rail-security-alliance-expresses-concern-about-crrc-to-u-s-dept-of-defense/.

expand CFIUS jurisdiction to greenfield investments. Even though the U.S. Government will never be able to entirely eliminate all threat vectors from its borders, it must do a better job of addressing the range of threats that exist right now.

E. Trade Remedy Laws Must Be Improved to Protect Injured U.S. Industries

Substantial improvements must also be made to existing U.S. trade remedy laws to better protect injured U.S. industries and provide American businesses with the support needed to re-grow.

1. The PRC's Distortion of the Surrogate Country and Surrogate Value Methodology

From the early 2000s, following the China's 2001 accession to the WTO, the PRC government began an aggressive push to erode U.S. industries through predatory pricing practices. Trade with China increased over the years, and the number of trade disputes grew exponentially.

Presently, the United States has over 223 trade remedy cases against the PRC versus a total of 441 cases against all other nations combined.[37] This is astounding, and the level of harm inflicted by PRC exporters through their underpricing behavior is the most significant of any other trading nation. What is more, the number of complaints against the PRC continues to increase well into the its third decade of WTO accession. This tells us something very important: that the PRC is continuing to take advantage of the multilateral trading system in order to displace competitors from the global market.

While the United States currently maintains a robust set of trade remedy laws (antidumping and countervailing duty laws) to offset unfair trade and "level the playing field" for domestic

[37] United States International Trade Commission Website, available at https://www.usitc.gov/.

manufacturers, many of the policies that the U.S. Government pursues to carry out these laws need to be updated to address the PRC's growth.

One of the most compelling areas for change is the manner in which the U.S. Government selects "surrogate" countries in dumping proceedings to value goods produced by the PRC. Because the PRC is a non-market economy, the U.S. Government relies on third country prices, or "surrogate country" prices to value the cost of production in the PRC (which is then compared to U.S. prices to measure unfair dumping). However, because PRC goods have penetrated global markets so aggressively, it is nearly impossible to find a surrogate country that has not been adversely affected by the PRC's predatory pricing. Prices around the world have been depressed so extensively that virtually all benchmark prices in trade cases are now understated and inadequate for measuring underselling by the PRC.

The result is that the tariffs ultimately imposed by the U.S. Government on Chinese imports to offset dumping are inadequate to "level the playing field," and consequently proper relief is denied to American firms. The U.S. Government must update its tools to more effectively prevent harms to the domestic industry. The present system is failing.

2. Creation of An Innovation Fund

Finally, Section 301 of the Trade Act of 1974, as amended, provides a remedy against country-specific unfair trade practices, and action is permissible if the United States Trade Representative determines that U.S. rights under a trade agreement are being denied, or a practice by a foreign country violates or is inconsistent with a trade agreement, or is unjustifiable and burdens or restricts U.S. commerce.[38] If such a finding is made, Section 301 authorizes the U.S.

[38] Section 301 of the Trade Act of 1974, as amended (19 U.S.C. § 2411).

Government impose a range of remedial trade measures, including, but not limited to, the imposition of tariffs on the goods of the foreign country.

It has been rumored that the United States may be considering, in addition to the current Section 301 tariffs imposed on PRC goods (*i.e.*, tariffs ranging from 7.5% to 25% on specific imports),[39] additional tariffs in response to the PRC government's use of industrial subsidies. That is, if a new Section 301 investigation determines that such industrial subsidies have harmed U.S. interests.

If new Section 301 tariffs are pursued, then the U.S. Government should consider shifting the tariff payment responsibility on to PRC exporters rather than U.S. importers. Currently, U.S. Customs and Border Protection requires that the "importer of record" (which may be the U.S. importer or foreign exporter) pay tariffs on imported goods. However, often for the payment of Section 301 tariffs, PRC exporters pressure U.S. importers to bear the costs. If, however, the responsibility for the Section 301 tariffs were legally placed on the PRC exporter, it would relieve the U.S. importer of this financial burden. Through a Presidential Proclamation, the U.S. Government could legally require PRC exporters to be liable for 301 tariffs.

Furthermore, the U.S. Government should consider using the tariff revenue collected to create an "Innovation Fund" dedicated to capitalizing high-technology U.S. industries. The fund should ideally be used to assist U.S. manufacturers and innovators, including high-end semiconductor technology companies and infrastructure companies, obtain a strong foothold in the U.S. market through augmented research and development investments and facility builds. The U.S. Government has collected well over $100 billion in Section 301 tariffs since their original

[39] Section 301 tariffs were imposed by the United States on imports from the PRC to recoup the approximately $50 billion a year economic harm to the U.S. economy caused by the PRC's intellectual property theft. *See Section 301 Tariffs on Goods from China: International and Domestic Legal Challenges*, Congressional Research Service (April 5, 2022), available at https://crsreports.congress.gov/product/pdf/LSB/LSB10553.

imposition in 2018, and these tariffs, in addition to any new ones, should be directed at growing and catalyzing U.S. innovation and industry growth. The revenue stream certainly exists, and so the U.S. Government should leverage this opportunity to support the nation's industrial and engineering advancements.

III. CONCLUSION

I would like to conclude with a one final note. The world may very well be on the brink a new national security crisis. In order for the United States to lead and defend our nation and our allies, we must have a robust economy, a strong manufacturing base, and the protection of critical assets and technologies. Our vulnerabilities are currently significant, and we need to quickly make important decisions to solve them. Time is not on our side and the challenge ahead of us is enormous.

I look forward to your questions.

ATTACHMENT

July 30, 2020

Statement of Nazak Nikakhtar
Assistant Secretary, International Trade Administration, Industry & Analysis
U.S. Department of Commerce

Before the
Senate Committee on Commerce, Science, and Transportation
Subcommittee on Security
"The China Challenge: Realignment of U.S. Economic Policies to Build Resiliency and Competitiveness"

Good morning. Chairman Sullivan, Ranking Member Markey, and Members of the Subcommittee, thank you for providing me the opportunity to testify today regarding the United States' economic relationship with the People's Republic of China (PRC). We are at historic cross-roads in the U.S.-China relationship, as the steps we take now will chart the course for U.S. economic and technological leadership, and will shape the landscape for the democratic world for decades, and possibly centuries to come.

The Department of Commerce's International Trade Administration is responsible for strengthening the competitiveness of U.S. industry in the United States and global marketplace, increasing investments in America, monitoring compliance with U.S. trade agreements, and enforcing U.S. trade laws. At Industry and Analysis (I&A), we are, in particular, responsible for working with businesses to develop international trade and investment strategies for a range of industries from the manufacturing sector to the financial services sector, including industries that are critical to the United States' national security interests. I&A also leads the Commerce Department's participation in the Committee on Foreign Investment in the United States (CFIUS), a committee that reviews certain specific foreign investments and real estate transactions in the United States for their impact on U.S. national security.

Today, I would like to speak about challenges to the United States' national security industries and set the stage for the successful commercial growth of our most critical sectors. In 2017, the U.S. Government began, for the first time, to confront head-on the challenges posed by China's predatory practices. Those challenges had been ignored for decades and, as a result, over the course of the past 40-plus years, the United States has continuously lost capabilities in sector after sector in manufacturing, technology, and services that are essential to our national security. In goods alone, the offshoring of manufacturing has created supply chain vulnerabilities across hundreds of critical products, ranging from semiconductor and electronics manufacturing to the development of active pharmaceutical ingredients. This has led to job losses of between 3.4 to 3.7 million between 2001 to 2018.[1] In key sectors such as communications equipment, electronics and computer technology, we ceded up to 40 percent of

[1] Scott, Robert; Mokhiber, Zane, Economic Policy Institute, "*Growing China Trade Deficit Cost 3.7 Million American Jobs Between 2001 and 2018*," (Jan. 30, 2020) https://www.epi.org/publication/growing-china-trade-deficits-costs-us-jobs/; *also* Census Data and Department of Commerce calculations.

the domestic market share to Chinese imports, and globally China has captured 40 percent of market share in those sectors as well.

To underscore with examples of where that leaves us, the United States does not have the domestic supply chains required to manufacture many key electronic components for our telecommunications systems, or many active pharmaceutical ingredients for medicines to serve America's health needs. Nor does the United States process the rare earth elements that produce magnets that are essential for military and weapons uses, as processing is now dominated by China. Even the more mature steel and aluminum industries have been experiencing existential challenges, as global overcapacity continues to weaken American firms. Where the United States was once the undisputed leader in technological innovation and industrial advancements across the board, it is now struggling to remain competitive in many key industries.

There are two classes of state actors in the global economy. The first class is comprised of nations that generally adhere to their obligations under the rules and principles of the global economic and trading system, as enshrined in international organizations such as the United Nations, International Monetary Fund, Organization for Economic Cooperation and Development, and the World Trade Organization (WTO). The second class is comprised of nations that either do not adhere (or selectively adhere) to these rules and norms, or actively circumvent them. While both classes of nations can introduce distortions into the global economic order – for example, through corporate subsidies and discriminatory nontariff barriers – the distortions can be managed when dealing with rules-based state actors and market-oriented economies. Here, international agreements may provide viable legal mechanisms to address non-competitive, market-distorting behavior, and states have historically adhered to their binding commitments or improved their practices when compliance fell short.

The Chinese Communist Party (CCP), on the other hand, does not just fall within this second class of state actors. It is also, by far, the most distortive economic actor that the global trading system has ever encountered. Not only are the current rules of international trade and monetary policy largely ineffective when dealing with China but, as a non-market economy under the tight control of the CCP, the government of the People's Republic of China flagrantly flouts those rules when it believes it is in its interest to do so, and shows no intention of reforming to a market-based system or adhering to its international obligations when those rules frustrate its national industrial goals. And because of China's size and scale, it has been able to weaken international supply chains and disrupt the global economy significantly. In this respect, the threat from China is formidable, and it is the largest threat the United States has encountered to date.

But we need to remember that this threat is nothing new, it has its roots in the Cold War. Khrushchev famously said "We," meaning the Sino-Soviet bloc, "declare war upon you," the United States, "in the peaceful world of trade. We will declare a war; we will win over the United States." Again, quoting from the Prime Minister of the Soviet Union, "We," again referring to the Communist states, "value trade less for economic reasons and most for political reasons." The hearing transcript for the Trade Act of 1962 includes these powerful statements. Perhaps in response to this threat, in the "Statement and Purpose" subsection of the Trade Act of 1962, 19 U.S.C. 1801, Congress explicitly enacted into law the goal of Chapter 19; it is *inter*

alia, "through trade agreements affording mutual trade benefits" to "prevent Communist economic penetration." This provision is still valid today precisely because the threats continue today. And after 1979, when the United States formally normalized trade relations with China, the PRC government accelerated its plan to augment global economic and military strength in a quest that it concedes will ultimately lead to a great power struggle against the United States.

The PRC government's weapon of choice is predatory economic tactics, and it has successfully used such tactics to disrupt global supply chains and weaken the technological advancements of the United States and its Western allies. China has transformed itself into the epicenter of global commerce, has centralized manufacturing and research and development (R&D) hubs within its own borders and, with this, it has accumulated the power to influence all economies that are dependent on it.

CHINA'S USE OF PREDATORY ECONOMIC TACTICS TO CAPTURE CRITICAL SUPPLY CHAINS AND TECHNOLOGY

In order to understand the PRC government's predatory economic strategy, it is important to understand the specific trade tools that it deploys. Indeed, China's most effective tools, by design, are those that are governed by weak or non-existent international rules and disciplines. To understand a "strategic competitor" or an "adversary," one has to understand their tactics. To counter those tactics, we need to consider how our laws need to be strengthened.

Case in point: China's economy has grown in large part because of the massive subsidies it provides to industries, and the lack of transparency on the subsidies it provides results from its failure to notify them completely to the WTO, as well as the absence of effective WTO rules governing the types of market-distorting industrial subsidies used in China.[2] It is difficult to legally challenge what we do not know about or what the rules do not cover. Moreover, China leverages its self-designated developing country status to avoid complying with existing WTO rules and obligations, and WTO rules are generally silent on how a member state can challenge another country's self-designated status.

Next, the PRC government takes advantage of the absence of applicable international rules over state-owned enterprises (SOEs) to funnel massive amounts of capital and other resources to SOEs with the well-publicized intent of dominating strategic sectors worldwide. The PRC government also distorts prices and costs throughout its economy (e.g., land and property, energy, wages, and raw materials) through direct price controls and to export undervalued goods and services worldwide, thereby weakening the competitive positions of

[2] Examples include Chinese government subsidies that constitute unlimited guarantees to corporations, subsidies to insolvent or ailing enterprises lacking credible restructuring plans (also known as "zombie" companies), subsidies that encourage global overcapacity, subsidies to firms unable to obtain long-term financing from independent commercial sources that are operating in sectors or industries in overcapacity, and direct debt forgiveness.

market-based firms. Dangling possible access to China's large consumer market and making available cheap labor, goods and services are also how China lures foreign manufacturing capacity and technological know-how into its own borders. And as the CCP controls the government of a sovereign state, it knows full well that its non-market economic system is unaffected by legal challenges or the prospect thereof by the rest of the world; even possible losses of legal challenges at the WTO may not be incentive enough to compel China to reform a system that has served it so well and eroded the competitive positions of its adversaries so quickly.

Just as alarming, the PRC government takes advantage of the dearth of rules governing global overcapacity to flood world markets with distortedly low-priced goods. In 2019, China's overcapacity significantly depressed global prices in the fiber optical cable market. Its strategy is to eliminate competitors and obtain absolute control over this critical 5G infrastructure asset. The PRC government has previously deployed the same strategy in the steel and aluminum sectors, among many others, and the same strategy will create excess capacity in new sectors in the future. And notwithstanding the fact that the 2020 coronavirus pandemic has dramatically reduced demand for steel and aluminum products worldwide, China has once again ramped up steel and aluminum production and dramatically increased inventories, contributing to drastic global price depression. This illustrates the national security threat to our steel and aluminum industries and why the President imposed Section 232 tariffs to address the impact of overcapacity and the threat posed by steel and aluminum imports. Outside the United States, however, the global surge continues and China's actions are still destabilizing the global steel and aluminum industries.

The PRC government is further exploiting opportunities abroad to monopolize strategic ports and mines (among other assets). State-backed Chinese investors own 10 percent or more of equity in ports in Europe, and it has major deals in Greece, Italy, Spain, France, the Netherlands, and Belgium. This is in addition to a growing number of investments in more than 40 ports in North America, South America, Eastern Europe, the Middle East, Africa, Central Asia, South and Southeast Asia, Australia, and the Pacific. The PRC government is similarly increasing control of the raw materials necessary for manufacturing high-technology products (*e.g.*, phones, vehicles, advanced energy storage systems, and magnets) that are sourced from a small number of countries, and for which substitutes are unavailable. Operating in niche markets with limited transparency, often in politically unstable countries, Chinese firms continue to capture supplies of cobalt, graphite, lithium, nickel, niobium, and platinum, to name just a few. Because these minerals and metals are finite assets that cannot be replaced, China is able to exert influence over the rest of the world by withholding access to these assets to compel nations to bend to its will.

Additionally, in its never-ending quest for technological superiority and control over key positions in the industrial value chain, the PRC government regularly has supported or directed the theft and misappropriation of U.S. technology and intellectual property (IP). Monetary damages accrued to the United States are estimated to range from $50 billion to as high as $600 billion annually. Moreover, by making short-lived market access promises to cutting-edge technology companies, the PRC government pressures the most technologically-advanced firms to transfer IP and sensitive data to it. The PRC government ultimately uses the IP it extracts from companies to displace them from the market. China's increased dominance in key

segments of the industrial value chain further cements its technology transfer approach. Even where Chinese firms are perceived to "collaborate" in technology development, take for example Huawei's announcement that it plans to build a $1.2 billion optical fiber research facility in the United Kingdom, the gains are only one sided.[3] Chinese companies will, as directed by the PRC government, benefit from scientific research and collaboration with international scientists abroad, resulting in some cases in the repatriation of technology to generate overcapacity to eliminate competition and obtain a monopoly position. In sectors like 5G, where optical fiber cables provide the infrastructure for an impending technology revolution, the national security implications are obvious.

It is also reported that the Chinese government, this year, is implementing a nationwide credit rating system for all corporations – foreign-owned or Chinese-owned – operating within China. Companies handling sensitive personal data and proprietary technical information will be required to transfer that data to the Chinese government. The European Chamber reports this credit rating system as amounting to "life or death" for companies. [4]

China's engagement in international standards as a way to influence the global technology market also is of great concern, but it is often not fully understood. To illustrate this attempted influence, take for instance the fact that, from 2011 to 2019, the number of Chinese-led technical committees in the International Organization for Standardization, one of the largest international standards setting organizations, increased by 75 percent.[5] Further, China has strategically increased its participation in the International Telecommunication Union (ITU), an agency of the United Nations responsible for coordinating telecommunications operations and services, with the hopes of expanding its influence around the globe. In fact, in key technology working groups of the ITU, China alone comprises 40 percent of participants.[6] Moreover, China's press into international standardization ranges from introducing weak proposals into the standards development process, flooding the organizations with low-quality proposals that detract from and take resources away from sound proposals, to making financial contributions as a way to wield power over those organizations and to punish member companies and countries

[3] Gold, Hadas, CNN, "*Huawei to Build $1.2 Billion Cambridge Facility as It Faces Uncertain UK Future*,"(June 25, 2020) https://www.cnn.com/2020/06/25/tech/huawei-cambridge-uk/index.html.

[4] European Chamber of Commerce, "*European Chamber Report on China's Corporate Social Credit System, A Wake Up Call for European Businesses in China*," (Aug. 28, 2019), https://www.europeanchamber.com.cn/en/press-releases/3045/european_chamber_report_on_china_s_corporate_social_credit_system_a_wake_up_call_for_european_business_in_china.

[5] Kamensky, Jack, China Business Review, "*China's Participation in International Standards Setting: Benefits and Concerns for U.S. Industry*," (Feb. 7, 2020) https://www.chinabusinessreview.com/chinas-participation-in-international-standards-setting-benefits-and-concerns-for-us-industry/.

[6] Department of Commerce calculations.

that do not side with its agenda. Indeed, China's participation in international organizations has become a vehicle to advance its One Belt One Road Initiative, and the more influence China has over standards development, the more likely this initiative will succeed.

Additionally, China uses other international organizations to advance its global ambition, including the Belt and Road Initiative. To illustrate, it has been reported that the head of the UN Department of Economic and Social Affairs used his position to discriminate against people and organizations who were drawing attention to the CCP's repression of the Uighur ethnic group. The World Health Organization's capture by the Chinese government, by failing to alert countries to the rapid transmission of the coronavirus, is yet another recent example. Even more to the point, if the Chinese government is currently threatening to retaliate against Nokia and Ericsson for the EU's possible move to ban Huawei from their 5G systems,[7] imagine the types of influence that China could wield if it is able to dominate global standards organizations and the standards themselves.

Finally, it is worth emphasizing that because China is a sovereign state, foreign laws can never be sufficient to fully address its conduct. In fact, the PRC government takes advantage of the United States' lack of an extradition treaty with it to advance cyberattacks on sensitive U.S. assets. The attacks not only obtain proprietary trade secrets from companies and sensitive personal information about American citizens from servers, but these attacks also target crucial weapons systems and sensitive military technology (well-documented examples include attacks that extracted sensitive information about U.S. submarines, cryptographic systems, the F-35 Joint Strike Fighter, and anti-ship missiles that are crucial for deterrence and developing countermeasures). China's medium of cybertheft also includes stealing computer software source codes, design technology, and technical product specifications. And the PRC government continues to violate its 2015 bilateral commitment to the United States in which it had vowed to refrain from stealing and misappropriating U.S. IP.

The tactics used by the PRC government over the course of the past 40 plus years have enabled the country to move its economy from the 12th largest in the world ($191 billion gross domestic product, GDP (current prices), in 1980) to the second largest ($14 trillion GDP (current prices) in 2019); become the second largest foreign holder of U.S. debt at $1.09 trillion in 2019 (the first largest being Japan holding $1.27 trillion), and grow as the world's largest exporter of goods. Indeed, the United States' largest bilateral trade deficit is with China ($345.6 billion in deficit in goods in 2019). In addition, China today holds uniquely powerful positions in the most critical supply chains in the world including rare earths elements, medical equipment and supplies, pharmaceuticals, and electronics.

The past policies of the United States did not effectively impede or curtail China's rise as a predatory economic actor. To build our seemingly efficient supply chains, we flocked to China

[7] Lin, Liza; Woo, Stu; Wei, Lingling, "*China May Retaliate Against Nokia and Ericsson If EU Countries Move to Ban Huawei*," Wall Street Journal (July 20, 2020), https://www.wsj.com/articles/china-may-retaliate-against-nokia-and-ericsson-if-eu-countries-move-to-ban-huawei-11595250557.

as the low-cost producer of virtually every link in the chain, allowed the PRC government to build reserves of U.S. dollars which it used to devalue its currency, traded our most sensitive intellectual property in exchange for short-term market access and profits, and did not adequately use legal enforcement tools to protect our industries. Our motives were short-sighted, and we failed to sufficiently anticipate the vulnerabilities that this trading relationship would create.

As a result, we willingly transferred our debt and exported our manufacturing capabilities (and jobs) to a non-market economy where market principles, transparency, and predictability do not exist. By doing this, we created a global economy where distorted prices and non-market conditions are allowed to proliferate. We also put China in control of our revenue stream. This vulnerability is often not discussed among policymakers, but it is important to emphasize: within our highest-technology sectors, substantial revenue comes from U.S. exports to China. This means that China, by controlling America's revenue stream, also controls America's ability to earn income and fund R&D. This is an extraordinary vulnerability that, if unaddressed, will be used by the PRC government to further halt America's technological progress.

RESHORING CRITICAL SUPPLY CHAINS

Traditionally, economists have viewed calls for countries to pursue policies aimed at protecting national security production capacity skeptically. They argued that a nation could, in a globalized world, always turn to other countries if the domestic supply chains eroded at home. However, what we have learned from the coronavirus crisis is that borders do matter because any state has the sovereign right, and ability to, restrict exports to the rest of the world. Indeed, the PRC government strategically withholds exports: (1) as a bargaining chip to extract concessions from trading partners; or (2) to punish trading partners that do not bend to its will. Even our allies introduced earlier this year – at the height of the pandemic – emergency export restrictions over much needed medical equipment in order to provide for their own citizens to the detriment of neighbors in need.

These facts should serve as an important reminder to the United States that the security of domestic supply chains is essential, and it must be regained because the basic political and economic unit should *always* remain the nation-state. Indeed, the protection of American citizens requires that the United States' vulnerable supply chains be strengthened, and a major component of supply chain resiliency must be reshoring. But how can the United States reverse the excessive offshoring that has occurred over the course of the past 40 years?

The problem is complex, but it can be solved through a whole-of-Government approach. That is, if we collectively are prepared to tackle difficult policy questions, even those that may run counter to long-held economic biases. To the extent that those biases once formed policies that incentivized critical industries to offshore, then logically they need to be revised or reversed.

Understanding what has led to the degradation of our supply chains, then it stands to reason that a comprehensive reshoring strategy must remedy those causes. At the outset, the United States must systematically and routinely identify all products, goods, and technologies that are critical to national security to address the country's dependency on imports from strategic competitors, whether in a time of war, cyber-attack, pandemic or other national

emergency. This Administration – my office in particular on behalf of the White House – has begun doing this. We need to continue this on a permanent basis. An additional component here is measuring the flow of technology if it is now as equally as important, and in many instances more important, than the traditional "national security good."

A second essential component of a reshoring strategy is incentivizing inward investments in domestic manufacturing and R&D activities. We have begun doing this to boost innovation and economic growth through tax cuts. A whole-of-Government approach, in partnership with Congress, will continue to make this effort successful.

Third, we have in our arsenal of tools powerful U.S. Government procurement authority, including the Defense Production Act authority, to provide capital to new American investments and also as a tool to generate demand, through U.S. Government purchases, for national security-related items that are produced within the United States. Reliance on Government procurement authority is what will compel many companies to take a leap of faith and re-invest in the United States. This is an important tool that we are using and should be empowered to use even more.

Fourth, it is, of course, axiomatic that U.S. investments must be encouraged to grow to commercial scale in order to compete against more mature foreign competitors. Further, an industry's commercial viability will generate robust upstream and downstream supply chains, draw in new market entrants to enhance production efficiency and moderate prices, attract greater private sector investments, and encourage competition to accelerate R&D. These are the fundamental building blocks of a resilient domestic supply chain.

Finally, we have the ability to increase exports of all U.S. firms – including those that re-shore to the United States – through trade agreements. We have begun to increase exports thorough the U.S.-Mexico-Canada Trade Agreement and the U.S.-Japan Trade Agreement, and we should continue to encourage greater exports through new trade deals.

With the support of Congress, we can build the strongest supply chain in the world, enhance our comparative advantage with allies, and create an ecosystem where market-based principles prevail and market distortions are eliminated. We have begun doing this; we can do more together, which is why this hearing is so important.

CONCLUSION

Historically, through times of adversity, the United States has led the world out of war and economic turbulence into recovery. And now too, the world will look to the United States to lead the way in solving today's supply chain challenges. It should not be forgotten that the global economy of the 20th century was developed by the United States and, although China is aggressively seeking to shape the global economic order of the 21st century, it is not too late to act. While the United States remains the largest economic power in the world (a status that is not guaranteed as China's exponential growth continues), it has the ability and leverage to act in coordination with allies. Time is of the essence, and our supply chain vulnerabilities are too great to await another national security crisis that may expose this country to even more devastation and destruction.

OPENING STATEMENT OF ALICIA GARCIA-HERRERO, SENIOR RESEARCH FELLOW, BRUEGEL

MS. GARCIA-HERRERO: Good morning. It's a pleasure to share my views with this Commission. And I thank you for the opportunity to contribute to your deliberations.

Today in my remarks I focus on China's non-market practices, their negative impact on the world, especially the U.S. and the EU, and what to do about it, in a sense, my recommendations on that front. And because I might run out of time, I'd like to mention that I make three types of recommendations.

The one, the first one is the possibly the easiest, which is really about better defining the lack of market practices in a comprehensive way through the concept of competitive neutrality.

The second set of recommendations is about, is basically learning about what measures Europe is taking and, as we call them, autonomous measures, to protect its single market from modern non-market practices, and particularly of China.

And the third is really about leveraging like-minded problems to preserve the international economic order.

And, so, if I may start with the first point, I'd like to share with this Commission that it is extremely difficult to measure the degree of distortions that China's economy is putting on top of us. And the reason is that China has to go from being a much smaller economy to a much bigger economy, but also from an inward-looking point of view by which the distortions were affecting our exports, basically market access, and our investment in China to a model in which these distortions are affecting our own markets.

And this is because China has started about 10 years ago to invest in the world, and also to create magnificent, large companies, and banks which are financing these companies.

So, basically, the area of distortion has moved away from China's market to the world. And I think that is why it is very important to realize that the consequences are different.

So, in my research on the measurement of subsidies I like to highlight three points.

The first is that there is ways to measure certain types of subsidies. We have financial statements to do that. From that, the only thing that I'd like to highlight is that of course they are much smaller than reality but they are comparable to Europe and the U.S., but they are just basically a drop in the ocean.

But we can still learn that these subsidies now are no longer for state-owned companies only. Actually it's 50/50 already. So, we need to, in a way, forget that it's only about SOEs that we need to focus on. This is a much more general practice.

And also, the fact that it's not about old sectors, but actually new sectors. New sectors receive more than half of these subsidies, semiconductors, et cetera.

So, on that note I'm going to move to the recommendations.

So, competitive neutrality is a concept that is well developed by Australia and that the OECD has been pushing, that the IMF has been working on. And with China, trying to have China accept this idea of ensuring that private and public enterprises operate under the same rules and conditions.

Unfortunately, China has been unwilling to accept this concept in any negotiations, including the negotiations with Europe on the comprehensive investment agreement. So, it might be a good idea to push this further to either multilateral organizations or bilateral dialog with China to see whether we can at least measure the degree of distortion in a better way.

The second point I'd like to make is Europe.

So, Europe, of course, has tried, as many others, to use commerce. And the most obvious measure we have is the EU-China Comprehensive Agreement on Investment which, as you know, has been put on hold because of sanctions of the European -- on members of the European Parliament.

But there is one thing to realize from this CAI, as we call it. And it is that China by now has already upgraded its national security laws and, of course, their corporate credit system is making any of these deals in a way able to, China is able to hold up these deals because all of these national security laws are in a way giving China leverage not to comply with these deals if they may occur.

So, we have to be very careful in these negotiations down the road.

On the autonomous measures that Europe has been working on, I'd like to highlight the anti-subsidy legislation, which is not yet fully ratified, but will certainly be very soon. And in here the whole idea is that Europe will be able for the European Commission to basically impose including bans on investment or procurement in case that the foreign subsidies are found. And this is, in a way, similar to the U.S. Level Playing Field Act 2.0.

But I think it would be interesting to compare the two and see whether they include loopholes in either the European or the American side.

The second is the anti-coercion mechanism which, of course, is set to prove quite useful for Lithuania, given its situation, and the retaliation that Lithuania is suffering at the current juncture from China. And this is again similar to the U.S. Countering China Economic Coercion Act. And, again, I think it would be a good idea to compare and see whether there are any loopholes.

We also have our own type of CFIUS, but much weaker, I have to say, than foreign investment screening mechanism. And, again, there it would be good that in our discussions we try to compare the two.

I'd like to highlight one more very important issue which deals with the fact that China is going abroad. And this is the use of companies purchased by Chinese entities overseas. There's many of those in the U.S. There's many of those in Europe. And they are starting to issue legislation of anti-circumvention to take good care of the fact that these new production plants established by Chinese companies may actually be under sanctions from the EU Trade Defense Instruments. So, this is one more area of concern that we need to focus.

And then, finally, the financing. And this is about the belt and road initiative and the fact that China, of course, offers below market financing, or at least with different type of constraints, as we all know.

Europe, in that regard, has recently announced a major program, the Global Gateway, mobilizing 300, up to 300 billion in investments.

So, I move to the third topic. And this is, indeed, joining forces with our partners. I think there's two things I realize that trade now is complex in the U.S., but I think we need to use the existing instruments, one is the EU-U.S. Trade and Technology Council and, in particular, a working group that deals with global trade challenges. I think this is a very good venue for this task.

It's hard to put together a response to the market, non-market practices.

And, finally, bringing Asia, of course, to the discussion. I realize that a major issue is this economic Indo-Pacific strategy, but the question is if the U.S. is not ready to go full wind on a trade offer, that the only thing I could think of is to bring more weight to the table and bring Europe to the EU-U.S. Trade and Technology Council onboard and find like-minded countries to

step in and together create rules which include, as I mentioned before, competitive neutrality or execution of subsidies, national security concepts, everything that relates to what we can put together for the sake of avoiding the impact of these non-market practices of China's economy on the world.

The good thing about this is that if we work this way in the absence of a better solutions, which would be a trade investment deal, no doubt about it, we can at least in transition deal with important issues that Asian problems in the region that we worry about, sovereignty, data sovereignty, the impact of these subsidies on investing, being based in Asia I can see very clearly that many Asian economies are very worried about China's monopoly by now -- not monopoly, close to that, of batteries and components of batteries for the sake of electric vehicles.

So, we're going to come up with some sort of standard that offers this. I think this would be a good thing, a good start for us.

Thank you.

PREPARED STATEMENT OF ALICIA ARCIA-HERRERO, SENIOR RESEARCH FELLOW, BRUEGEL

Testimony before the U.S.-China Economic and Security Review Commission

April 14, 2022

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China's non-market practices, impact on the world, and what to do about it?

I want to thank you for the opportunity to contribute to the deliberations of this Commission. Today, my remarks will focus on China's non-market practices and their negative impact on the world, especially the US and the EU. Then, I will offer some potential actions to reduce such adverse impacts, starting with developing and applying the concept of competitive neutrality internationally and in China, followed by possible instruments based on the European experience. Finally, the usefulness of leveraging on like-minded partners to preserve international orders and the functioning of market economies in a global setting is also essential.

1. The state of play: China's non-market practices, impact on the world, and what to do about it?

As China's economic and geopolitical weight continues to grow, its entanglements with the world are only increasing. However, beyond its size, China also has a different economic model characterized as state-capitalism and as socialism with Chinese characteristics by President Xi himself. The combination of China's sheer economic size and its state-driven economic model has international implications. This section looks at the size and characteristics of its model and the global impact.

China's economic size has ballooned over the years, and it now contributes to the lion's share of global economic growth (Figure 1). More specifically, the percentage of China's GDP in the world increased from 3.6% in 2000 to 17.4% in 2020. In trade, the share of exports in the world also surged from 3.9% in 2000 to 14.8% in 2020. The strong growth momentum and exports have nurtured the expansion of Chinese firms and financial institutions.

There are 124 Chinese firms on the Fortune Global 500 league table as of 2019, higher than 121 in the US (Figure 2). If we exclude financial institutions, 72% of the Fortune Global 500 league table firms are state-owned enterprises.

However, it is also important to note that Chinese entities have mainly grown on the back of their domestic market, and they are still lagging from a global perspective. There are only 9 Chinese firms among the top 100 non-financial multinational enterprises measured by foreign assets (Figure 3). Even if it is small compared to the US, Chinese firms' share of overseas revenues has grown over time (Figure 4). From a sectoral perspective, semiconductors and information technology have the largest share of overseas revenues (Figure 5).

In addition, Chinese financial institutions are the largest globally, with total assets rising from 195% of GDP in 2002 to 302% in 2021 (Figure 6). Compared to Asian peers, the size of China's banking sector is bigger than Japan and Korea as a percentage of GDP, which are known to be bank-based financial systems (Figure 7). The overwhelming relevance of the banking sector to channel credit in China is an additional aspect of China's state-led capitalism, namely the government-controlled financial industries through its banks.

There is plenty of literature on the bias in resource allocation toward state-owned enterprises (SOEs) in China and state-controlled banks. In the past, the focus was mainly on how such distortions could reduce market access to China and hurt the interests of US multinationals or any other foreign firms. However, given China's dominance from large companies and the higher overseas corporate revenues today, China's economic model will impact the rest of the world in its own and third markets.

The trend is even more the case as China strikes more trade and investment deals with other countries and economic blocs, such as the Regional Comprehensive Economic Partnership (RCEP) with ASEAN and other major Asian economies. In a nutshell, China's state-led capitalism is bound to affect the US much more now than in the past because of the growing size of China's economy, corporates, and trade and investment agreements.

The other key reason its impact might be more prominent is that China's economic model is becoming increasingly interventionist. How the state interferes in the Chinese economy is complex and hard to measure because of the different channels to support specific companies or sectors. Government subsidy is the most obvious tool, and part of the support can be measured through publicly available data in corporates' financial statements. Based on this approach, Chinese firms received $50 billion (RMB 323 billion) worth of government subsidies in 2020, up from $35 billion (RMB 224 billion) in 2017 (Figure 8). This amount is small compared with more comprehensive definitions of government support to corporations. However, it is still worth analyzing as it can offer a sense of the trends in the Chinese government's support of its industries.

First, 85% of all listed firms have received fiscal support, which is beyond loss-making companies. The share of loss-making firms as a share of total listed firms surged from 12% in 2017 to 21% in 2020 (Figure 9). The subsidies reported ($50 billion) only managed to reduce the ratio of loss-making firms to 18% in 2020.

Second, there is a sharp increase in the subsidies received by Chinese firms in the new sectors, such as technology and renewables. The share of new sectors in total subsidies grew from 47% in 2017 to 51% in 2018-2020, mirroring the policy shift towards the industrial upgrade, support from indigenous innovation, and moving up the ladder (Figure 10). In turn, old sectors, such as industrial, metals and materials, and infrastructure, saw their share of subsidies reduced from 53% in 2017 to 49% in 2020. An even more granular breakdown points to the industrial sector and information technology as major recipients of subsidies with 24% and 27% of the total respectively between 2017 and 2020 (Figure 11). For information technology, 27% of profits came from subsidies in 2020. Beyond these two, software and service, technology hardware, automobiles, transport, and semiconductors are the sub-sectors with a high share of subsidies to profits (Figure 12). The above sectoral breakdown of Chinese publicly known subsidies fits quite closely the sectors in which China has been more successful internationally.

Finally, subsidies are channeled to both SOEs and privately-owned companies (POEs), and the latter forms 50% of total subsidies (Figure 13). This trend can be interpreted as more equal treatment between state-owned and private firms in China, but also as broader government influence in the private sector. For example, Chinese SOEs can get golden shares in tech firms. Anti-trust measures and data laws can also favor state-owned firms and create extra constraints for private firms, including the obligation to have a party representative in the companies' oversight bodies. Both SOEs and POEs have a more extensive reliance on subsidies for profits (Figure 14).

Although the above narrow definition of subsidies offers some hints about the Chinese leadership sectoral preferences, it still does not reflect the whole picture. It can even show that Chinese subsidies look like those granted by the US or European member states, as Evenett and Fritz (2021)[1] analyzed in a cross-country comparison of government subsidies. The reality is that the government can give subsidies in different forms, many of which are not reflected in financial statements.

An example is that the utility sector in China has received support as the government has subsidized households' costs on the policy of coal-to-gas conversion, which can boost corporate revenue. Other relevant comparisons are in the semiconductor and electric vehicle (EV) industries. For the former, beyond the higher share of subsidies to profit ratio of 21%, Chinese semiconductor firms have also received significant financial support through two ad-hoc semiconductor funds, namely China Integrated Circuit Industry Investment Fund Phase I and II) with the equivalent of $53 billion (RMB 344 billion) distributed since 2014.

In the case of EVs, local players are the primary recipients of subsidies. Based on the "regulations on the standards of automotive power battery industry" in 2015, the Chinese government created a whitelist to offer subsidies to qualified domestic battery makers leaving all foreign firms out of the game. In other words, this means only firms able to fulfill all the requirements can receive the subsidies, and many foreign firms are not eligible. The policy has also helped upstream makers of EV battery components, supported by domestic orders to expand capacity and achieve economies of scale. Such an approach is why Chinese battery maker Contemporary Amperex Technology Ltd (CATL) has become the leading battery manufacturer, with a market share of 31%. Beyond fast domestic growth in China, CATL's share of overseas revenue has surged from 5% in 2019 to 30% in 2021.

[1] https://www.globaltradealert.org/reports/gta-28-report

2. Competitive neutrality to better gauge the degree of government in the Chinese economy

Given the lack of conclusive evidence on the size of Chinese government support to its corporate sector and the distortions it creates globally, it seems vital to introduce a more comprehensive definition that is comparable across countries and helps step up the dialogue with Chinese counterparts.

The concept of competitive neutrality seems the best place to achieve this objective. The OECD developed this concept in 2004 following Australia's own experience in measuring competitive neutrality to offer equal footing to Australian private companies versus state-owned ones.

In 2004, the OECD started the first discussion on how the role of the government affects the way markets function. Through subsidies and skewed government procurement rules, the public sector may enjoy financial advantages over private firms (OECD, 2004[2]). Competitive neutrality would ensure that private and public enterprises operate under the same rules and conditions and thus compete on an equal footing. Otherwise, the government should at least appropriately measure the differences and take actions based on the results (OECD, 2009[3]). The idea should then be formalized into national practices and regulations to ensure a level playing field (OECD, 20122). While the meaning of competitive neutrality is clear, measurement of it is less obvious considering the realities in different countries and access to data (OECD, 2012[4]; UNCTAD, 2014[5]).

Several countries have taken steps to implement competitive neutrality. A frontrunner is Australia, which underwent a comprehensive reform of the state's role in the economy in the 1990s. Starting from the Hilmer Report in 1993, Australia created the environment to inject greater competition into its markets (Commonwealth of Australia, 1993[6]). However, the framework relied heavily on ex-ante components, namely policies governing the operation of state-owned enterprises, which gave them an arm's length relationship with the government (Brennan, 2019[7]). The key aspects are maintaining neutrality in terms of regulation, debt, and tax while ensuring SOEs achieve commercial rates of return and that loss-making institutions exit the market.

Against such a backdrop, Garcia-Herrero and Ng (2021[8]) developed a data-rich approach to gauge the degree (or the lack thereof) of competitive neutrality in the Chinese economy. To that end, we measure the monetary and fiscal support given to Chinese companies across different sectors. In particular, we focus on debt and tax neutrality, measured by interest expense-to-total debt and the effective tax rate.

In China, the state still controls the financial sector, meaning that banks and other financial institutions also play an important role in the competitive environment companies in China are facing. Commercial banks are the biggest bondholders in China. As a simple measure of debt neutrality, we calculated how low interest payments might be per unit of debt for a certain SOE compared to a private company within a specific sector.

On tax neutrality, the lack of data on subsidies and other types of benefits prompted us to focus on tax payments and how low the effective tax rate of a certain SOE might be versus a private company within each sector. A generally lower effective tax rate for SOEs is an obvious form of financial support since it allows companies to retain their earnings and boost returns on assets.

The return on assets is a measurement of the result of the existence or non-existence of comparative neutrality. It is an important indicator to assess how efficiently/productively an SOE utilizes its resources. If an SOE has received financial support from the government and its profitability is high, it may mean that the support has been well-utilized. The opposite means the government support has not translated into an efficient outcome, which means the subsidies may be better allocated. We set out to measure whether there is competitive neutrality between SOEs and privately-owned enterprises (POEs) in China. Foreign firms are not included as it is hard to argue they will enjoy competitive neutrality with local firms if it does not even exist for SOEs and POEs.

[2] Organization for Economic Co-operation and Development (2004). 'Policy Roundtable: Regulating Market Activities by the Public Sector'
[3] Organization for Economic Co-operation and Development (2009). 'Policy Roundtable: State Owned Enterprises and the Principle of Competitive Neutrality'
[4] Organization for Economic Co-operation and Development (2009) 'Competitive Neutrality: Maintaining a level playing field between public and private business'
[5] UNCTAD (2014) 'Competitive neutrality and its application in selected developing countries'
[6] Commonwealth of Australia (1993) 'National Competition Policy'
[7] Brennan M. (2019) 'Competitive Neutrality in Australia', International Monetary Fund
[8] https://www.bruegel.org/wp-content/uploads/2021/02/PC-05-2021-3.pdf

Our results support the view that China's competitive environment is poor, with conditions tending to favor SOEs. For the cost of funding, the implicit interest rate on the cost of debt is generally higher for POEs than SOEs (Figure 15). As for the effective tax rate, it is also higher for POEs (Figure 16). In addition, the return on assets (ROA) has been higher for private firms than state-owned enterprises until recently, which means that higher implicit subsidies have not changed the trend of lower return on equity of SOEs (Figure 17).

From a sectoral perspective, private firms cannot borrow as much as SOEs in most sectors, including renewables, healthcare, and ICT – the sectors with a relatively high private ownership. For funding costs and effective tax ratios for different sectors, SOEs tend to pay lower effective tax rates than private firms in most cases (Figure 18).

Therefore, the general and sectoral trends show that private firms cannot leverage as much as SOEs while facing higher funding costs. As SOEs often carry large responsibilities in supporting government-led spending and the fiscal cash flows, the business environment is relatively favorable versus private firms. As such, tax advantages to compensate for the lack of competitive neutrality in other areas have now diminished.

Given the above, it seems clear that developing a workable definition of competitive neutrality that the US and other like-minded countries can use in their respective economic dialogue with Chinese counterparts could help. It would reduce the pressure on chasing the proper definition of state support and subsidies to Chinese corporates given the lack of transparency and thereby have a more constructive conversation on market access. This framework is also appropriate for foreign companies operating in China to measure competitive neutrality.

3. What else can the US do? Some ideas from Europe

The EU has switched its view on China from an economic partner to a competitor and systemic rival[9]. The change has led to engagement measures, such as the completed EU-China Comprehensive Agreement on Investment (CAI) negotiations. However, the deal has not been ratified, and it is likely to be stalled in the foreseeable future as China has imposed sanctions on Members of the European Parliament (MEPs) in retaliation for EU sanctions on Chinese individuals for human rights abuses. At the same time, the EU has introduced "autonomous" measures to deal with the competition and rivalry part of the bilateral relations.

Starting with the "carrot" part of EU strategy toward China, CAI is an engagement tool to increase European foreign direct investment (FDI) in China while keeping the EU's relatively open the door to Chinese investment in the continent. In that context, CAI includes measures to ensure more equal treatment in subsidies beyond those covered by the WTO, namely in the services sector and transparency in state aid[10].

The steps forward in terms of market access achieved by the EU in its negotiations for CAI are bound to benefit other countries under the Most Favoured Nation rule. The arrangement is quite different from the achievements obtained by the US in its negotiations for the "Phase 1 deal", which is one of the key reasons why the EU further pushed to reach an agreement with China on CAI after eight years of arduous negotiations. In particular, the EU managed to secure some of the provisions obtained by the US negotiators through the "Phase One" deal for American companies, such as banning forced technology transfer.

CAI offers an example of how China's growing web of national security laws and China's Corporate Credit System enter new-generation trade and investment deals, offering much more leverage for China regarding its commitments[11]. In any event, the latest EU-China Summit last April 1 did not open the door to potential ratification of CAI any time soon as Chinese sanctions on MEPs remain in place.

Beyond the “carrot” aspect of CAI, the EU has also developed “sticks” to deal with China, under so-called “autonomous” measures. Two of them are worth noting. The first is the anti-subsidy legislation, approved by the European Commission and now pending ratification by the European Parliament. This instrument aims at closing the existing regulatory gap, whereby subsidies granted by non-EU governments go currently unchecked, while subsidies granted by Member States are subjected to scrutiny.

[9] https://ec.europa.eu/info/sites/default/files/communication-eu-china-a-strategic-outlook.pdf
[10] For a review of CAI and its impact on the EU, see https://reinhardbuetikofer.eu/wp-content/uploads/2021/04/CAI_Report_Final.pdf
[11] A good analysis of this important point is offered by Violi, Kampourakis, Triefus and Arcuri (2020) ”Legal Analysis of Selected Issues under the EU-China Comprehensive Agreement on Investment.

The tools included in this draft legislation to tackle foreign subsidies effectively are to give the Commission the power to investigate the existence of distorting foreign subsidies, including in the financing of acquisitions of European companies, bids in public procurements, and other general cases and take redressive measures under the EU's competition policy. The latter includes the divestment of certain assets by the company being subsidized and the access to the infrastructure in the case of procurement measures[12].. Any EU firms or industrial groups to lodge a complaint with the Commission if there is the impression that imports of a product from a non-EU country are subsidized and injuring the EU industry producing the same product.

I understand that the US has also introduced legislation, namely the Level the Playing Field Act 2.0, which is addresses subsidies by a government to companies in another country, referred to as "transnational" or "cross-border" subsidies. Comparing EU and US efforts on this front would seem warranted.

The second autonomous measure worth highlighting is the anti-coercion mechanism proposed by the EU Commission in December 2021[13]. It is designed to de-escalate and induce discontinuation of specific coercive measures. Still, offering dialogue as a first step and this anti-coercion tool grants the EU Commission a toolbox of countermeasures in the case of coercion towards an EU member state or the EU. Such countermeasures include imposing tariffs and restricting imports from the country in question, restrictions on services or investment, or even steps to limit the country's access to the EU's internal market.

The current case of China's retaliation against Lithuania offers a clear case of the potential use of the new anti-coercion mechanism once the EU Parliament is ratified. It goes without saying that the current geopolitical environment is strengthening the stance of policymakers on the EU autonomous measures and the anti-coercion mechanism much more positive, especially after Russia invaded Ukraine. In the same vein, it would seem useful to compare the EU's actions with existing ones in the US for the foreign subsidy legislation, including the Countering China Economic Coercion Act.

Other than the two autonomous measures, it is essential to mention the EU foreign investment screening mechanism, which became fully operational in October 2020[14]. However, the US is surely well ahead of the EU thanks to the reform of the Committee of Foreign Investment in the US (CFIUS). The two mechanisms above mainly focus on trade, but there are many other ways China creates non-market incentives in the global economy. An obvious one is through the acquisition of companies abroad. In that regard, it seems crucial to understand better how Chinese firms' operations overseas are also creating distortions in our markets and how to react.

An example is the use of companies purchased by Chinese entities as an entry point to operate in the US or the EU's single market. The European Commission has already started to react to this threat by using anti-circumvention legislation to target entirely new production plants established by Chinese companies abroad when such plants use Chinese inputs under sanctions from EU Trade Defence Instruments (TDIs).

The Commission extended the duties on imported aluminum foil from China to imports from Thailand after a Chinese producer built a rolling plant using imported aluminum foil stock from China. Similarly, it extended the trade defense duties on importing glass fiber fabrics from China to imports from Morocco after a Chinese firm set up a new plant in Morocco. Still, it imported the necessary glass fiber ravings (which were targeted by separate trade defense investigations by the Commission in the past as a different product from the fabrics) from China.

In a recently initiated anti-circumvention investigation, the Commission now targets a new glass fabric production line established in Turkey owned by the same group as that targeted by the Commission in Egypt. I understand that the US is following a similar path as it has extended trade defense duties to import oil country tubular goods from China to imports from the Philippines and Brunei. A similar pattern can be seen in the case of corrosion-resistant steel products from BRI countries, like Malaysia. Furthermore, in February 2022, a US producer requested the US authorities to investigate solar cells and modules manufactured in Malaysia, Thailand, Vietnam, and Cambodia using inputs from China.

[12] https://ec.europa.eu/competition-policy/international/foreign-subsidies_en#:~:text=On%205%20May%202021%2C%20the,extensive%20consultation%20process%20with%20stakeholders.
[13] https://trade.ec.europa.eu/doclib/press/index.cfm?id=2339#:~:text=The%20anticoercion%20instrument%20is%20designed,which%20can%20take%20many%20forms.
[14] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1867

More generally, it seems important to increase the oversight of Chinese companies' operations overseas and the supply chains they are building. More and more, they are shifting the final assembly of products to other emerging economies while keeping all the inputs, including R&D and capital investment in China.

In addition, Chinese financing of overseas projects at below market rates through their policy banks and how to respond can create extra distortion. The EU has recently announced a major program, the Global Gateway, which aims to mobilize up to €300 billion in investments between 2021 and 2027 in developing assistance and other types of funding across the emerging and developing world with the objectives of contributing to the green transition globally, pandemic recovery and digitalization.

The European initiative is still in its infancy, but it shows the way toward increasing awareness of how China's subsidized funding can be adding to the distortions. The US has also responded to this need from a more micro approach. The US EXIM has set up the China and Transformational Exports Program (CETP) to help US companies compete for projects against Chinese competitors in specific strategic sectors is welcome by granting them similar financial conditions to those awarded by Chinese financial institutions. It is a good idea but with still limited funding ($141 million so far for 104 transactions). It seems crucial to balance the need to counter the distortions created by China's directed lending overseas and create new ones by mimicking a model of subsidies that will introduce further imbalances in the global economy.

4. Joining forces: the Transatlantic Alliance, the Indo-pacific and the CPTTP

China's sheer size and increasing impact on the global economy, coupled with an even more state-led economy, has material consequences for the world. There is no way the US can isolate its economy from the change. As such, the world must come up with an action plan in cooperation and finding the right policy tools.

First, the growing influence of China's state-led economic model means it is important to engage like-minded countries to find solutions to the distortions created. In that context, the EU-US Trade and Technology Council could serve as the platform for coordination. It is a relevant issue for global trade, economics, and technologies, precisely within its scope. Its working group dedicates to tackling "global trade challenges," which surely include distortions from China. In that regard, given the magnitude of the joint effort needed to fight back against Chinese distortions, the EU and the US should set aside, at least temporarily, the irritants in their trade relationship and the areas where their views do not converge and focus on reducing the distortions in the global economy.

Beyond the EU, involving Asian economies in setting up rules to reduce the impact of such a huge state-led economy on the rest of the world seems critical. There are two potential venues. The most obvious is to jump on the existing wagon, namely the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), or create a new venue based on the Indo-pacific strategy.

Focusing first on the former CPTPP option, it is important to realize that this economic block is superior to its coverage of market distortions, such as SOEs and subsidies, versus the RCEP. The fact that China (Mainland) officially submitted its application last September, three months after the United Kingdom and only days before Taiwan, points to the systemic importance of CPTPP for different reasons. The entry of China into the CPTPP can be a de-facto quality stamp of its economic model. In other words, it is a general acceptance of the Chinese economy being a market economy.

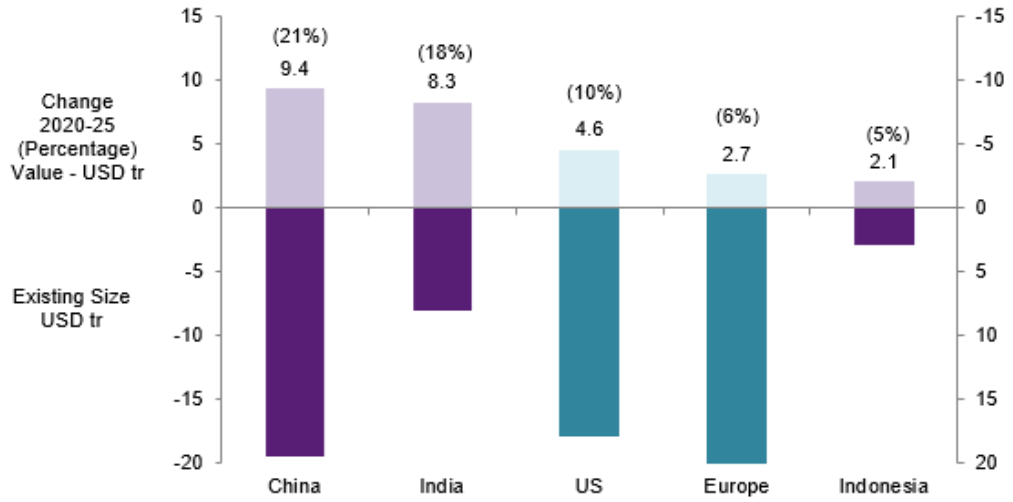
As for the United Kingdom, the quest to be part of Asia's large market is the apparent reason, especially after Brexit. For the US, its application means it is not only a security power but also an economic one and that it is open for business. It is even more the case if the US and the EU were to align forces by applying to CPTTP or embark on a new trade and investment deal with like-minded partners. For the latter, a critical factor in defining how like-minded partners might have to be the economy's structure and how close each of those Asian economies might be to a market economy.

Second, some potential tools to deal with this issue are reviewed, such as introducing and implementing the concept of competitive neutrality internationally and, most importantly, in China. Making such a concept more operational could improve the efficacy of the US's measures and those of the EU and other like-minded parties – to identify relevant distortions in the Chinese economy, especially that stemming from the large state support to specific companies. The EU's increasing efforts to protect its single market from foreign non-market practices are worth analysing.

No matter how the US economic and political landscape might evolve in the future, the size of the challenge that the Chinese economic model presents is such that alliances should be at the top of the agenda. A closer Transatlantic relation in economic and technology fields is long overdue and should include protecting the well-functioning of our markets from foreign non-market practices. Beyond that, the US would need to show the rest of Asia that it is not only a security power but an economic one by pushing a trade and investment deal in the region. Bringing the EU and the UK into this endeavour would make it more relevant. No economy is big enough to embark on this goal alone.

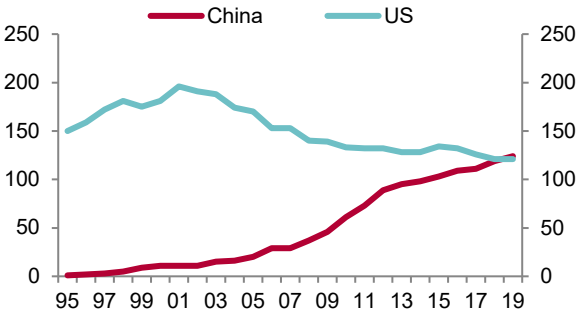
Appendix

Figure 1
Contribution to world growth (USD tr, PPP, %)



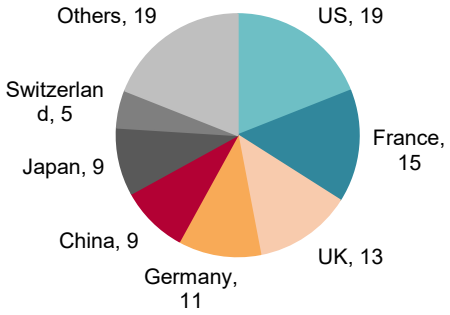
Source: Natixis

Figure 2
Number of Firms in Fortune 500 by Country



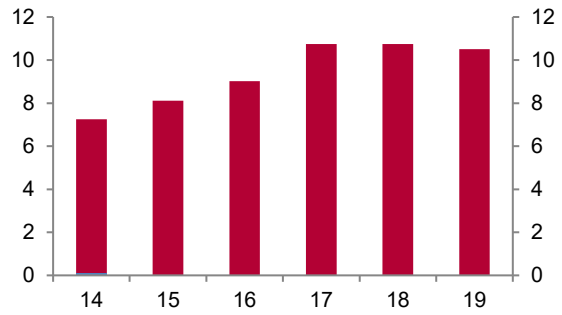
Source: Bruegel, Fortune 500

Figure 3
The world's top 100 non-financial MNEs, ranked by foreign assets (%, 2019)



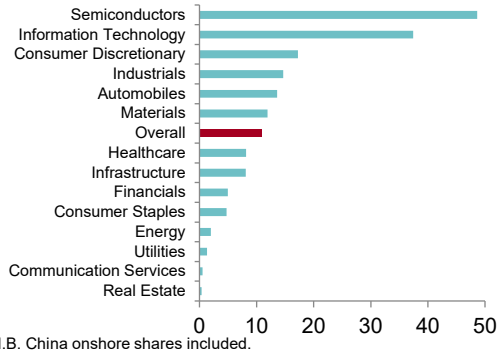
Source: Bruegel, UNCTAD

Figure 4
Proportion of Overseas Revenue (%)



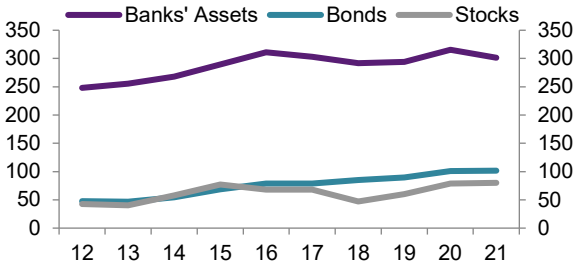
N.B. China onshore shares included.
Source: Bruegel, Financial Statements, WIND

Figure 5
China: Proportion of Overseas Revenue by Sector (%, 2019)



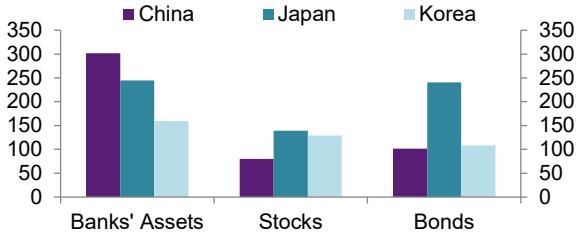
N.B. China onshore shares included.
Source: Bruegel, Financial Statements, WIND

Figure 6
China: Banks' Assets and Financial Markets (% of GDP)



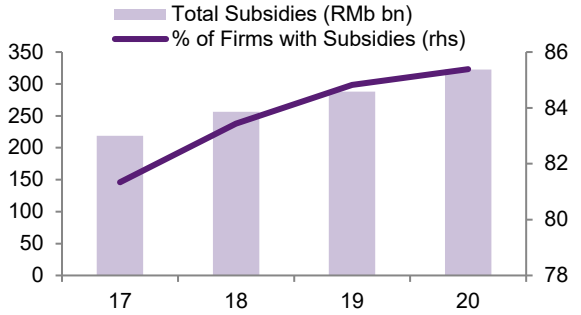
Source: Natixis, China Banking and Insurance Regulatory Commission, Shenzhen Stock Exchange, Shanghai Stock Exchange, China Central Depository & Clearing Co., Shanghai Clearing House, China National Bureau of Statistics

Figure 7
China: Banks' Assets and Financial Markets (2021, % of GDP)



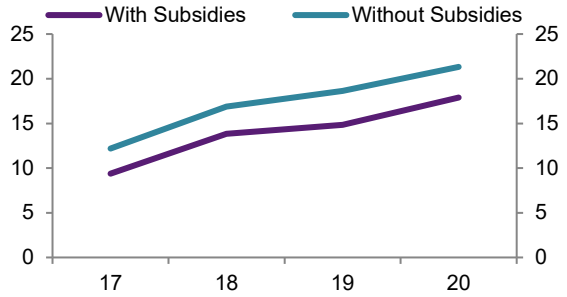
Source: Natixis, China Banking and Insurance Regulatory Commission, Shenzhen Stock Exchange, Shanghai Stock Exchange, China Central Depository & Clearing Co., Shanghai Clearing House, China's National Bureau of Statistics, Japan's Economic and Social Research Institute, Bank of Japan, Japan Exchange Group, Japan Securities Dealers Association, Bank of Korea, Korea Financial Supervisory Service, Korea Exchange

Figure 8
China: Direct Governemnt Subsidies into Listed Firms



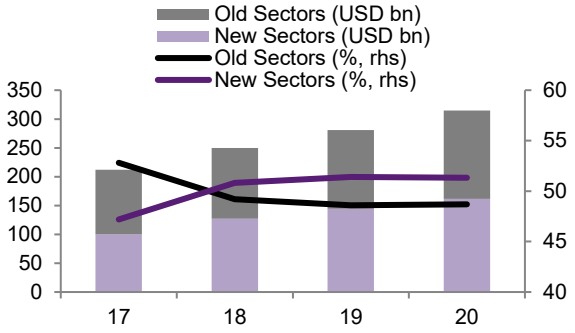
N.B. Listed firms in both onshore and offshore markets included.
Source: Natixis, Financial Statements, Bloomberg

Figure 9
China: Share of Loss-making Firms and Government Subsidies (%)



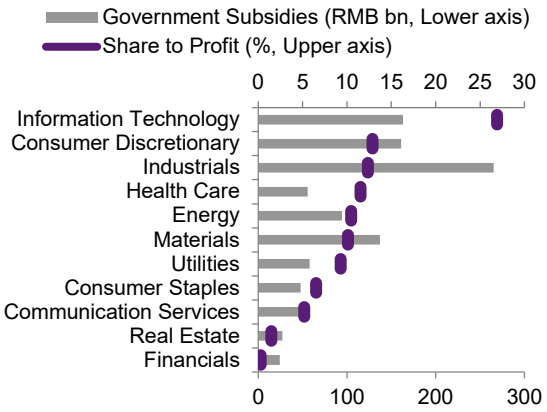
N.B. Listed firms in both onshore and offshore markets included.
Source: Natixis, Financial Statements, Bloomberg, WIND

Figure 10
China: Direct Government Subsidies by Old/New Sectors



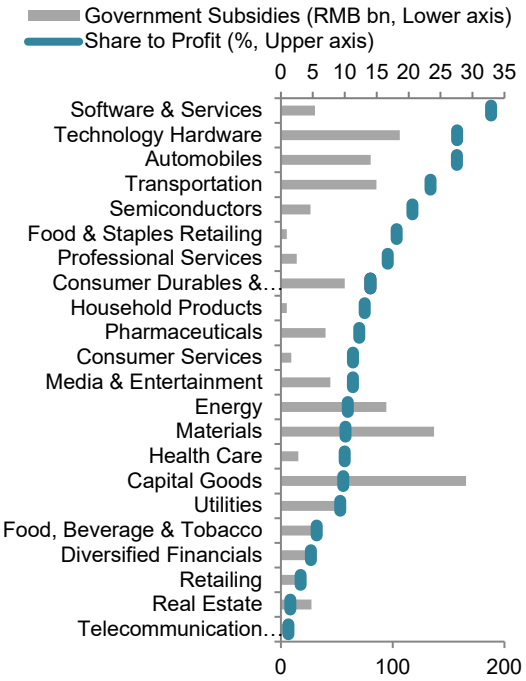
N.B. Listed firms in both onshore and offshore markets included.
Source: Natixis, Financial Statements, Bloomberg, WIND

Figure 11
China: Direct Government Subsidies per Sector (2017-2020)



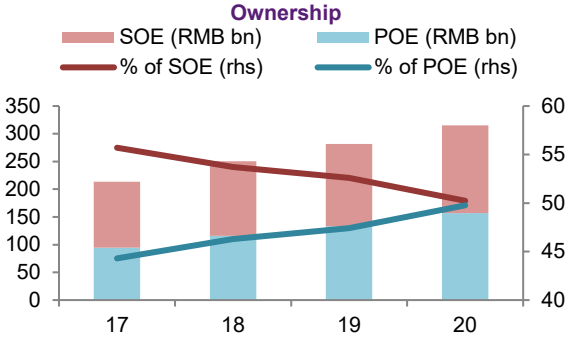
N.B. Listed firms in both onshore and offshore markets included.
Source: Natixis, Financial Statements, Bloomberg, WIND

Figure 12
China: Direct Government Subsidies per Sub-sector (2017-2020)



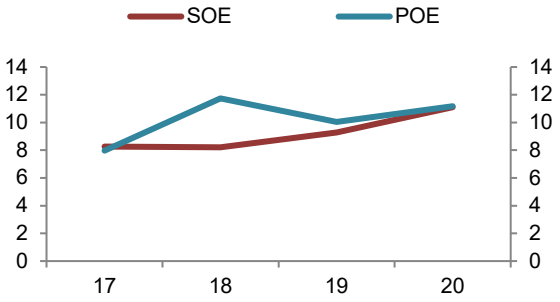
N.B. Listed firms in both onshore and offshore markets included.
Source: Natixis, Financial Statements, Bloomberg, WIND

Figure 13
China: Direct Government Subsidies by Ownership



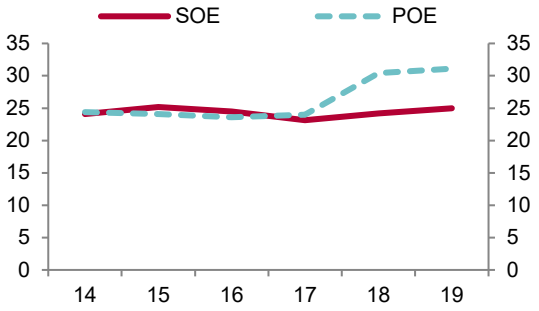
N.B. Listed firms in both onshore and offshore markets included.
Source: Natixis, Financial Statements, Bloomberg, WIND

Figure 14
China: Share of Government Subsidies to Profit (%)



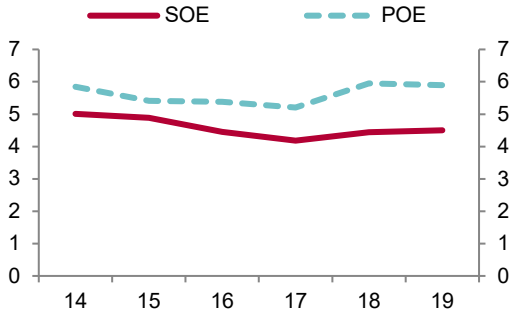
N.B. Listed firms in both onshore and offshore markets included.
Source: Natixis, Financial Statements, Bloomberg, WIND

Figure 15
Effective Tax Rate (%)



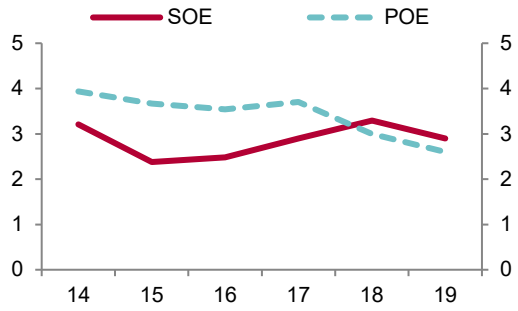
Source: Bruegel, Financial Statements, Bloomberg

Figure 16
Funding Cost (%)



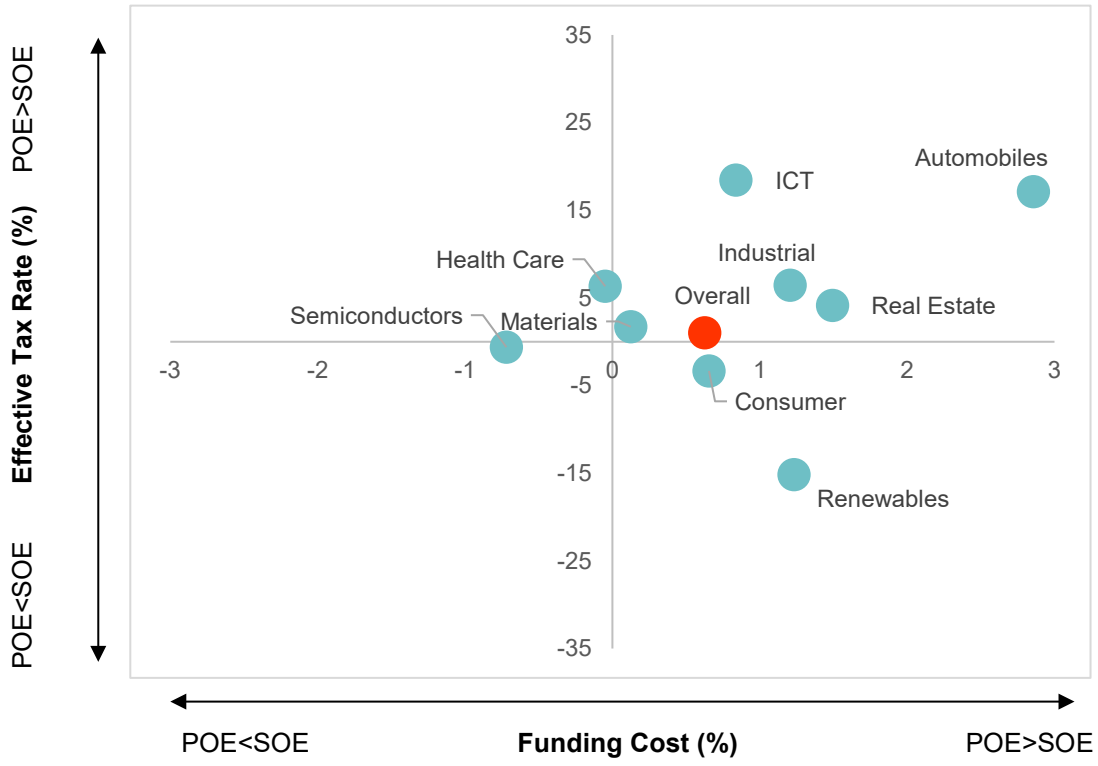
N.B. Funding cost is calculated from interest expense over total debt
Source: Bruegel, Financial Statements, Bloomberg

Figure 17
Return on Assets (%)



Source: Bruegel, Financial Statements, Bloomberg

Figure 18: Divergence of effective tax rate and interest rate for state-owned and private enterprises in China (Values of POE – SOE, 2019)



PANEL I QUESTION AND ANSWER

COMMISSIONER WESSEL: Thank you. And thank you to all of our witnesses.

As we're still operating in a hybrid fashion, we will proceed with this panel and in alphabetical order for commissioner questioning, although I'm going to take the prerogative of the chair and insert a W before the B and go first.

Ms. Nikakhtar, as an official of the last administration who was deeply involved in looking at the China issue and, as you noted in your testimony, you've been doing it for many years, my recollection is near the end of the administration there was a discussion at senior levels at the NSC that relates to the point you made in your testimony about affiliated companies.

Can you, if appropriate, identify what the administration was considering -- I believe a lot of it was leaked -- and what value that initiative might have, and whether it's something that Congress and this administration should be considering as a new tool?

MS. NIKAKHTAR: Thanks for that. It's a really good question. And I'm happy to openly talk about it because the executive order that we had drafted was leaked. And so, hopefully, somebody will pick it up.

But I'll quickly --

COMMISSIONER WESSEL: We'd welcome a copy for the record. I believe it was in the, it was leaked in somewhere. So, if either our staff or if you could help us, we'd love to look at it.

MS. NIKAKHTAR: I have retrieved it because it's very valuable. So, I'm happy to submit that.

COMMISSIONER WESSEL: Thank you.

MS. NIKAKHTAR: But, but let me provide some context into this.

I was at a discussion with somebody in the government who was, it was a very senior official, who was becoming very frustrated saying -- and, and I'm going to give you an example to sort of underscore this -- you know, if, hypothetically, the U.S. auto, major U.S. automakers in China, and we know that the Chinese Government, whether openly or not openly, is just syphoning information. Right? And it's not just IT, it's cost information, and all sorts of competitive information.

And let's say the Chinese Government gives -- making up a name -- Guangdong Auto, right, and now gives Guangdong Auto that ability to get ahead, the government, this official said, unless Guangdong Auto is affiliated with the Chinese Government I can't offensively go and do something about this.

I had a separate conversation with somebody in the World Bank saying, here's a room full of Huawei equipment that the World Bank is using. My response is, oh my gosh, why are you guys buying Huawei equipment? We don't have a criteria to establish affiliation with Huawei.

Well, coming from the trade world you've got decades of jurisprudence. Incidentally, in trade and trade laws, trade remedy laws, we have this concept of China, Inc. Every entity in China is affiliated with the central government, unless you prove otherwise. Right?

It makes sense right now especially with the Civil Fusion Strategy, with, you know, the social credit, support for credit system that China leverages over corporations, that if you don't behave in the way I want you to behave, then, you know, I'm going to take adverse actions on you.

So, it all kind of makes sense. And so, we have the Chinese companies demonstrate,

again in the trade scheme, that they're independent from the government if they want X, Y, and Z treatment.

Now, when you look at sort of affiliation with the Chinese Government in the context of China, Inc., and establishing that you're separate from them, we have this concept of de facto or de jure affiliation. Right? You're either legally affiliated or affiliated by fact.

Legal affiliations, you look at the laws. If there's signed affiliation, right, that's self-explanatory.

De facto is interesting because we just look at it to say if there's control by the government over a company such that the company loses autonomy over its key business decisions, for example, the Chinese Government gives you so much subsidies that it's fundamental to your business operations, or the Chinese Government is a major supplier or customer and including the SOEs, right, then it's manipulating your business decisions, then we allow them to find -- then we find them affiliated with the central government.

The rest of the government doesn't have this legal framework. So, you have a whole bunch of federal agencies who have really explicit legal authority to do things, but they just can't act on it because they're missing this link.

So, why not take decades worth of jurisprudence, it's been upheld by the highest court, apply it in an executive order, proclamation, something, maybe even law, apply it to the rest of the federal agencies so all of our agencies can better execute on the laws they have.

And the last thing I'll say is the reality of the PRC economy and the PRC Government makes clear that this affiliation criteria is fundamentally sound, so why aren't we using it?

Thank you.

COMMISSIONER WESSEL: Thank you. I may come back to you in our second round.

Commissioner Bartholomew.

COMMISSIONER BARTHOLOMEW: I'm going to pass on this round but might have some questions at the end of the first round.

COMMISSIONER WESSEL: Commissioner Borochoff.

COMMISSIONER BOROCHOFF: Thank you very much. And thank you for that, all of you for that enlightening testimony.

When, Mr. Prestowitz, in your testimony you talked about market access charges, what they did historically, and then a little later you talked about the flexible charge of 1 to 5 percent on non-productive incoming investment in the U.S. would do much to level the playing field, do you mind explaining in detail a little bit more how the market access charge works and what that comment meant, to level the playing field?

(No audible response.)

MR. PRESTOWITZ: The Chinese are probably cutting off my mike.

COMMISSIONER BOROCHOFF: We heard you.

MR. PRESTOWITZ: So, the market access charge there is one product only made in America that everybody in the world wants. And it's -- U.S. T-bills. More broadly, investment in the U.S. And because of this heavy flow of foreign capital into the U.S., the tendency is for that to raise the value of the dollar, thereby making U.S. exports less competitive.

And we know that many countries, and China is one of them, are managing their currency. You know, their currencies don't float freely like the U.S. dollar. We know that they manage their currencies to keep them a bit undervalued in order to promote exports.

So, the way to counter that would be to effectively impose a charge, we call that a market access charge, on inflowing foreign capital.

Now, an objection to that would be but, gee, some of this foreign capital might be to build a semiconductor plant fab in the U.S., or another plant in the U.S.

So, the idea that, that I and some others have been suggesting is, okay, greenfield investment coming into the U.S. to actually produce stuff in the U.S. will be exempt. But if you're investing in just your portfolio, or you're buying real estate, or essentially unproductive investment, then we can apply a charge.

And the charge should be flexible, depending on what the state of the U.S. current account is. If we're in big deficit, we have a higher charge, if it's a small deficit or even a surplus, then we would have a lower charge. But let's say 3, 4 percent on the amount of the inflowing investment. And that money would go into an infrastructure development fund to improve U.S. infrastructure.

So, kind of a two-pronged attempt. On the one hand we raise some money to improve infrastructure, on the other hand we make U.S.-based production more competitive and we counter the currency management of the other side.

COMMISSIONER BOROCHOFF: So, thank you for that. We only have a little bit of time, but if either of our other two witnesses would like to comment on that, I'd love to hear it.

(No response.)

COMMISSIONER BOROCHOFF: Hearing none, I will pass. Thank you.

COMMISSIONER WESSEL: Commissioner Cleveland.

COMMISSIONER CLEVELAND: Thank you. Again, thank you to our witnesses. I appreciate your testimony.

I have a question that sort of looks backward, and then and one that I hope looks forward.

Ms. Garcia-Herrero, I really appreciate the level of data that you presented on tax and debt neutrality, and defining competitive neutrality. The Commission tends to talk about state versus non-state sectors rather than the private sector. I think we shifted to that a year ago because there's little evidence, as your data shows, that there really is a true private sector.

But what I'm interested in is you talk about how helpful more detail on competitive neutrality would be in the dialog with China on market access.

What do you think would fundamentally change in the access that might be granted in the event that a more robust definition was developed?

MS. GARCIA-HERRERO: Thank you very much for your question.

One of the issues, the problems we really have with the lack of market access, but more generally no market practices in China, is that we cannot demonstrate it.

Again, if we just look at subsidies, China will simply say, look, you know, your subsidies are as big. So, if we look at some recent research, the subsidies during COVID were about 50 billion in the U.S., in the EU, in China. So, you know, the problem we have is that are available data don't really prove that China distortions are much, much bigger.

And I think competitive neutrality is a good way to do this because we don't even have to say it's about us. It's about China. It's about, so it's about improving their market rather than, you know, creating hassles on their market. And I think that sometimes trying to show that what we're trying to do is actually positive for China. It's very competitive.

So, this concept is about China's own market, our own as well. It's about improving the competitive environment of any market. And that's how the OECD uses this concept.

The calculations I have conducted because of lack of data for foreign companies who are not big enough in China to include them, compares state-owned companies and private companies in China.

But interestingly, the sector in which we find the least competitive neutrality -- which, by the way, we define with the data available, which is tax and financial access -- so we look at how subsidized the funding is of state-owned companies in that case, compared to private. And then how -- what is the effective tax ratio, how much lower it is.

So, we go company by company to show that.

And, interestingly, it's the auto sector that is the most uncompetitive, which lacks the most competitive neutrality. Guess where the foreigners are, in that sector. So, we suffer from the lack of competitive neutrality for private companies in that sector, so we suffer as well because we operate in that market.

So, I think it's a, in a way, it's kind of a way for China to set its own reforms, it's own lack of reform. And I know that Governor [] was very keen on introducing this concept at the very beginning of the negotiations with the U.S. on the very beginning of negotiations with the U.S.-- during the trade war. But even with Europe, then eventually they gave up because there was a lot of pressure, not do so from their leadership, from other parts of their leadership.

But I do think it's a constructive concept because we might not measure it all, but at least we have a better sense of what we're talking about rather than just focusing on subsidies.

COMMISSIONER CLEVELAND: Thank you. I'm going to get one more question in for all of the witnesses.

As we look forward, I'm curious what we know about Chinese firms' operations overseas, especially using Chinese-purchased companies as a way of establishing an entry point to U.S. and the EU single market system. I think, Ms. Garcia-Herrero, you raised this in your testimony. And I think, Ms. Nikakhtar, you did as well.

So, do we have sufficient data to assess how they may be using companies that they buy as a back door to circumvent trade policies?

MS. NIKAKHTAR: So, you know, it's a really good question because our government doesn't collect this kind of data. And so everything is, it's just anecdotal.

But we know through the CFIUS -- and maybe I should say the huge gap that's created by greenfield investments, and that we don't review those, and that's pretty horrific. So, whether it's sort of a foreign acquisition of an existing company, I mean, you know, I mentioned sort of some problems we have with mitigation agreements, or if it's greenfield investment, one, we don't collect data to see how adverse sort of the predatory practices are. And our government maybe should really start looking and collecting data like that.

But, also, so we have a lot of anecdotal information. Right? And so, we have Chinese acquisition of companies that basically bankrupt our companies, steal the IT and bankrupt the companies.

We have, we see economic disruptions that have been caused by investments in the U.S. market, but then Chinese companies are bringing in subsidized goods and then making things more cheaply here, and then wiping out the domestic industry. And by the time the domestic industry now wants to bring some kind of action they've been wiped out. And then legally they don't meet the statutory threshold.

And there's this other notion of you set up a business in the United States, a medical business, or you hire a bunch of engineers. Medical business, now you're getting people's genetic data, sensitive information. Or you hire engineers and use the U.S. ecosystem sort of to develop high tech products. And then once you're done with the company, you shut it down and then you move production overseas.

I mean, they are, the Chinese Government they are very keen on using every vector in the

United States to get in our economy and our allies' economies and just exploit, exploit, exploit. And the fact that we have just basically allowed the market to take care of it, we have at least two, three decades of evidence and that the market hasn't taken care of it. Let's study it, let's figure it out, and let's put an end to this.

COMMISSIONER WESSEL: Thank you.

Just as a quick clarifying yes or no question. My understanding is Commerce has the statutory authority to get the data that Commissioner Cleveland just asked for but is not utilizing. Is that correct?

MS. NIKAKHTAR: So, there's two points. So, yes, Commerce has the statutory authority. So, you have the Defense Production Act ability, the Bureau of Economic Analysis census collect a lot of data.

The problem is twofold. The Defense Production Act survey authority, you can't make some of the key findings public. And we've got to figure out how to resolve that.

And then the Census Bureau's economic analysis data also, by statute, there's not much they can release publicly.

So, it's fine and great, the Government's sitting on all this data. They're certainly not doing anything about it. And then the rest of the people who want to give recommendations don't have access to the data to do anything.

And this is really just a fundamental problem that we've been dealing with for decades.

COMMISSIONER WESSEL: Thank you.

Commissioner Fiedler.

COMMISSIONER FIEDLER: I want to revisit Mr. Prestowitz's testimony.

You indicate that it's not enough to just look at trade, you've got to look at investment. And Nazak you were talking about how to use established trade law to apply across the board to various government agencies.

It appears that the United States is unable to construct its own house to deal with a unique threat that China poses. So, for instance, we have the SEC says we don't have country-specific laws or regulations, but we have a country-specific problem in China, in a way that we have not had with any other country, apparently, in history, certainly recent history.

How do we get, how do we construct a regulatory system that is competent to deal with what everybody thinks is the threat? I don't want to have to describe the threat again. But we're calling China a competitor as opposed to an adversary, officially. And that may color what's going on.

How do we, how does the United States Government that doesn't coordinate very well anyway, how do we get them to coordinate against this singular threat?

MR. PRESTOWITZ: So, can you hear me?

COMMISSIONER FIEDLER: Yes.

MR. PRESTOWITZ: Okay. I think the point you made is that we are -- we have, since the early 1980s we have dealt with China on the basis of the assumption that by engaging in the kind of open, free market, free trade, free investment that we engage in with the EU, or with Japan, or other market economies, that China would reciprocate, that China would, in Bob Zoellick's words, become a responsible stakeholder in the rules-based global order.

That has been a huge mistake. China does not intend to be a responsible stakeholder in what it considers to be our global economic order. It intends to build its own economic order.

And so, I think you used the term "adversary." I think we need to begin to think of China as an adversary, an across-the-board adversary. It's not just, in fact it's not even primarily a

military adversary, it's primarily a technological and economic adversary.

And if we think about it that way, then we do have the capability -- we have the legal capability and we have the bureaucratic capability to, as Nazak said, to not only collect data but to share it, and even to make it public.

I don't think it's so much a failure or an absence of U.S. legal capability, I think it's much more a problem of attitude and kind of arriving at a shared perspective on the reality of China.

And I think that, you know, if you look at the Defense Production Act, if you look at all the things that the U.S. Government can do during wartime, or can do even not during war but can do in terms of look at what we're doing with regard to Ukraine right now, the Government has powers and authority that it doesn't use.

And it doesn't use them, one, because until very recently our approach to China was the notion that they wanted to be a responsible stakeholder in this global order that we thought we had built.

And, secondly, we don't use it because we have fooled ourselves about how the global economy is working. I think it's really more a matter of fully recognizing what we're up against and changing our attitude to see China as fundamentally a major competitor.

MS. NIKAKHTAR: May I also -

COMMISSIONER FIEDLER: Please.

MS. NIKAKHTAR: -- answer that question, please?

COMMISSIONER FIEDLER: Uh-huh.

MS. NIKAKHTAR: It's important, and I want to make a couple points.

So, China's made it too easy for businesses, U.S. businesses, global businesses, to make money there. So, we've just become addicted to selling, moving operations there, et cetera. And, you know what, businesses are going to do it until we tell them not to because they have a short-term interest that they think that the Chinese markets will help satisfy. And as long as they can say, look, it's not illegal, right, they're going to keep doing it.

And that's where the laws come in. We've got to leverage stronger laws to prevent some of the economic harm, much of the economic harm that we're worried about.

But I also wanted to say just, look, we have to dispel the prevailing notion that U.S. businesses need revenue from sales to China in order to invest in next gen technologies and survive economic competition. Any revenue lost from sales to China can be replaced and can even be augmented by increasing sales within the United States and the nations of our allies.

It makes absolutely no sense to invest in the supply chains of our adversary instead of our own. We have to build our own supply chains, we have to build our allies' supply chains in order to obtain the much needed redundancies in our most critical supply lines. Redundancy is essential when our supply chains are most vulnerable.

The U.S. Government has to support those investments as well. And in my testimony, I mention the creation, using some of the Section 301 money to create an innovation fund where we capitalize industry growth, capacity, and innovation.

But the point is, we have to make, establish clear red lines that businesses can't cross because, again, China's made it just too easy for them.

MR. PRESTOWITZ: Let me add one other segue.

COMMISSIONER WESSEL: We're going to have to go on. I apologize.

Commissioner Friedberg.

COMMISSIONER FRIEDBERG: Thank you very much. And I join my colleagues in thanking our witnesses for their testimony.

I'm struck in listening to everyone and reading the testimony that we're going to hear later today that a real convergence on our diagnosis of the problem basically goes something like this: we let China into this open international economic system that we've built on the assumption that by doing so we would encourage them to transform themselves into a market-centered system.

They haven't. They're not going to. And the policies that they're pursuing pose a growing threat to our prosperity and security, and not only ours but those of our democratic allies.

So, then the question is, what is to be done?

And here it seems that there's a range of answers from adjusting the terms of our relationship with China to really cutting ourselves off from them to a considerable degree.

So, I wanted to start by asking, Mr. Prestowitz, you had two references to something you refer to as ENATO that you describe as superseding WTO and DTO, Democratic Trade Organization, that you refer to as a multilateral pathway outside the World Trade Organization.

Could you say a little bit more about what you think those would look like and what would be necessary in order to construct that?

MR. PRESTOWITZ: Sure. Thank you.

Well, I think that the U.S., it's not just the United States that is waking up to the reality of China. I think we're seeing that other democratic, free market countries are having the same recognition.

So, I, if I look at the World Trade Organization, there has been a lot of talk about trying to make the World Trade Organization work better, changing the rules of the World Trade Organization. I think it's hopeless because the World Trade Organization works on the basis of consensus. They don't take a vote in the World Trade Organization on particular approaches or regulations.

But what I could imagine is a trade organization that encompasses the major democratic, free market countries, so the EU, the U.S., Canada, Mexico, Australia, India, others, that are operating in a global economy more or less along the lines and according to the rules of a truly free market rule of law structure.

And I think, actually, if we look at the current situation in Ukraine, for example, it's clear that the free world, and particularly the U.S., and the EU, and Japan, it's clear that they have come more together and have begun to view China in a much more similar way.

They all have the same problems that we have with China. They all have the problems that Nazak was mentioning about secret investment, and stealing of intellectual property, and so forth. And I could imagine, in the past I myself worked on an EU-U.S. free trade agreement. It didn't happen, but I think it's possible. And I think it's possible to bring other major countries into that kind of an arrangement.

And I think actually it's necessary to have that kind of arrangement in order to be able to share information and in order to be able to bring united pressure to bear on China to combat what is really a state-run capitalism in China.

So, that was that thought.

You know, I mentioned ENATO. I talked about a democratic conglomeration of countries. It's essentially the same thing. I'm talking about bringing together the truly democratic countries and the countries that truly operate on a rule of law, and that truly operate with free market economic concepts.

COMMISSIONER FRIEDBERG: Thank you. I think I am out of time. I have some other questions but that's for the second round.

MS. NIKAKHTAR: Maybe just one second.

I like Mr. Prestowitz's points because if we could leverage those systems, too, to make sure that we have currency, the United States dollar, the strength of common currencies so that we can fend off the growth of the yuan in the global market and maintain our leverage over China, that's a very important concept, too. So, these organizations could be leveraged for that important mission.

COMMISSIONER WESSEL: Thank you.

MS. GARCIA-HERRERO: May I add a very short point, if you don't mind.

COMMISSIONER FRIEDBERG: Please.

MS. GARCIA-HERRERO: Because I think we need to recognize that China is a humongous economy. I'm an economist and I'm hearing you. And I just want to highlight that we, we can't do this alone. We need Asian partners. China has more Fortune 500 than the U.S. today.

So, the point I'm trying to make here is that it is not all about reassuring. We need to find other economies to help. Because if we don't, because of China's presence in those economies, like Indonesia, it's a humongous economy, we just won't be able -- it won't be about China, it will be about China plus Indonesia, the question that we were asked about, you know, their presence in companies and how China exports from their countries. It's happening as we speak.

So, I just want to say that the more countries are support it, the easier it will be. It has to be an inclusive strategy. That was just my point.

COMMISSIONER FRIEDBERG: Thank you very much.

COMMISSIONER WESSEL: Thank you.

Commissioner Glas.

VICE CHAIR GLAS: Many thanks to all of you for your testimony this morning.

You know, I'm kind of reminded of there was a Vanity Fair piece, I think it was published last night, about Ambassador Tai talking about the more complicated relationship that we're having with China right now, and recognizing the House and the Senate are trying to reconcile very different packages associated with China, including key trade provisions.

We've heard a lot of -- I've heard a lot of different things in recommendations today from your written testimony and your verbal comments, everything from creating a greater community, an international community to help combat the forces of China, duplication of our supply chains, going out to U.S. companies for exporting, or who are locating or buying their inputs from countries like China, export controls, CFIUS review.

You know, we're, as Congress is finalizing the China bills, what is, as you're reading the provisions of those bills, what are things that essentially need to remain in order to ensure that we are having the most aggressive approach related to China? And what's missing?

MR. PRESTOWITZ: If I could reply quickly.

There's one element that I think is very rarely discussed which I think is absolutely critical. I mentioned Apple earlier, I mentioned the Hong Kong map live incident. I think what we have to understand is that our corporations, our major business leaders, the Ray Dalios of the world, the Tim Cooks of the world, they are powerful here in Washington. They spend bazillions. You know the money they spend, the entre they have here in Washington.

In Beijing they're on their knees. They kowtow. And they, you know, let's keep in mind China is not a rule of law country. So, Tim Cook knows, Ray Dalio knows that if they get a little bit out of line with what Beijing wants, oh gee, the electricity could go off, or the water could be turned off. They can suffer the death of a thousand cuts.

And, you know, there's no, they can't go to some court. They can't hire some lawyer to stop that. In fact, they have party cells in their companies. The party cell in their company will stop them from taking appropriate responsive action.

So, one of the things that I think is very important for the U.S. Government to put, put the CEOs of global corporations on notice that they're not going to be able to operate in this kind of two-sided, unbalanced world.

So, I mean, this may sound a little radical, but when Tim Cook comes to testify before Congress, he testifies as the head of an American multinational. No. He should be compelled to testify as a foreign agent. He's much more an agent of Beijing than he is of Washington.

I could say that of the head of the Chamber of Commerce. I could say that of the head of the U.S.-China Commission here in Washington. They are all tools of China, not of the United States. And it's important, I think, for the Congress and, obviously, for the White House to find a way to reduce the imbalance of corporate power.

VICE CHAIR GLAS: Nazak?

MS. NIKAKHTAR: Yeah. So, actually, the foreign agent comment, the affiliation issues that Commissioner Wessel discussed, if we actually do something like the executive order that we proposed, we could actually have companies register as foreign agents because tying these companies to the central government.

But I just wanted to quickly make a point and we can talk about it later if anybody is interested.

But, look, the new legislation is just one, it's just one iteration. Right? The complexity, the challenges with China are just too great, as you all know, to just stop at one legislation. Yes, let's move forward, but we've got to keep doing more, keep doing more. And we have to do it quickly because time is running out.

But there's one thing I really want to emphasize about I think it's great is the outbound investment restrictions for two main reasons:

One, our companies are forming joint ventures in China, developing technologies there. And by virtue of developing technologies there it's outside U.S. export control jurisdiction. When those JVs are harming interests, semiconductors, explicit technology, lithium ion, we've got problems.

The other one, the other item is that at least at the end of 2020 the value of our dollars invested in China exceeded 2.3 trillion. Why aren't we investing that in the U.S. economy, tying this to our allies, again to fill the redundancy in our supply chain?

And so, those two key points really underscores the fact that we need to do this, and the fact that we need to do this broadly. Because if we end up doing this narrowly, this ship may sail and we may not get a re-do unless, really, our government comes together, which we know that, you know, isn't always the case. But let's just do things right for a change. Let's just take legislation, make it meaningful.

Yes, is it going to hurt companies in the short term? Absolutely. But the medium term impacts, the longer term impacts are going to be so substantial that they don't need to be doing this.

Thank you.

COMMISSIONER WESSEL: Senator Goodwin.

COMMISSIONER GOODWIN: Thank you, Mr. Chair.

Dr. Garcia-Herrero, let me just ask you a question.

MS. GARCIA-HERRERO: Very quickly. Yes, very quickly.

I hear you and maybe from a distance. And I understand that a lot needs to be done to reduce the harm made by a non-market economy. But, but, you have the most successful multinationals in the world, and we need to find other markets for them.

I don't think, as an economist, it's enough to cut borders and, I mean, to basically put, to put barriers in, in their business plans. I think you need to do that at the same time offer other markets. I think this is extremely important for the U.S.

And I think if you only cut but you don't do that, your companies and your country will suffer.

COMMISSIONER WESSEL: Senator, and reset the time if you could.

COMMISSIONER GOODWIN: Thank you.

Doctor, I do want to ask you a follow-up question about subsidies. And I appreciate up front, as you said in your testimony, that looking at subsidies alone doesn't tell the whole story, and it doesn't give the full picture or fully capture the complement, the full complement of Chinese support and intervention in the Chinese market.

But, nonetheless, it is valuable for us to look at these and compare what they are doing and how it distorts global trade. But, of course, for subsidies, you know, it's all in the eye of the beholder. So, what one country would view as a legitimate measure of support and exercise of sovereignty, their trading partners may view negatively.

And the U.S. and the EU, certainly try to incentivize certain investments in our own markets.

So, how is it different? How do we talk about this in a way about subsidies with our client, the U.S. Congress, to fully capture the difference of what China is doing just with thee subsidies in terms of type, scope, eligibility, sector-specific targets, and so forth?

And I'll say, you offer a couple of examples in your written testimony, including how they offset household rising electricity bills. That sounds a lot like something we would do here. So, how is it different?

MS. GARCIA-HERRERO: So, are you, this question is addressed to me?

COMMISSIONER GOODWIN: Yes. Yes.

MS. GARCIA-HERRERO: Because I didn't hear the beginning. Sorry, sorry.

It's such a good question. And this is why I don't like to focus on subsidies. Because we all offer subsidies, you're absolutely right. And the question is how distorted they are and how much they affect market access.

So, so I think we need to put together types of the subsidy and the objective of the subsidy. So, one thing is to support a market, say the semiconductor industry, and the other thing is to cut imports of components of semiconductors so that they are substituted, which has an impact on those exporting semiconductors to the PRC.

So, I think this is why I like the concept of competitive neutrality because it starts from China itself. It is not about us, it's about their own market. And what that concept does is to try to create a level playing field among Chinese companies. And that's why I think it's much more powerful because if we focus on subsidies only, you know, the PRC could just say you have the very same thing that we do. I fully agree with that.

COMMISSIONER GOODWIN: Thank you.

MR. PRESTOWITZ: Could I, could I say a word?

COMMISSIONER GOODWIN: Sure.

MR. PRESTOWITZ: So, for at one point in my career I was on the Advisory Board of Intel, the semiconductor maker. At that time Intel did not have any operation, any production

operation in China.

And I remember touring Intel with Andy Grove. And at every meeting we would go the issue of Intel producing in China would come up.

And, you know, the offer was, look, Mr. Grove, if you put a semiconductor fab here in China we'll give you the land free, utilities at half price, no taxes for 20 years.

How much does that fab cost? About $12 billion.

Oh, we could put in a grant of $2 billion.

Now, that same kind of policy attitude prevails in China, not just in semiconductors but in aircraft, and robots, and all of the targeted industries that China has adopted. And I think that it's important for us to kind of respond in kind. And, in fact, President Biden is doing that with the act that's going to put I think about 50, 55 billion U.S. dollars into building semiconductor fabs in the U.S.

So, I think it's important to also consider fighting fire with fire.

MS. NIKAKHTAR: And I just wanted to make one quick point. I think it's always important to remember subsidies coupled with tech transfer, because I think Chinese subsidies have really sort of helped the Chinese and these industry giants grow.

It would be very different if they didn't also benefit from our tech transfer. The subsidies plus tech transfer is allowing them to run way faster than us.

COMMISSIONER WESSEL: Commissioner Mann.

COMMISSIONER MANN: Thank you. Thank you to the witnesses for lots of very helpful ideas and proposals.

I want to step back from the nuts-and-bolts and Executive Branch issues that have been raised, and focus on a couple of the broadest and longstanding policy questions that have been in Congress. And I want to address this to Mr. Prestowitz and Ms. Nikakhtar.

The first is, should we repeal PNTR? I think, Mr. Prestowitz, you said that would mean withdrawing from the WTO. So, is that a wise move or not?

And the second, again for both of you, is because I sense this will come back around should the United States join the new and revised version of TPP?

MR. PRESTOWITZ: Well, the PNTR question, as you know, is one of those that is very slippery. I mean, I think that it was a mistake to give so-called PNTR.

I'm old-fashioned. I like to use the old language, most-favored nation. It was a mistake to give China permanent most-favored nation treatment.

But having done so, to withdraw it would be, I think, very difficult, given that we are members of the WTO and we're probably not going to withdraw from the WTO.

But at the same time, I think that one thing that has been little-used, but could be very powerful, is the authority of the Secretary of Commerce to self-initiate anti-dumping cases.

We did it once in the late-1980s on Japanese semiconductors. The Secretary of Commerce has the power to self-initiate anti-dumping cases. And I urge that the Secretary use that power more frequently and more systematically. Your second question is what?

COMMISSIONER MANN: TPP.

MR. PRESTOWITZ: TPP. Yeah, I think that TPP, or any, let's say, revised TPP, which people are talking about, is not going to solve any of the trade issues or any of the inequities of trade between us and China, or between the free world and China.

I can see diplomatic value in a new TPP. I can see it as a SOP to the Indonesians or the Malaysians, or the Singaporeans, or what have you.

But in terms of addressing the underlying fundamental problems of globalization and

trade with China, it would not have any significant impact.

And also, I don't think China has its own RCEP, which is often presented as equivalent to what we were doing in TPP, but it's not.

And I'm skeptical of the argument that somehow China is taking the lead in Asia because it has RCEP and we don't have TPP. I mean, the truth is that almost all the Asian countries have trade deficits with China. They have trade surpluses with the U.S. and trade deficits with China.

And to the extent that they export to China, a large part of what they export to China winds up in the U.S. or winds up in the EU. So, I think that that discussion has been very superficial and not very deep.

Now, having said that, coming back to the idea of an eNATO, or since NATO is focused on Europe, if we make it eDemocracy, then I could see some real benefit in pulling together all of the democratic countries.

So, Korea, Japan, Philippines, all of the democratic countries, into a free-trade agreement. That, I think, is something we ought to be thinking about.

MS. NIKAKHTAR: May I also answer that question?

COMMISSIONER MANN: Quickly, if possible.

MS. NIKAKHTAR: Yes. So, with respect to PNTR, I don't think in the short-term that's possible. I think economic interests are too great. I don't think it's going to be passed.

What I think we should do is identify the items that are most critical to our national security, raise our tariff rates there. We could use Article 21 of GATT to allow us to do that.

And the reason we want to do that is make sure that then we can invest in the United States and make those industries grow without the threat of being displaced by cheap Chinese import.

And with respect to the TPP argument, what I'd really like for us to do is to give the Chinese firms less ability to exploit our markets. I think that, first and foremost, should be our priority. Thank you.

COMMISSIONER WESSEL: Thank you. Commissioner

(Simultaneous speaking.)

COMMISSIONER WESSEL: Time is we're running out of time. Commissioner Schriver.

COMMISSIONER SCHRIVER: Thank you. And thank you to our witnesses. Really excellent statements and excellent discussion. I'm learning a lot.

And speaking of learning a lot, as a non-economic trade person, one of the things I struggle with a little bit during these conversations, is understanding prioritization. It's really impressive we get witnesses that can speak on subsidies, IP, outbound investment, and it sort of runs across a very wide spectrum.

So, if I were to force you, to the extent I can from this side, to say, my biggest concern is X and this administration will get a passing grade from me if they do Y, so in terms of prioritization, what would you say is the biggest concern you have in this broad category of economic trade, and what is the one tool that you wish would either be strengthened, or a new tool that you wish existed? And start with Ms. Nikakhtar, please.

MS. NIKAKHTAR: Since I'm only limited to one, I really think right now we've to stop the bleeding, as you've pointed out. And I think we've got to deal with export controls.

We are just seeping too much technology over to China, and there's a way for our government to track it, right? And our government has data, and we can track that data better.

But at the end of the day, we're prolonging the problem. We know what the problems

are. We've got to look at our export control rules, we've got to look at all of the loopholes in those rules, and we've got to tighten it up.

And not to allies, right? We want our allies to have our technology. We want to encourage interoperability. What I'm really talking about is the Chinas and the Russia's of the world, and we have to stop our tech transfers to them. Thank you.

COMMISSIONER SCHRIVER: Mr. Prestowitz, same question.

MR. PRESTOWITZ: I'm very sympathetic with what Nazak just said. Look, China has you know, it's so interesting. China tells you what they want and what they're going to do.

China has a made-in-China 2025, or made-in-China 2035. The Chinese have told us that they intend to be self-sufficient and to be the world leader in virtually all of the new high-tech areas robotics, artificial intelligence, semiconductors, etc. And China is pouring gazillions of RMBs into building that capacity.

It's spending gazillions to obtain the technology, the secrets, the patents, whatever it is that gives the U.S. or other free market countries leadership.

China is pulling out all the stops to get all of that stuff. And we are doing a little bit. Our government's doing a little bit. We leave an enormous amount of freedom of action to our corporate CEOs, who, as I mentioned earlier, are often hostages of Beijing.

The interesting to me in the last several months, has been the focus in the U.S. on bringing semiconductor production back to the U.S.

That is a good thing to do. It's not enough. We need to match China's made-in-China 2025, 2035 programs.

And when I say match, I mean we need to pour money into those, we need to facilitate the pouring of private money into those, we need to develop techniques to obstruct China's progress, and we need to not encourage not just research.

Remember that the research is if you're a corporate leader, R&D is an expense, it's not a profit. It's an expense. You only make money if the R&D results in something that you make and sell.

And so, yes, we need to spend more on R&D. But we really need to bring production and development into the U.S. And I sympathize with the other witness about other markets.

Yes, India has 1.4 billion people. It's going to have a bigger population than China in a few years. We ought to be developing the Indian market. And we ought to be looking at Africa and other places.

But at the moment, the big markets, outside of China, are Europe, Japan, and the U.S... And we need to have coordination with those countries, to do the kind of thing that I'm talking about, matching China in those cutting-edge technologies.

MS. GARCIA-HERRERO: I'd like to say what I think I would do. And I agree with everything that has been said. But again, you need other markets.

And I think if you want to do that fast and stop China because that's what it is from upgrading its straight deal with Asia, you need to get into CPTTP, like the U.K.

Which, I mean, the U.K. is waiting, Taiwan is waiting, China is waiting. So, if the U.S., and possibly even Europe, comes and enters the CPTTP, it closes China the access to a much higher level trade deal.

And I think that's so important. Because it's not only about keeping technology at home. It's about having the markets to use your technology.

So, I just wanted to say that. I do think CPTTP is very important for the U.S.

COMMISSIONER WESSEL: Thank you. Commissioner Scissors.

COMMISSIONER SCISSORS: Everybody else thanks the witnesses. I'm going to apologize to the witnesses. I did read everyone's testimony and I tried to ask a question and I failed.

So, I'm just going to rant. And I don't really expect you guys to respond. And maybe I won't even leave you any time to.

Nazak touched on this. China acquires mass-market technology, which is Panel 2 topic. And then, it uses subsidies, a Panel 1 topic, to scale up to destroy competition.

And Clyde's the dean of this, but all of us, or many of us, have been in this field for a long time.

Forget our responding to subsidies and market access restrictions and excess capacity. We need to stop helping the Chinese benefit from them.

I'm not talking about us neutralizing them. I'm talking about us stopping assisting them.

The Department of Commerce fails to enforce existing U.S. law and foundational technology export controls, making it easier for China to acquire the technology.

It's then followed by subsidies, which we complain about but do nothing about, that scale up and drive out U.S. and other competition.

There are many examples, but telecom is a prime example. It's now happening in CHIPS. CHIPS are supposed to be a U.S. government priority.

The problem here is maybe two decades old. It certainly didn't start with this administration or this Congress. But Secretary Raimondo insists that we need to have CHIPS subsidies, while her agency allows, against an overwhelming bipartisan Congressional vote, to continue to transfer technology to the competitors of the plans we're supposed to be subsidizing.

And this verges on a scam where the taxpayers are asked, hey, provide money to firms so they can build in the U.S., while the firms assist the Chinese in distorting the market, which allows them to come back to the U.S. and say, we need money.

I want to clarify that. Give money to companies that are helping China warp the market, and then the companies come to us and say China's warping the market, you have to give us money.

There's a painful parallel here on the Alpine investment side which I know I'm stretching beyond the topic, but I'll come back to the topic, I promise which Secretary Mnuchin was protecting the financial relationship, 2017 to 2020, to the tune of nearly $800 billion in new U.S. money going to China, while we were supposedly waging a trade war to bring the Chinese to the table.

You don't pressure the Chinese to negotiate and make meaningful confessions by giving them $800 billion over four years.

So, again, it's not just this administration that is talking one way, but assisting, enabling the assistance of China, while we're supposed to be trying to change their policies.

I very crudely estimate about $130 billion of that money was in tech. And there's been no policy change in the Biden administration.

They talk about restricting Alpine investment. They cannot describe a cover transaction for their proposal in public.

All right, back on topic. One reason why the Chinese won't change on subsidies, market access, excess capacity, is that we've not only caved, we've supported them, with money and technology.

Multiple administrations, multiple Congresses, Republican and Democratic, I and perhaps others here have been attacked for promoting decoupling.

The first step in responding to China is stop helping them. Not sanctioning them, not punishing them, not taking WTO legal actions. Stop helping.

If you're not going to stop helping, then stop pretending that you're actually going to respond effectively to their market distortions. Rant over.

COMMISSIONER WESSEL: And reclaiming that time.

MS. NIKAKHTAR: Well, actually, I have one really quick point, which is, it's really incredible. We spend so much money, we spend so much time, developing our technologies through trial and error.

Twenty years, twenty-five years to develop technology, and then we just hand it over to China without the cost of developing it, without the trial and error of lead time, and then we're just allowing them to raise the head in this way. It's absurd. I agree, in other words.

COMMISSIONER WESSEL: Chairman Wong.

CHAIRMAN WONG: I want to ask, or focus in on your recommendations regarding Greenfield investments, Ms. Nikakhtar.

You explained the rationale for regulating and screening these investments based on a number of reasons, some of them based on surveillance and espionage, some on perhaps vulnerability or Chinese infiltration of certain critical infrastructure.

There's also an aspect of this of preventing our own industrial base from being eroded by having these companies founded here become a vector for subsidized goods, or some other mechanism.

That's a wide range of reasoning behind why we have to look at Greenfield investments. That indicates to me your proposal for screening and regulation would also have to be pretty wide-ranging.

So, I want to kind of focus in on the practicality of that. I understand the dollar amount of Greenfield investment in the U.S. from China is relatively small compared to M&A.

But do you have a feel for what the number of transactions we're actually talking about here is on an annual basis?

MS. NIKAKHTAR: A lot of it's not tracked. You've got a lot of investments, a lot of sort of experts in Silicon Valley say that just these sort of startup companies, garage companies, the Chinese are not only buying, and that's an existing business, but also sort of helping fund new emerging sort of technologies and new business ventures.

We don't have a good way to estimate what the value of those Greenfield investments are.

But we are seeing it in the news. Right now, there's an enormous land acquisition deal in North Dakota, right by the Grand Forks Air Force Base. Right? And that falls under CPS jurisdiction, but a lot of people are really worried about that.

And so, you have ample anecdotal evidence to make you very, very worried. And we could craft it as narrowly as current CFIUS jurisdiction. I mean, I would like it a little bit broader.

But ultimately, to minimize the economic impact and the burden on the government, in terms of handling all of this, we really just look at the few high threat actors, where you want to limit Greenfield investment, knowing full well that once they're in your economy, they're within your borders, they're just going to reap a lot of harm.

CHAIRMAN WONG: When you say high threat actors, what do you mean?

MS. NIKAKHTAR: So, our governments both the Trump administration and the Biden administration have identified countries that it deems to be adversaries China, Russia,

Cuba, Iran.

Obviously, there's a whole bunch of countries that are already sanctioned, so those aren't going to be a real issue. But with respect to China, which is the biggest foreign adversary that still has incredible access to the market, that's where the ultimate impact is going to be, restricting Chinese Greenfield investments in the United States.

CHAIRMAN WONG: So, again, the practicality of this. Let's say there's a thousand, which I think is a low number, of Greenfield projects in America funded by the Chinese.

How would we identify those? Would it be self-reporting? Would it be a complete block? Unless it's reported and restructured, and then who would be responsible for reviewing it?

I know we have a CFIUS committee now, which draws from various expertise from various agencies, but considering, again, the wide range of reasons why Greenfield investments might be a threat, particularly years away because these are Greenfield, right?

It's going to take some time for these projects to mature. It's not as apparent as an existing like an M&A transaction. I'm just trying to get a sense of what we're actually recommending, if we recommend this to Congress?

MS. NIKAKHTAR: Yeah. So, I want to stress that it's not necessarily always the quantity, but it's the quality. Right? And so, you're getting land acquisition.

You're a military base, an Air Force base, that's doing a lot of space work, right? That gives you a lot of access to surveillance of pretty unique things.

But it would work just like the current CFIUS way, where if you want to purchase land in the United States, whether you're looking into a Greenfield investment, you would notify the government. I think the government bodies that are already supposed to look at this maybe the FTC, other authorities don't have national security components built in to their work so we'd make sure that there's a mechanism for the government to review that, much like CFIUS, and then work with parties, see if the transaction needs to be blocked or mitigated.

In my testimony, I did flag a danger with mitigation agreements where we say in our agreements, yes, but if you set up a hospital here, you can't transfer the data to China, even though the Chinese government says, no, no no, you need to give me the data by law.

You have an inherent inconsistency. Until we resolve that, we shouldn't do mitigation agreements. But fundamentally, it's a great question.

It would work exactly like the current CFIUS process, because that's been tested over time and it's relatively a well-oiled machine with some of these problems that I just talked about.

Ideally, it should be expanded because the China threat is great. But it's a starting point.

CHAIRMAN WONG: Thank you. I have a follow-up question, but I would like to save it for written, because I'm short on time, but it involves I know, Mr. Prestowitz, you seemed a bit more open to Greenfield investments, but it seems that you're trying to get at different threats here.

You want the current account and you want a whole wide-range of national security issues, as well as economic issues. But I'll follow up in a written question.

COMMISSIONER WESSEL: Commissioner Bartholomew, did you have a question?

COMMISSIONER BARTHOLOMEW: I do, thank you. Thank you to all of the witnesses. Sometimes it's helpful to hang back and hear what other people are asking.

Some of us, of course, have been raising concern about Chinese unfair trade practices for a long time. Some of us going on 30 years now.

And I'm just wondering, listening to all of you, are there any trade mechanisms that we

have tried that have worked to actually change Chinese trade practices, the practices about which we're concerned?

And I know we have cases that help individual companies, or individual sectors, but has anything actually changed about unfair trade practices, that we've been raising concern about? Dr. Garcia-Herrero, we can start with you.

MS. GARCIA-HERRERO: Well, what I can say is that of course we've not changed non-market practices in China. But we've certainly scared China.

I mean, a lot of your import tariffs have made life difficult for China, but especially the entity list. I think the entity list is a very obvious case of beyond export controls, so basically making it much harder for China to move up the ladder.

And I think that's one of the key concerns that China has had over time. So, if you ask me, the entity list has been, in my opinion, quite successful in targeting certain Chinese companies away from certain technology.

COMMISSIONER BARTHOLOMEW: Thank you. Clyde?

MR. PRESTOWITZ: Well, I think there have been cases I'm thinking of Huawei, particularly in which U.S. actions have had a major impact on that particular company.

But nothing that we, or any of our allies, have done has changed the fundamental approach and process of the Chinese system.

We talk about private companies in China, but you see what has happened to Alibaba and other so-called private Chinese companies.

Ultimately, they are very much under the control of the government. And as long as the Chinese Communist Party is running China, we're not going to change they might shift from one technique to another, but the fundamental approach and philosophy is not going to change.

COMMISSIONER BARTHOLOMEW: Nazak?

MS. NIKAKHTAR: Yeah, thank you. So, it's a great question, because the answer is, of course not. We can't change China.

China's too big, it's too powerful, it seduces all of our companies U.S., European companies with money, to basically become the mouthpieces of the CCP.

I mean, I mentioned this a couple of weeks ago at a different hearing, but the Chinese government doesn't need to hire lobbyists. U.S. companies, other companies, are becoming their mouthpieces and doing the lobbying for them.

And what I want to mention about the entity list, which is very sort of nice and symbolic, we can't put ourselves in a position where we're just constantly playing whack-a-mole. Right?

China's just too big. It has millions of companies. We're just never going to keep up. So, now we can't change China. We have decades of experience showing that we can't change it.

But at the same time, to Commissioner Scissors' point, we haven't really been serious about changing it, because we keep giving China everything.

And as long as the sort of silliness, I think continues, China will have no incentive to change. I think we need to be really serious about cutting off a lot of our ties.

Our economy will recover. Businesses are great at finding money, finding revenue. They will find other markets to sell to, which is what we've been talking about as well.

But we shouldn't ever expect China to change, because we have decades of experience demonstrating that they will not change and have no interest in changing.

COMMISSIONER BARTHOLOMEW: Wasn't China's entry into the WTO was supposed to be changing China's trade practices? Right? That was the way that it was pitched, was this was going to be incorporating China into the global trade regime, and its practices

would change to align with it.

So, I always go back to the question, like, I know people asked about PNTR, but I guess we just have to ask do we need to fundamentally change the WTO, or is it working as an institution? And it's an unfair question to ask when there are only 20 seconds left to respond. So, maybe you all could respond in writing to that question.

MS. NIKAKHTAR: One quick point though. What the United States makes the mistake of doing and over again, is we assume that our competitors are adversary. Just foreign countries think the way that we do.

And by assuming that they think and they value the same things that we value, we completely miss the mark. We need to get in their heads better, so we know how to position ourselves to be able to respond.

COMMISSIONER BARTHOLOMEW: Thank you.

COMMISSIONER WESSEL: On that note, and on that final set of questions, thank you to our witnesses for the time you put into your written testimony, your oral testimony, being here today, and for your service.

We hope that you'll be available to answer some questions in writing that we may have afterwards. And with that, we will take a ten-minute break before our next panel. Thank you.

(Whereupon the above-entitled matter went off the record at 11:14 a.m., and resumed at 11:23 p.m.)

PANEL II INTRODUCTION BY COMMISSIONER ROBIN CLEVELAND

COMMISSIONER CLEVELAND: Panel Two, welcome back. Our second panel will assess how the U.S.-China trade relationship impacts issues regarding U.S. innovation and our technology base, and what the U.S. and partners can do to maximize resilience and overcome China's non-market practices in these areas.

First, we'll hear from Emily Kilcrease, Senior Fellow and Director of Energy, Economics and Security Program at the Center for New American Security. Ms. Kilcrease's testimony will focus on export controls, and investment screening and response to China's unfair innovation and technology-related trade practices, as well as the opportunities for stronger collaboration with Europe and other key allies and partners. Ms. Kilcrease has not previously testified before the Commission, so welcome.

Next, we'll hear from Stephen Ezell, Vice-President of Global Innovation Policy at the Information Technology Innovation Foundation, where he focuses on science, tech, and innovation policy, as well as international competitiveness, trade, and manufacturing policy issues.

Mr. Ezell's testimony will discuss China's innovation mercantilism, U.S. domestic responses to promote innovation, and coordination with our allies.

And, Mr. Ezell, your testimony is the most comprehensive I have ever read. I felt like you wrote our chapter for us.

MR. EZELL: Thank you, Commissioner.

COMMISSIONER CLEVELAND: Finally, we welcome back Mark Cohen, Director for the Asia Intellectual Property Project at Berkeley Center for Law and Technology.

Mr. Cohen's testimony will discuss developments in China's IP ecosystem, and how the U.S. can improve its ability to respond to Chinese practices.

Thank you all so much for your testimony. We'll proceed in the order that I introduced you, and this time questions will be in reverse alphabetical order. So, we'd start with Commissioner Wong. Just to alert you. So, Ms. Kilcrease, if you'll proceed, please.

OPENING STATEMENT OF EMILY KILCREASE, SENIOR FELLOW AND DIRECTOR, ENERGY, ECONOMICS AND SECURITY PROGRAM, CENTER FOR A NEW AMERICAN SECURITY

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We also need to massively step up our efforts to shape the global and regional economic order in which we and China operate.

At the Commission's request, I'll focus my remarks on defensive tools that are intended to protect against specific national security harms that may arise from economic interactions with China. This is why I spent most of my career in government as well.

This mainly means export controls, inbound investment screening, as implemented through the Committee on Foreign Investment with the United States, or CFIUS, and the possibility of new authorities related to outbound investment controls.

Because these tools are focused on national security, they will not be able to solve every problem associated with China's non-market innovation practices, particularly in sectors that don't have a strategic importance to the United States.

But these tools can and should play an important role in an overall strategy to more robustly defend U.S. innovation and technological leadership.

As a start, we must redouble efforts to identify and control technologies of strategic importance to the United States, including emerging and foundational technologies.

We must also establish new authorities for the control of outbound investment capital flows to address gaps in current authorities which regulate the transfer of technology to China, but not investments that support the development of that same sort of technology in China.

Any type of economic restriction will be most effective if it can be implemented in coordination with partners and allies.

I'm particularly encouraged with the ongoing work in the U.S.-EU Trade and Technology Council Working Group on Export Controls.

A ministerial statement from the TTC's fall meetings included important recognition of the challenges that China presents to traditional approaches of export controls.

The TTC also provided an important channel of communication that enables the unprecedented set of export controls that the allies imposed on Russia as a result of its invasion of Ukraine.

And obviously, we're here today to talk about China. But when it comes to export controls and other national security-related economic restrictions, we can't ignore the massive changes to existing frameworks that have occurred as part of the allied response to Russia's invasion of Ukraine.

These will have direct relevance to how the United States addresses the China challenge moving forward, both because the economic actions against Russia have changed the conversation about what is possible, and also because China's complicity in supporting Russia has hardened views against China, including in key countries that used to favor closer economic integration, particularly in Europe.

The work in the TTC is a strong first step. But the United States must push farther and advocate for the creation of a new multilateral investment and export control regime with our closest allies, that reflects the reality with Russia, and truly rises to the China challenge.

The objectives of the new regime must extend beyond the traditional purpose of export controls, which is to prevent destabilizing accumulations of conventional weapons.

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e ore of t is re i e s o ld be e ort ontrols. nd t e ob e tives laid o t ere are dire tly intended to address so e of t e rdles in o r e istin ro esses and allen es in wor in wit e istin ltilateral instit tions.

But the United States should also use a new regime to seek cooperation and shared policies on a wider range of tools beyond export controls.

We need to have a shared understanding with our allies of what technologies allow us to maintain a strategic advantage, vis-a-vis China, and how we can use all of the tools at our disposal to protect our advantage in these technologies, regardless of the nature of the underlying commercial transaction, whether it's an export transaction, or an investment transaction.

On inbound investment screening, which is done on a transaction-by-transaction basis, full coordination on specific reviews is likely not practical. But we should leverage the identification of technologies of shared strategic interest, so that when national regulators are reviewing transactions involving similar threat actors in similar technologies, we're getting similar outcomes from those processes. And that's not happening today.

On outbound investment controls, this will be the hardest piece, as it is the newest piece. But it's also one of the most important to tackle in a multilateral context, given how easily money can move through various jurisdictions.

A targeted approach, tightly bound, preventing investments into the development of technologies that would be controlled if they originated in the United States or allied countries, is likely the right balance of the admission and pragmatism.

Finally, building analytic capability within government, and publishing regular statistics that cross along export control classifications of trade and investment flows, will be crucial to assessing the impact of the new regime, and projecting the impact of future controls.

Make no mistake, standing up a new regime will be difficult. But we are at a transformational point in how our international economic institutions are orders, and we must think creatively and boldly about how to reorder these institutions to best strengthen the economic and national security of the United States and our allies.

an yo , and loo forward to yo r estions.

PREPARED STATEMENT OF EMILY KILCREASE, SENIOR FELLOW AND DIRECTOR, ENERGY, ECONOMICS AND SECURITY PROGRAM, CENTER FOR A NEW AMERICAN SECURITY

APRIL 14, 2022

TESTIMONY BEFORE THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Hearing on Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators

Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators

Panel II:

Innovation, Technology, and Intellectual Property Concerns

BY

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The author thanks the Commission for the opportunity to provide testimony on China's trade practices, which present serious challenges to the leadership of the United States in key innovation and technology areas. As the prospects for direct negotiation with China on these issues have grown increasingly dim, the United States has leaned more heavily on defensive tools, such as investment screening and export controls, to mitigate the potential national security harms arising from the strategic competition with China. Traditional concepts of what constitutes a national security risk and the frameworks and institutions that the United States uses to manage these risks are no longer sufficient. The United States must strengthen implementation of its own authorities and engage in an intensive diplomatic effort to persuade key likeminded allies to do the same. Noting that an effective response to China's unfair trade practices impacting U.S. innovation, technology, and intellectual property rights will require a broad strategy encompassing many new tools, this testimony focuses on the specific role of export controls and investment screening and the opportunities for stronger collaboration with Europe and other key allies and partners on these specific tools.[1][2]

I. Summary of Key Recommendations

STRONGER IMPLEMENTATION OF U.S. EXPORT CONTROL AUTHORITIES

- Congress should require that the newly confirmed Under Secretary of Commerce for Industry and Security conduct and report to Congress on the results of a top-to-bottom assessment of the emerging and foundational technology authorities provided under the Export Control Reform Act of 2018.

NEW AUTHORITIES TO REGULATE OUTBOUND INVESTMENT

- Congress should authorize a targeted set of new outbound investment controls, designed to work in tandem with export control authorities, that allow the United States to regulate the flow of U.S. capital into China that supports the development of technology that is against U.S. interests, addressing a gap in current U.S. authorities that focus on the transfer of technologies.

ENHANCED COOPERATION IN THE U.S.-EU TRADE AND TECHNOLOGY COUNCIL (TTC)

- In the TTC, the United States, the European Union (EU), and EU member states should:
    - Intensify work in the TTC export controls working group to develop export controls that extend beyond the traditional objectives of the multilateral export control regimes, leveraging the extraordinary allied coordination on Russia export controls to build momentum for a stronger export control approach to China.
    - Identify critical technologies of shared strategic importance to the United States and Europe, develop a shared understanding of national security risks associated with such technologies, and consider joint guidance for reviewing transactions involving such technologies under the U.S. and EU member state export control and investment screening mechanisms.

[1] This testimony reflects the personal views of the author alone. As a research and policy institution committed to the highest standards of organizational, intellectual, and personal integrity, the Center for a New American Security (CNAS) maintains strict intellectual independence and sole editorial direction and control over its ideas, projects, publications, events, and other research activities. CNAS does not take institutional positions on policy issues and the content of CNAS publications reflects the views of their authors alone. In keeping with its mission and values, CNAS does not engage in lobbying activity and complies fully with all applicable federal, state, and local laws. CNAS will not engage in any representational activities or advocacy on behalf of any entities or interests and, to the extent that the Center accepts funding from non-U.S. sources, its activities will be limited to bona fide scholastic, academic, and research-related activities, consistent with applicable federal law. The Center publicly acknowledges on its website annually all donors who contribute.

[2] The author would like to thank Carisa Nietsche, Emily Jin, Jason Bartlett, Martijn Rasser, Daniel Bahar, and Kevin Wolf for their assistance in developing the ideas in this testimony. The recommendations and views in this testimony, along with any errors, are the responsibility of the author alone.

- Develop shared approaches to identifying risks with and solutions to China's practice of abusing its regulatory authorities to extract concessions from firms executing international deals that are also undergoing investment screening reviews in the United States or EU member states.

- Explore EU willingness to establish outbound investment screening controls to accompany a new U.S. authority in this area.

A NEW MULTILATERAL INVESTMENT AND EXPORT CONTROLS REGIME

- The United States should begin the diplomatic process of establishing a new multilateral regime that addresses the reality with Russia and rises to the China challenge, working closely with a tight group of likeminded allies. The objectives of this regime, which would act as a successor to the Wassenaar Arrangement regime on dual-use technology, should include:

    - Promoting international security and **common security** of the member nations;
    - Preventing the **destabilizing accumulations** of conventional or emerging weapons globally and **preventing the transfer** of dual-use technologies important for such weapons to countries of concern;
    - Promoting **technological leadership** in science, technology, engineering, and manufacturing sectors, including in foundational and emerging technology areas, that are material to the national security and foreign policy of the member states; and
    - Supporting the protection of **human rights and democratic institutions.**

- The U.S. objective should be to include export controls and targeted outbound investment controls within the regime mandate, along with a mechanism for stronger coordination and sharing of information relevant to transaction reviews conducted by each member's inbound investment screening mechanism.

- The United States should create a publicly accessible database of statistics that map trade and investment flows against export control classification numbers and encourage all partners to do the same.

II. Full Testimony

Introduction

The U.S. views of China's nonmarket innovation practices are increasingly pessimistic, as these practices persist and the United States and allies and partners have yet to develop fully effective responses to ensure that our companies and workers can compete on a level playing field. Core Chinese practices, such as forced technology transfer, restrictive market access, and industrial subsidies, have been a concern for U.S. policymakers since before China's accession to the World Trade Organization (WTO). Yet, twenty years on, China has intensified rather than modified these practices and has failed to live up to its WTO accession promise of moving towards a free market economy. It has expanded its nonmarket playbook to include cyber theft of intellectual property, talent acquisition, exploitation of the open U.S. academic environment, and economic coercion. At the same time, China's homegrown technology development presents new challenges to U.S. innovation leadership, particularly in emerging technology areas where Chinese capabilities are not always dependent upon transfers of technology from the United States.

Against the backdrop of heightened geopolitical tensions between the United States and China, competition in the technology and innovation domains has direct implications for U.S. national security. The Interim National Security Strategy of the Biden Administration notes that China "is the only competitor potentially capable of combining its

economic, diplomatic, military, and technological power to mount a sustained challenge to a stable and open international system." It highlights the strategic competition with China, arguing that "economic security is national security" and implicitly bringing longstanding economic concerns with China, such as their nonmarket innovation policies, under the national security umbrella.

As the United States seeks an effective strategy to manage the economic and technological competition with China, it will lean heavily on national security-focused defensive tools, *i.e.*, export controls, inbound investment screening, and potentially new authorities related to outbound investment controls. It is important to recognize the limitations of these tools to address China's nonmarket innovation practices writ large. The U.S. toolkit of national security-focused defensive tools is designed to address specific risks arising from discrete commercial transactions. These tools set clear rules around the types of technology that may be transferred, either through an export or an investment transaction, but not the commercial terms on which the transfer occurs. In contrast, many of the U.S. concerns about China's nonmarket innovation practices involve technology that may be legally transferred to China, but U.S. firms are pressured to do so on terms that provide an unfair advantage to their Chinese competitors. The use of an export or investment control may therefore not be wholly responsive to concerns around nonmarket innovation practices in all instances, though they can be an important part of a broader strategy.

Policymakers may want to use national security-focused defensive tools to restrict economic activity in a broader range of sectors, including in sectors that are economically significant or important for U.S. critical supply chains. When the national security tools work well, it is due to predictability in the policy process, a well-defined and bounded concept of what constitutes a national security risk, and buy-in from the private sector, which is ultimately responsible for the first line of compliance. The further the United States strays from a well-defined construct of national security, the higher the risk of engaging in purely protectionist behavior. It is therefore critical that the United States clearly define and bound the appropriate policy objectives of a more aggressive deployment of national security tools. Objectives should include maintaining U.S. technological leadership in domains that are directly or indirectly important for future U.S. military dominance, U.S. intelligence capabilities, and resilient operation of U.S. critical supply chains and physical and digital infrastructure, as well as preventing the use of technology to undermine democratic institutions and human rights. The United States should develop alternative approaches for addressing concerns with China's nonmarket practices that do not have a connection to this expansive concept of national security and should consider the use of national security tools as just one part of a holistic strategy to address China's nonmarket innovation practices.

Strategies for addressing China's nonmarket innovation practices

As the United States moves forward to address the challenges with China's nonmarket innovation practices, the United States may consider three strategies to manage the economic relationship. The framework provided here is relevant when assessing strategies for any trading relationship, with the emphasis on each piece more or less emphasized depending on the nature of the partner and the ability to work collaboratively together. First, the United States may pursue direct negotiations with China, either bilaterally or in the WTO context, to seek China's agreement to change its unfair, nonmarket innovation practices. Second, the United States may take defensive measures to mitigate the harm of China's practices on U.S. technological leadership, economic competitiveness, and national security. Third, the United States may engage with likeminded partners to shape the international and regional economic order in which China operates. With a close democratic ally, such as the European Union (EU), the emphasis should naturally be placed heavily on direct negotiations. The strategy for China, as a nonmarket, nondemocratic strategic competitor, will be almost exactly the opposite.

DIRECT NEGOTIATIONS

Direct negotiations with China are, at this point, unlikely to yield meaningful results. China has little incentive to commit to binding rules that will require structural changes to a system they believe works for their economic and political objectives. For example, U.S. trade negotiators have long recognized that U.S. firms operating in China face pressure to transfer technology to their Chinese competitors as a condition of market access and that this fundamental characteristic of the Chinese market undercuts the ability of U.S. firms to compete on a level playing field. China's WTO accession process in 2001 included emphasis on forced technology transfer concerns. The Economic and Trade Agreement (known commonly as the "Phase One Agreement") concluded between the United States and China under the Trump Administration includes broad prohibitions on China's forced technology transfer practices, among a range of other commitments from China. China has negotiated commitments, varying in specificity and level of ambition, related to forced technology transfer in agreements with other major trading partners, including the EU and the fifteen members of the Regional Comprehensive Economic Partnership (RCEP), in addition to its WTO commitments. Enforcement of these commitments is difficult in practice, as the U.S. and other governments are too often unaware of a violation of China's obligations unless they are informed by the targeted company. Foreign firms operating in China have strong disincentives from complaining too loudly lest they be targeted for retaliation. The result is that these rules are largely ineffective in disciplining China's practices.

Ambassador Tai, the U.S. Trade Representative, confirmed this sentiment in recent testimony before the House Ways and Means Committee: "[O]ver time it became clear that the [People's Republic of China (PRC)] would only comply with those trade obligations that fit its own interests. This is a familiar pattern with the PRC – from their actions at the WTO and in various bilateral high-level dialogues. The United States has repeatedly sought and obtained commitments from China, only to find that follow-through or real change remains elusive. While we continue to keep the door open to conversations with China, including on its Phase One commitments, we also need to acknowledge the Agreement's limitations, and turn the page on the old playbook with China, which focused on changing its behavior. Instead, our strategy must expand beyond only pressing China for change and include vigorously defending our values and economic interests from the negative impacts of the PRC's unfair economic policies and practices."

DEFENSIVE MEASURES

In this context of unsuccessful direct engagement with China, the United States will need to rely more heavily on defensive measures to mitigate the harm of China's practices. Defensive tools are attractive, in part, because they do not require the agreement of China or any other country to be implemented and they allow the U.S. government to take direct action to halt – or remedy the damage from - an economic activity that may present concerns. The prior administration intensified the use of existing defensive measures, though this is not exclusively a Trump administration approach. Certain of these tools were becoming more prevalent under the Obama administration and the Biden administration has carried over the use of many of these tools as well. Defensive tools are typically used for two primary purposes: to mitigate specific national security risks associated with a particular economic activity or to remedy economic harm caused by a trading partner's policies or practices.

- U.S. INVESTMENT SCREENING

In the United States, export controls and investment screening are the main tools used to mitigate specific national security risks associated with U.S.-China economic activity. The use of investment screening, as carried out by the Committee on Foreign Investment in the United States (CFIUS), to address national security risks associated with Chinese investment in U.S. businesses has grown expansively, both in terms of the legal framework for reviewing covered transactions and in the aggressiveness with which CFIUS implements its authorities. The use of investment screening is a direct response to one of China's nonmarket innovation tactics, the direction of Chinese investment overseas in strategic sectors. CFIUS has largely been effective at reducing the number of Chinese investments that may present national security risks, in terms of traditional mergers and acquisition activity. Venture capital flows, however, have not dropped as much as may be desired, as data shows that these flows remain roughly at the same level as they were before the 2018 efforts to expand CFIUS jurisdiction to capture these types of investments. This

may be, in part, due to the fact that Chinese venture capital investments tend to be in sectors with lower levels of export controls (*e.g.*, biotechnology) and export controls are used as a gating function for CFIUS jurisdiction over venture capital investments. However, it may equally be due to efforts by investors to structure deals to avoid granting a Chinese investor with rights that would trigger CFIUS jurisdiction (*i.e.*, a Board seat, access to material nonpublic technical information, or involvement in substantive decision-making). This latter explanation is a positive outcome, as it means that start-ups are structuring deals to minimize risks of transferring technology to an outside investor.

- U.S. EXPORT CONTROLS

Export control authorities were also expanded to address concerns related to the transfer of dual-use technology (*i.e.*, technology that has both civil and military applications) to China. The Export Control Reform Act of 2018 (ECRA), passed in tandem with the investment screening reform in the Foreign Investment Risk Review Modernization Act (FIRRMA), codified U.S. authorities to regulate the export, re-export, and in-country transfer of dual-use items in the furtherance of U.S. national security and foreign policy objectives. A primary objective of U.S. export control authorities is to implement the controls agreed under the multilateral export control regimes and the U.S. system is designed to prioritize multilateral controls, as over the long-term these are more effective than unilateral controls. However, the United States does have authority to implement unilateral controls outside the multilateral process and has used this flexibility more frequently in recent years.

In recognition of the national security risks that may arise in the context of U.S. investments in China, ECRA provided important new authorities to the Department of Commerce to implement export controls outside of the multilateral regimes. Section 4817 of ECRA on "emerging and foundational technologies" requires the Administration to conduct a "regular, ongoing interagency process to identify emerging and foundational technologies that . . . are essential to the national security of the United States" and not described in any of the existing export control regimes. It is clear from the relevant congressional hearings and the context of the legislation that a primary goal of this provision was to address China-specific issues that are outside the scope of the traditional regime controls.

Debate continues about whether export controls are being implemented as robustly as they should be. The newly confirmed Under Secretary of Commerce for Industry and Security should prioritize a top-to-bottom assessment of the emerging and foundational technology authorities and within six months report to Congress on whether:

- Commerce has sufficient resources to implement the emerging and foundational technologies authorities, including both budgetary resources and technical expertise;
- External resources, such as a federally funded research and development center, would provide valuable support in creating the emerging and foundational technologies lists;
- The legal framework for listing emerging and foundational technologies is overly restrictive, taking into consideration the fact that Commerce must consider the foreign availability of an item and that foundational technologies naturally tend to be globally distributed;
- Key allies have existing authorities that may be used more aggressively to join U.S. efforts to list emerging and foundational technologies; and
- A new multilateral export control regime is required to enable stronger multilateral coordination on emerging and foundational technologies.

The emerging and foundational technology authorities could be used to implement controls as part of a broader defensive strategy to respond to China's nonmarket innovation practices that disadvantage the United States in strategic sectors, but there will be limits to a strategy that leans too heavily on export controls. Export controls are not well suited to address the full range of sectors in which nonmarket innovation practices present concerns, as China uses these practices across its economy including in – but also extending beyond – sectors with strategic importance for the United States. Although the United States has broad authorities, key allies and partners have not yet demonstrated that they have either the legal authority or the political appetite to expand their use of export controls

beyond implementation of the Wassenaar Arrangement to address China-specific concerns. This may limit the effectiveness of any U.S. controls, if such controls are imposed unilaterally outside the regimes.

Finally, using an export control to address forced technology transfer risks confusing a national security concern with a problematic commercial practice. No firm should be transferring controlled technology to China in violation of U.S. export controls, regardless of the pressure placed on them by the Chinese system. That would be illegal and would subject the firm to civil and criminal penalties. In contrast, forced technology transfer involves the transfer of technology that may lawfully be exported. The concern is thus not of the technology transfer itself but in the inability of firms to set commercially based terms for such transfers. A strategy of export controls-led decoupling may be worth considering in a greater number of strategic sectors that present heightened security risks, particularly if the United States can secure support from other major producer nations, but it cannot respond to the entirety of the U.S. concerns with China's state-controlled economic system.

- NEW TOOLS

Ambassador Tai has reiterated that new tools will be necessary to protect the domestic U.S. market, though details on the administration's plans remain uncertain. A fresh Section 301 investigation may be under consideration to focus specifically on China's subsidies practices. Such an effort may be beneficial in building a strong case for engaging with allies and partners on the need to take action against China for its harmful subsidies practices. However, what a remedial action under a new Section 301 investigation would be remains unclear, as there may be little political appetite in either the United States or with our allies for further tariff escalation. One benefit of a new Section 301 investigation may be that it would allow the administration to adjust the tariffs under the existing Section 301 investigation. The U.S. Trade Representative will be forced to issue an opinion this spring on whether or not to renew the initial tranche of tariffs, which will otherwise automatically expire.

An affirmative industrial policy is increasingly viewed as a necessary defense against harmful subsidies that the United States does not have another way to neutralize. Most directly, commercial incentives for strategic industries, such as the CHIPS Act, can offset the negative competitive effects of Chinese subsidies that provide an unfair advantage to Chinese firms. Such incentives can also make it more commercially viable for firms to establish or maintain operations in the United States, given the cost differential in operations when compared to other locations. Beyond incentives, a broad range of policies and programs designed to nurture and grow strategic sectors in the United States will also be critical as part of a "running faster" strategy to competing with China in the innovation and technology spaces.

- OUTBOUND INVESTMENT CONTROLS

Both the Congress and the Administration have expressed interest in new authorities to regulate outbound flows of investment from the United States into China, renewing and expanding a debate from the 2018 reforms of the investment screening and export control authorities. A narrowly scoped mechanism that allows the United States to regulate outbound investment flows that make a direct and material contribution to China's growth in strategic sectors should be established. An effective mechanism must be implemented in coordination with allies and partners, as capital can easily move through various jurisdictions to evade a U.S.-only authority. It must also focus on areas of highest risk, which likely means that the capital flow is associated with an additional factor, such as management expertise or intellectual property, beyond what would be available through a passive investment. Finally, an outbound investment mechanism should complement rather than duplicate existing authorities, such as export controls. Even under perfect implementation, export controls would not be well suited to capture the intangible aspects of an investment such as management expertise, that may be critically important to building strategic sector growth and capacity in China. Consideration of an outbound investment mechanism must proceed in tandem with more robust efforts to list emerging and foundational technologies under export controls.

The United States should consider two approaches to using outbound investment regulation to address China's nonmarket innovation practices. The first approach is to use outbound investment controls to bootstrap export controls and ensure that U.S. capital is not undermining the effectiveness of export controls. An investment control in this context can be considered as adding a fourth prong to the existing three-prong approach to export controls, which includes: 1) list-based export controls, used when the technical specifications of an item have an inherently dual-use application, the item has not yet widely proliferated globally, and imposing a control on the item can effectively impede the transfer of the item to countries of concern; 2) end-use controls, used when the item may not be suitable for a list-based control but a particular application or end use of the item would be contrary to U.S. national security interest (*e.g.*, items destined for end use by the Chinese military); and 3) end-user controls, used when a specific end user is known to be acting against U.S. interests and the United States seeks to prohibit a broad range of controlled or otherwise uncontrolled items from transferring to that end user.

The three-prongs of traditional export controls have been designed to work in tandem, with each being most more or less suited for particular circumstances and allowing for broad coverage when used together. Adding an investment control to this structure can cover important gaps to prevent the *development* of technology that is against U.S. interests but that does not involve *transfer* of a U.S. item and thus cannot be captured under export controls. An investment control could be applied in support of each of the three existing prongs of the export controls system. Specifically, an investment control could prohibit U.S. financial support to: foreign entities developing, producing, or using technology that would be controlled if it were U.S. origin (list-based controls); foreign entities that are likely to use the technology for a prohibited end use (end use controls); or foreign entities that are listed on the Entity List (end user controls). This ability to restrict financing, including to entities listed on the Entity List, does not currently exist outside of U.S. sanction authorities. Additionally, there will be some instances in which an end product does not need to be controlled to China, but the government still has an interest in prohibiting investments into the underlying development of comparable technology in China, so the outbound investment controls must be flexible enough to capture these scenarios as well.

This type of outbound investment controls approach would not necessitate a screening or generally applicable review process, though there may be an argument to create licensing flexibility, if needed. Establishing an outbound investment control provides further teeth to the export control system and leverages the existing institutional processes for identifying technologies that are critical to U.S. national security and foreign policy. Under this approach, the outbound investment controls would largely be limited to sectors involving dual-technology, though policymakers could leverage the existing flexibility of the export control system to implement export controls – and in the future, complementary investment controls – to address a broader range of strategic sectors that are important for U.S. national security and foreign policy objectives.

A second approach could involve a stand-alone outbound investment screening process (*i.e.*, a "reverse CFIUS") designed to address broader concerns about U.S. investments that support China's growth in strategically important industries. China's market remains immensely attractive and individual firm decisions to invest in China, which may be completely rational on an individual basis, may undermine U.S. strategic advantage in the aggregate. An outbound investment screening process may be worth considering in this context, recognizing the immense difficulty in establishing a mechanism that efficiently and proportionately addresses these concerns while still allowing for investment flows that are beneficial to U.S. interests. This type of broader screening mechanism would not necessarily be tethered to those technologies that are or will be controlled under export controls and could be used to address concerns in sectors with purely commercial technologies that are nonetheless important for U.S. strategic interests. A broader screening mechanism could be pursued in tandem with the more targeted approach linked to export controls as described above. It may also be desirable to initially limit a broader screening mechanism to a discrete set of sectors of highest concern, to allow the government sufficient time to build capacity to implement the new authorities effectively. The current U.S. approach to screening technology imports under the *Executive Order on Securing the Information and Communication Technology and Services Supply Chain* should serve as a warning against establishing broad, ill-defined authorities without sufficient attention paid to adequate resourcing.

- DEFENSIVE ECONOMIC TOOLS

In addition to the national security-related defensive tools, the United States has also deployed defensive economic tools to remedy the economic harms caused by Chinese policies and practices. This includes anti-dumping and countervailing duties, which will be discussed in detail in another portion of the Commission's hearing. Under the Trump administration, a variety of tariff authorities were used, including Section 232 of the Trade Expansion Act of 1964 related to national security effects of certain imports and Section 301 of the Trade Act of 1974 related to unfair acts, policies, and practices of U.S. trading partners. Of particular relevance to the main topic of this testimony, Section 301 was used to investigate China's forced technology transfer practices, an investigation that was the basis for the "trade war" tariffs imposed on China during the Trump administration. A full assessment of the efficacy of these particular tools is beyond the scope of this testimony.

SHAPING THE ECONOMIC DOMAIN

Shaping the economic domain to the advantage of the United States and its allies and partners is a necessary third component of an overall strategy to addressing China's nonmarket innovation practices. Global economic integration through the negotiation of binding trade and investment rules has been challenged by China's presence as a major state-controlled economy, primarily because China does not agree to be bound by the rules or the broader ideal of free and open markets. However, the United States should not let the pendulum swing too far in the opposite direction towards autarky. Closer economic integration with likeminded countries who share U.S. values is more important than ever. Indeed, if deriving benefit from the world's second largest economy seems more contested, it is that much more important to accelerate efforts to integrate with markets of allies and partners. This is important in its own right to bind the economies of likeminded countries more closely together, as well as to ensure that third party markets are developing rules and standards that allows for and accords preference to integration with the United States rather than China. The following section discusses the key efforts that the United States is undertaking to shape the economic domain, along with the views on China of major U.S. partners and allies.

Regional perspectives on economic integration with the United States and China

INDOPACIFIC

Perceptions of China among the IndoPacific countries vary, ranging from close collaboration and alignment with U.S. views from countries like Australia, New Zealand, and Japan to more cautious engagement from countries like South Korea and more difficult prospects with countries like India. An overwhelming theme is that, while IndoPacific countries recognize the challenges that Chinese economic practices present to stability of the global economic order, they equally view it as problematic to be forced to choose between the United States and China as economic partners. This posture is the rational result of their geography, deep economic ties with China, and China's powerful presence in the region. China is the largest trading partner for most IndoPacific countries, complicating efforts of these countries to forcefully denounce China's trade practices. U.S. efforts to collaborate with IndoPacific partners on export controls and investment screening is not nearly as advanced as it is with the EU, outside of the close collaboration that the United States enjoys with Australia and New Zealand. Key partners that they United States will want to engage more closely are all either in the Comprehensive and Progressive Agreement for a TransPacific Partnership (CPTPP) or seeking to join, reflecting the preference from these partners to leverage the CPTPP as the high-standard trade architecture for the region.

In this critical region, China is outpacing the United States. China achieved a significant geopolitical victory with the conclusion of the 15-member Regional Comprehensive Economic Partnership (RCEP). It also filed formal papers to accede to the CPTPP, in a terribly ironic move to join the pact that was originally envisioned by the United States as a way to counter China's growing economic influence. Rather than reconsider its decision to remain outside of the CPTPP, the United States has begun initial discussions for an IndoPacific Economic Framework (IPEF), which is

intended to be a forum to seek closer cooperation with regional partners. The IPEF is not a traditional trade agreement and will instead focus on "new approaches" for priority trade issues, including labor, environment and climate, digital economy, agriculture, transparency and good regulatory practices, competition policy, and trade facilitation. The IPEF does not appear to have a clear mandate to negotiate on the types of issues most directly implicated by China's nonmarket innovation practices, including subsidies and forced technology transfer, nor the types of defensive tools that are included in the U.S.-EU Trade and Technology Council, such as export controls and investment screening. Its benefits may thus be limited to closer cooperation with this critical region, rather than an effort to create a new legal architecture in the region that would put pressure on China to reform its own nonmarket practices.

EUROPE

Europe has made substantial changes in its posture towards China, though substantial variation remains at the individual member state level. An important milestone in the evolution of Europe's position towards China was the publication of the EU 2019 Strategic Outlook, which noted that China, in different contexts, is a cooperation partner, a negotiation partner, an economic competitor, and a "systemic rival promoting alternative models of governance." Under this multifaceted perspective, the EU sought continued engagement with China to address global challenges, not unlike U.S. attempts to carve out climate change as an area of cooperation. It sought direct engagement with China to achieve more balanced and reciprocal conditions in the economic relationship, but also struck a more pessimistic tone by noting the need to "adapt to realities" and strengthen its own domestic polices and industrial base. In the most pointed shift, the reference to contexts in which China may be a systemic rival was an important recognition that China's state-led, authoritarian political system is inherently at odds with European democratic values.

Europe's desire to maintain collaboration with China in the economic sphere is driven by the size of the bilateral economic relationship and a (now contested) belief in promoting stability through economic integration. China is the European economy's largest trading partner, surpassing the United States. EU policy has retained a focus on working directly with China, including in the WTO and bilaterally. EU concluded political negotiations on a Comprehensive Agreement on Investment (CAI) with China in late 2020, handing China a substantial geopolitical victory for marginal economic gain. The EU justified the CAI, in part, by arguing that they needed to approach coordination with the United States from an equal footing, after the United States concluded its own Phase One Agreement with China. The CAI is now, for all practical purposes, dead after China imposed disproportionate sanctions on members of the European Parliament as retaliation for European sanctions on Chinese officials connected to human rights abuses of the Uyghur population.

Reflecting Europe's growing concerns related to China, the EU and member states have proposed or established new mechanisms to deal with discrete problems in the economic relationship. In 2019, the EU enacted regulations on investment screening that authorize – but do not require – member states to enact national-level mechanisms to review investments for national security and public order purposes. Most members states have established investment screening mechanisms with varying degrees of coverage and ambition and initial indications are that the levels of Chinese investment into the EU market are declining. The EU has also introduced instruments to deal with China-related challenges that do not yet have a parallel authority in the United States, including its anti-coercion instrument and an instrument to address distortions from foreign subsidies. The EU has not yet taken strong steps to utilize their export control system to address China-specific challenges, as their authorities are largely constrained to the implementation of traditional, country-agnostic dual-use controls as determined by the multilateral regimes. There are promising indications in the U.S.-EU Trade and Technology Council that this policy may be evolving, as noted later in this testimony.

Europe views its relationship with China, in part, through the lens of its relationship with the United States. Europeans were shaken by certain decisions of the Trump administration to downgrade the importance of key transatlantic alliances. Certain European initiatives, such as the drive towards tech sovereignty, are motivated by a

desire for Europe to be less reliant on the transatlantic alliance for its future security and prosperity. Similarly, policies such as the anti-coercion instrument are quite helpful in addressing challenges presented by China but may equally be used to push back against U.S. efforts to assert its policies extraterritorially in Europe, as evidenced by the frequent criticism of U.S. actions in the public comment process for the anti-coercion instrument. Thus, an increasingly skeptical European view towards China does not inherently guarantee automatic alignment with U.S. policy preferences. The United States must engage proactively with Europe to maintain confidence in the transatlantic alliance, based on both U.S. and European interests.

China's actions to support Russia in the coming days and weeks will be a clarifying moment for Europe, just as the Russian invasion clarified European views on Putin as an irredeemable aggressor. Europe had also believed it could use trade and economic integration as a means to manage the geopolitical relationship with Russia. That strategy has catastrophically failed. European leaders are increasingly concerned that China will provide material support to Russia as it continues to wage a horrific war in Ukraine and to assist Russia in mitigating the economic damage caused by the allied sanctions. At the April 1, 2022 EU-China Summit, Europeans drew a line in the sand, making clear that China has a responsibility to actively work for peace and that economic consequences would follow if China undermines the allied sanctions. European attitudes have been hardened by the war on their doorstep. Efforts by China to portray the conflict as a U.S.-inflicted crisis will be a grave miscalculation. China's professed neutrality is seen by Europe for the sham that it is. This posture by China is increasingly likely to lead to a more severe rupture in the relationship.

FIVE EYES

Though not a regional grouping that is engaged in trade discussions akin to the IPEF or the U.S.-EU Trade and Technology Council, the "Five Eyes" partners of Australia, Canada, New Zealand, and the United Kingdom will be essential partners in strengthening export control and investment screening cooperation. Indeed, they already are. The United States has assessed that each of these countries has and is effectively utilizing an investment screening regime. Accordingly, CFIUS has granted a waiver to exempt qualified investors from these countries from certain requirements of the CFIUS review process, indicating a high level of trust and alignment with these partners. These partners have also all joined the United States in imposing severe export control restrictions on Russia as part of the broader allied response to Russia's invasion of Ukraine. The United States should continue efforts to share information and best practices on both investment screening and export controls with these essential partners. These countries should also be among the first that the United States engages on developing a new multilateral investment and export controls regime, as discussed later in this testimony.

The promise of the U.S.-EU Trade and Technology Council (TTC) in enhancing coordination on export controls and investment screening

The TTC has great promise in developing shared approaches to the use of defensive tools and promoting stronger integration between the U.S. and European economies. Like the IPEF, the TTC is not a comprehensive trade agreement and is instead structured as a series of working groups focused on discrete trade issues of importance to the transatlantic relationship. The United States and the EU have expressed different motivations for engaging in the TTC work, with both sides seeking to repair the transatlantic relationship and the United States placing a heavier emphasis on using the TTC to develop shared approaches to China. Preferred messaging notwithstanding, there is a strong move in the TTC towards greater coordination on key defensive mechanisms, mainly on export controls and to a lesser extent on investment screening, that are central to efforts to deal with China.

TTC EMPHASIS ON NON-TRADITIONAL USES OF EXPORT CONTROLS

The "U.S.-EU Trade and Technology Council Inaugural Joint Statement" includes a "Statement on Export Control Cooperation." It states that dual-use export controls should be used to address certain policy issues that go beyond the traditional objectives of the multilateral regime-based dual-use control system, including to:

- respond to human rights abuses;
- support a "global level playing field" and promote a "multilateral rules-based trade and security system founded on transparency, reciprocity, and fairness;"
- address "legal, ethical, and political concerns" about emerging technologies;
- respond to civil-military fusion policies "of certain actors;"
- avoid disruptions to strategic supply chains; and
- respond to "technology acquisition strategies, including economic coercive measures."

These non-traditional objectives are directly responsive to shared concerns between the United States and Europe about China, though the statement does not single China out by name. The statement is a significant milestone for the two economies in publicly recognizing the need to apply export controls as a tool to manage the strategic relationship with China, as opposed to their traditional use as an arms controls mechanism to prevent the proliferation or destabilizing accumulation of conventional weapons.

At the time of the last TTC Ministerial, the ambitious objectives of the export controls statement were not yet matched by clear legal authorities and political direction to implement more far-reaching controls. While the United States already has broad authority to implement controls to meet these objectives, with limited exceptions there are not established traditions, political cultures, or legal authorities within the EU or EU member states to impose controls for reasons outside of the multinational regimes. Under the EU dual-export control authorities (EU Regulation 2021/821), individual member states have the ability to impose unilateral list-based controls under certain circumstances, primarily for public security or human rights reasons under Article 9 of EU Regulation 2021/821. Member states may also impose end-use controls under "catch-all" authorities pertaining to arms embargoed destinations. These authorities have only been used in a small handful of cases. Outside the context of EU sanctions authorities, the EU and EU member states do not have authorities to impose end user controls comparable to the U.S. Entity List designations. The existing member state authorities may be used more ambitiously to address the non-traditional objectives of export controls as outlined in the TTC statement but doing so would require a significant shift in existing practice.

In the Russia context, the EU imposed sweeping export controls that were substantially similar to the export controls imposed by the United States. These measures largely prohibited the export to Russia of all dual-use items listed under EU export control authorities, along with purely commercial items such as oil refining equipment. The EU implemented these measures pursuant to their sanctions authorities, whereas the United States did so under their export control authorities. The use of such broad export controls as a sanctions tool by both the United States and EU is unprecedented, and agreement to do so was driven by the clarity of purpose provided by the crisis in Ukraine and the existential threat that Europe feels as a result of Russia's aggression. In addition to the broad scope of the export controls, the level of coordination between the United States, Europe, and other participating economies was also unprecedented. In its export controls, the United States applied its novel foreign direct product rule, which extends the application of its controls extraterritorially if a foreign product is made using U.S. software, tools, or equipment. The United States excluded from the scope of the foreign direct product rule those countries that had implemented substantially similar controls, including the EU member states. This coordination presents a unified front and also ensures that the United States, EU, and other participating economies will be working together on enforcement, rather than the United States seeking to enforce unilateral rules in the jurisdiction of its allies.

The TTC working group was instrumental in building the relationships and communication channels that enabled swift imposition of these export controls immediately after Russia's invasion of Ukraine. Despite the tragic circumstances, these are positive signs about the ability of the United States and the EU to work together to use export controls in new ways. Directly transferring the approach on Russia to the China context will present challenges, given the vastly more integrated nature of China with the U.S. and European economies. Imposition of such broad controls, particularly when the controls are based on sanctions rather than export control authorities, may

not be politically acceptable outside of the context of an active war. However, as Europe becomes increasingly alarmed by China's sympathy with Russia, it becomes more likely that they will seek to work with the United States to craft a robust response to China in the export controls space.

TTC WORK ON INVESTMENT SCREENING

The TTC also includes a workstream on investment screening, which to date appears less ambitious than the work on export controls. Investment screening efforts in the TTC focus on information sharing and exchanges of best practices. This builds on existing work ongoing between the United States, the EU, and EU member states to establish and utilize new investment screening regimes. This work is critically important to ensure that the regimes are aligned to the greatest extent possible, in terms of the legal framework and types of transactions covered. However, the collaboration needs to deepen substantially to be truly effective.

The investment screening statement from the first TTC ministerial meeting included a reference to joint identification of critical technologies. Developing a shared understanding of risks associated with particular technologies is necessary to mature the U.S.-EU cooperation. For example, the United States and the EU generally agree that artificial intelligence (AI) is important but do not yet have a clearly articulated and shared understanding of which parts of the AI ecosystem are most sensitive and subject to Chinese exploitation. The TTC work should be used to identify those technologies that: reside predominantly in the United States, Europe, and allies; are fundamental to future technology and innovation leadership of the United States, Europe, and allies; and have relevance to a broadly defined concept of national security, encompassing not just the defense industrial base but also critical physical and digital infrastructure and emerging technologies and applications. The United States, the EU, and the EU member states should agree on general parameters in which transactions involving similar threat actors and similar technologies result in similar outcomes under their respective regimes. This does not mean that the respective review process would have predetermined outcomes, as each transaction would still need to be considered based on the particular facts and circumstances. It would, however, provide more rigor and consistency to an otherwise ad hoc process and allow for more well-informed decisions under each national-level investment screening process.

The TTC should also include work on developing shared approaches to address China's practice of abusing its regulatory authorities to extract concessions from firms executing international deals. Investment transactions are often reviewed by regulatory authorities in multiple jurisdictions, so that CFIUS or an EU investment screening regulator may be reviewing a global merger or acquisition at the same time that the Chinese authorities are reviewing the same transaction. The investment screening authorities must assess how the Chinese authorities may seek to extract concessions as a condition for approval of the deal and assess whether such concessions present national security risks. Conducting this assessment is difficult, as there is not full transparency into the Chinese regulator's actions and the timelines of the various review processes are usually not aligned. CFIUS and the EU investment screening regulators may wish to consider crafting mitigation terms to attach to their own approvals of transactions that allow them the legal ability to require amendments to the deal should Chinese regulators seek concessions that raise national security concerns. This will not be an easy solution, as it will almost certainly result in the United States and the EU member states imposing requirements that contradict those of the Chinese regulator in certain cases, and thus deserves careful consideration by the United States and the EU member states to calibrate an effective strategy.

INTEGRATING EXPORT CONTROLS AND INVESTMENT SCREENING

In addition to the collaboration within the distinct export controls and investment screening categories, the TTC can and should be used as a forum to encourage integration between these mechanisms in both the United States and Europe. Both export controls and investment screening seek to prevent the unfair exploitation of the U.S. and European open innovation ecosystems and transfer of technology that is contrary to U.S. and EU security interests. Just as in the United States there is a need for these tools to work in tandem, the coordination with allies must also ensure that the two types of authorities are reinforcing of each other. There is no indication yet that this sort of cross-pollination between the two workstreams is occurring in the TTC. Identification of shared U.S. and EU technology

advantages would be relevant to both sets of authorities and could be the basis of further work to ensure tight alignment between the export control and investment screening processes.

USING TTC TO EXPLORE EU VIEWS ON OUTBOUND INVESTMENT CONTROLS

The TTC must also become a forum to explore EU appetite for outbound investment screening. A well targeted outbound investment control is a necessary complement to existing authorities, but one that will almost certainly fail if it is done on a unilateral basis. Export controls work best on a multilateral basis, so that all sources of a technology impose the same controls and U.S. exporters are not put at a competitive disadvantage. This dynamic is even more pronounced with capital flows, given the greater ease with which money may be transferred across borders and through complex structures. The United States is significantly further along in its consideration of an outbound investment mechanism than is the EU and the EU is unlikely to agree to a broad-based mechanism intended to pursue a broad decoupling from China. However, with an intense technical and diplomatic effort, the United States may be able to secure support for a targeted mechanism that envisions an outbound investment control as a necessary complement to export controls. Importantly, if the United States and the EU are also agreeing to expand the use of export controls to include non-traditional, China-specific objectives as envisioned by the TTC export controls statement, then the scope of both the export controls and the complementary outbound investment controls will inherently cover a broader range of sectors and economic activity than currently captured under an approach that is based on a traditional, dual-use technology export controls.

The right next step: a new multilateral regime on investment and export controls

The work in the TTC offers a strong foundation for enhancing collaboration on export controls, outbound investment controls, and inbound investment screening. The United States must build upon and expand this work to effectively meet the challenges presented by China. This includes working with the EU but also a broader range of likeminded partners, including at least the Five Eyes partners and Japan. Existing multilateral organization are ill suited to meet the challenges of the moment. The very concept of multilateralism among a broad group of democratic and nondemocratic stakeholder has been fundamentally shaken by Russia's invasion of Ukraine and China's complicity. Allies have taken important steps to remove Russia from receiving the economic benefits of the international rules-based order, an order which it flagrantly violated with its unprovoked invasion of a sovereign state, including at the WTO, the World Bank, and the International Monetary Fund. Political pressure is rising to expel Russia from key institutions of the United Nations. The right next step is to address Russia's role in the export control multilateral regimes and leverage the intense allied coordination on Russia export controls to launch a new export control regime that reflects the reality of the crisis with Russia and rises to the systemic challenge presented by China.

The structure of the Wassenaar Arrangement, as the primary venue for setting dual-use technology controls, is no longer fully sufficient to meet the needs of the United States and its partners and allies for several reasons. Wassenaar is intentionally a country-agnostic mechanism and its legal framework notes that the regime "will not be directed against any state or group of states and will not impede bona fide civil transactions." This constraint poses obvious difficulties in seeking to impose controls to deal with the unique challenges presented by China. Wassenaar controls only those technologies that have technical attributes that make them suitable for dual-use, *i.e.* for both civil and military purposes. This makes it difficult to list technologies that do not have such attributes but that are nonetheless important for national security or foreign policy objectives, such as emerging technologies the full applications of which are not yet known. The consensus-based process of Wassenaar is not in and of itself problematic, as it is the membership of Wassenaar – which includes Russia although not China – that presents difficulties rather than the decision process. While it may not be possible to expel Russia from Wassenaar, the United States and its partners and allies should strive to establish a new regime that both operates alongside Wassenaar and makes that process ultimately less relevant to the export control strategy of the United States and its partners and allies.

A new regime must provide the United States and its partners and allies with the forum to coordinate export controls for a broader range of strategic objectives, including those that are specific to China, Russia, or other countries of concern as may be identified. The objectives of the new regime should include:

- PROMOTING INTERNATIONAL SECURITY AND COMMON SECURITY OF THE MEMBER NATIONS.
    - This would allow the members broad flexibility in setting controls to pursue joint security objectives, including the use of export controls as a sanctioning instrument. Common security of the member nations would be a core focus, but the regime should also facilitate the use of export controls to support non-members if doing so is in the broader interest of international security (*i.e.*, similar to the support that NATO is providing to Ukraine as a non-NATO member).
    - To the extent that members wish to diversify key supply chains away from China or to promote decoupling in strategically sensitive technologies, this objective would permit them to use export controls to do so.
- PREVENTING THE DESTABILIZING ACCUMULATIONS OF CONVENTIONAL OR EMERGING WEAPONS GLOBALLY AND PREVENTING THE TRANSFER OF DUAL-USE TECHNOLOGIES IMPORTANT FOR SUCH WEAPONS TO COUNTRIES OF CONCERN.
    - This objective allows for the allies to adopt more expansive dual-use export controls outside of the Wassenaar process, if the Wassenaar process retains some role for export control policy in the future.
    - In a distinct shift from Wassenaar, it also allows for the members to set controls based on an objective of limiting transfers of a technology to a specified destination, in addition to the technical attributes of an item. To achieve this, the new regime would need to establish common licensing or "no undercut" policies.
- PROMOTING TECHNOLOGICAL LEADERSHIP IN SCIENCE, TECHNOLOGY, ENGINEERING, AND MANUFACTURING SECTORS, INCLUDING IN FOUNDATIONAL AND EMERGING TECHNOLOGY AREAS, THAT ARE MATERIAL TO THE NATIONAL SECURITY AND FOREIGN POLICY OF THE MEMBER STATES.
    - This objective is explicitly designed to face the strategic challenge presented by China and its range of nonmarket practices that may have negative impacts for U.S. technological leadership in areas important for national security and foreign policy.
    - This also directly addresses one of the stumbling blocks in the U.S. process for establishing more robust emerging and foundational controls, as the United States has been reluctant to impose such controls if partners do not have similar authorities to do so.
- SUPPORTING THE PROTECTION OF HUMAN RIGHTS AND DEMOCRATIC INSTITUTIONS.
    - This objective provides the ability to use the new regime to address China's systemic abuse of human rights, which is enabled by technology.

The members of the new regime should also include outbound investment controls as part of a new regime structure, along with a mechanism for coordination on inbound investment screening. All likely members will have established investment screening mechanisms for inbound investment in their jurisdictions. Inbound investment screening is conducted on a transaction-by-transaction basis, which would make full regime coordination on particular transaction reviews impractical. However, the regime could add value to the national-level investment screening processes by identifying technologies that are of strategic importance to the members as a whole and serving as a basis for shared

analysis of investment-related trends. Creating institutional linkages between the new regime and the national-level investment screening mechanisms also underscores the need to ensure that strategic technologies are protected regardless of the form of commercial transaction that may lead to their transfer, whether it is an export or an investment transaction.

Including outbound investment controls as part of a regime would be novel, particularly since most countries other than Taiwan and South Korea do not have established outbound investment screening mechanisms, including the United States. Similar to the recommendation for exploring the EU appetite for outbound investment controls under the TTC, including a limited outbound investment control mechanism to a new multilateral regime would add an important complement to the regime's use of export controls for a broader range of strategic objectives. Members could view an investment control as an add-on to any export controls established under the new regime, so that the members could jointly decide on a technology-by-technology basis whether to additionally restrict capital flows that would support the indigenous development of a particular technology in countries of concern. A broad-based, stand-alone outbound investment screening mechanism is likely a bridge too far for most countries and like coordination on inbound investment screening would be impractical to coordinate in the regime context given the transaction-by-transaction nature of that sort of process. However, persuading the members to include a targeted outbound investment control as a complement to export controls would be hugely impactful on its own if implemented across the major producer democracies.

- BUILDING ANALYTIC CAPACITY

The objectives of the new regime are ambitious, impacting a broader range of commercial activity than current export controls and investment screening do. Governments must have the ability to analyze the impact of the new controls and model how future controls may effect bilateral, regional, and global trade and investment flows. Today, there is no existing database that allows for government officials or researchers to analyze data that integrates trade and investment flows with export control classifications comprehensively and across various jurisdictions. While it is possible to use proxy indicators, such as broad product categories, this is a poor substitute for disaggregated data that allows for the dynamic tracking of controlled goods at a detailed level.

In the United States, exporters are required to report exports of certain items based on their export control classification number or other factors, and this includes a requirement for the export of all items listed on the Commerce Control List to either China or Russia. The United States should assess whether the collected data is comprehensive enough to allow for effective analysis on the expanding use of export controls and whether it can be regularly published, consistent with the need to maintain confidentiality for specific export transactions. Publication of export control data would allow independent researchers a valuable tool in assessing the effectiveness of a new export control regime, including how actors may seek to evade export controls. It would also enhance collaboration with other members of a potential new regime, by establishing a solid analytic foundation to support the establishment of new controls. The United States should also encourage other members of a new regime to collect, share, and publish comparable data.

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OPENING STATEMENT OF STEPHEN EZELL, VICE PRESIDENT OF GLOBAL INNOVATION POLICY, INNOVATION TECHNOLOGY INNOVATION FOUNDATION

COMMISSIONER CLEVELAND: Wow. Right on seven minutes. Thank you, Ms. Kilcrease. Well done. Well rehearsed. Mr. Ezell, if you would proceed, please. Am I saying your name correctly?

MR. EZELL: Yes.

COMMISSIONER CLEVELAND: Thank you.

MR. EZELL: Well, good morning Commissioners, and thank you for the invitation to testify today. It's an honor.

In ITIF's view, the manner in which China conducts its economic and trade policies, particularly in advanced technology industries, are extremely harmful to U.S. and global innovation. Today, I'll explain how so, and what the U.S. and what other countries can in response.

First, it's imperative to recognize that China fundamentally rejects the foundational WTO principle of comparative damage, and instead seeks absolute advantage, dominance, or at least self-sufficiency, in virtually all advanced technology industries, from aerospace and autos, to batteries and biotech.

That China's goals are autarky and import substitution, while still expecting unfettered access to global markets, are clearly demonstrated by China's national integrated circuit strategy, which calls for having imports of U.S. semiconductors by 2025, and ideally eliminating them entirely by 2030.

But not only are China's economic goals not consonant with WTO principles, so are the broad suite of innovation mercantilist policies China deploys to achieve them, from massive industrial subsidies, forced intellectual property and technology transfers and conditional market access, to IP theft and market access restrictions.

And such policies enable Chinese enterprises to sell their products on less-than-market terms while remaining in business, and so draw market share from more innovative companies, depriving those companies of revenues needed to recoup investments, and fund future generations of innovation.

This is why virtually all academic studies find a negative impact from China's mercantilist policies on both U.S. and global innovation.

For instance, David Autor, et al, examined the impact of Chinese competition on U.S. patent protection from 1975 to 2013.

They find, quote, a robust, negative impact of rising Chinese competition on firm-level and technology class-level patent production, a drop of 40 percent in fact, and find that, quote, global employment, sales, profitability, and R&D expenditures, all declined within China trade-exposed firms.

A 2021 ITIF study examined the impact of Chinese innovation mercantilism on five high-tech industries solar panels, high-speed rail, biotechnology, semiconductors, and network and telecommunications equipment. It found similar results.

For instance, Chinese semiconductor companies with beneficiaries of 86 percent of their below-market equity infusions, the OECD could identify in 21 semiconductor companies globally, between 2014 and 2018.

Fully 40 percent of SMIC China Semiconductor Manufacturing International Companies revenues over that period were direct government transfers to their bottom line.

Thanks to such policies, ITIF estimates that the market share captured by less efficient Chinese competitors led to over 5,000 fewer U.S. semiconductor patents than would have otherwise been the case.

If we look at solar panels, from 2003 to 2016, China's share of the global market grew from just 14 percent to 60 percent, abetted by $42 billion of subsidies from 2010 to 2012 alone.

And China's policies have finally shifted the landscape of global high-tech competition, with China's share of the global output of high-tech manufacturing industries more than tripling, from just eight percent in 2003, to 27 percent by 2018.

Moreover, when examining seven of the world's most important advanced tech industries, from biotech and autos to semiconductors, these industries' share of China's economy are 40 percent greater than they are in the United States.

And if we wanted these industries' share to match their share of GDP in China and the United States, we'd have to expand their output by one-third, or $650 billion annually.

ITIF's testimony provides numerous policy recommendations to deal with these challenges, but we must focus on both domestic and international responses.

Domestically, America's most important response must be strengthening its ability to innovate, notably, by passing the Bipartisan American Innovation Act.

But we must also increase our organizational capacity to respond to foreign corrupt practices.

Here, we should create a national industrial intelligence unit at the White House, and appoint a deputy USTR in charge of innovation and IP issues.

USTR should also pursue a Section 301 investigation into China's cloud, cyber, and related digital trade discretions.

But the most effective policies will be those undertaken in collaboration with our allies.

First, these countries should create a collective bill of particulars, like a super-NTE special field report, that comprehensively documents the extent of innovation mercantilist practices these countries encounter.

Second, allied countries should create a democratically allied trade organization, a DATO. Essentially, this would be a NATO for trade to combat Chinese trade aggression.

Allied nations would form a pact wherein they agree to put a country's firms on its unreliable list. If China did that, then DATO nations could agree to limit imports from Chinese firms.

Similarly, if their bill of particulars found a Chinese entity to be systematically pilfering IP from participating nations' enterprises, we could deny those firms access to our markets.

Lastly, the Commission inquired whether the United States should seek decoupling with China in strategic industries. In ITIF's view, what's needed isn't decoupling, rather we should be seeking to reduce the degree of dependency America has on China, on both the supply and the demand side.

For instance, the administration is right to identify critical dependencies, such as we have on China for rare earth's critical minerals, and develop alternative domestic and foreign sources of supply.

The administration can also assist companies looking to diversify their sources of supply, as they increasingly implement China plus-one sourcing strategies.

We should also call on the development of finance corporations to support supply chain

resilience, and build up supply chains of critical products within many countries.

The government should also consider reducing demand dependencies. It's concerning when U.S. semiconductor companies depend on China for 36 percent of their sales, but China wants this to be zero.

The solution is to build up the technology ecosystems of like-minded countries, to diversify the global production of ICT goods.

In conclusion, of course the ultimate outcome would be to prevail upon China to come into full and immediate compliance with its WTO commitments.

But failing that, the U.S. and like-minded nations need to consider a more aggressive range of options, to limit China's gains from unfair trade practices, raise the cost of their doing so, and reduce the damages it causes to our innovation industries. Thank you.

COMMISSIONER CLEVELAND: Thank you. Mr. Cohen.

PREPARED STATEMENT OF STEPHEN EZELL, VICE PRESIDENT OF GLOBAL INNOVATION POLICY, INNOVATION TECHNOLOGY INNOVATION FOUNDATION

Testimony of

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"U.S.-China Innovation, Technology, and Intellectual Property Concern"

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Contents

The Information Technology and Innovation Foundation (ITIF) appreciates the United States-China Economic and Security Review Commission's invitation to provide testimony regarding U.S. concerns with China's innovation, technology, and intellectual property (IP) practices.

IMPACT OF CHINESE MERCANTILISM ON U.S. AND GLOBAL INNOVATION

This section examines the nature of Chinese innovation mercantilism, reviews academic literature assessing the impact of Chinese mercantilism on U.S. and global innovation, provides several case studies of the impacts of Chinese innovation mercantilism on U.S. industries, and concludes with an assessment of the broader impacts of China's innovation mercantilist practices on the U.S. economy.

An Overview of Chinese Innovation Mercantilist Practices

When it joined the World Trade Organization (WTO) on December 11, 2001, China committed to joining a community of nations pursuing "open, market-oriented policies" in accordance with the foundational WTO principles of "non-discrimination, market access, reciprocity, and fairness."[1] But while China has taken full advantage of its WTO rights, it has also largely ignored its responsibilities and commitments through its embrace of state-directed capitalism predicated upon aggressive innovation mercantilism.[2]

Indeed, China has contravened many of its WTO commitments, but perhaps the three most fundamental ways it has done so are through its rejection of the WTO's market orientation, its embrace of the principle of absolute vs. comparative advantage, and its adoption of a wide range of unfair, trade-distorting innovation mercantilist practices.

Regarding the first, during WTO entry negotiations, Chinese representatives averred that China would hew to a market orientation and that its government would not influence trade and business operations. As the *WTO Report of the Working Party on the Accession of China* notes, "The Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value, or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement."[3]

But China's embrace of "state capitalism" (or "China Inc.," as described by Mark Wu) shows how China has backtracked from (or simply ignored) this essential requirement of WTO membership through its embrace of, in Chinese President Xi Jinping's framing, a "socialist market economy with Chinese characteristics." The Chinese government—that is, the Chinese Communist Party (CCP)—exercises effective control over all domestic firms, whether state-owned enterprises (SOEs) or private ones, operating in its economy. In fact, under Article 19 of the *Company Law*, all SOEs or private Chinese companies have a Chinese CCP cell that management must listen to, if not necessarily obey.[4] Article 19 in essence codifies CCP influence over corporate governance and business decisions in China.

This gives rise to an economy wherein the party-state—a form of government in which a political party, rather than citizens or individual politicians, are the primary basis of rule—remains all powerful, though with a veneer of economic activity putatively driven by private enterprises. It is difficult to

apply labels such as "market vs. nonmarket" and "private-led vs. state-led" to the Chinese context.[5] To be sure, Chinese leaders may attempt to obfuscate or prevaricate about the true nature of their economic system with epithets, but, essentially, China fundamentally rejects a market-based system.

The intellectual foundation of the global trading system stems from the work of classical economist David Ricardo, who developed the theory of comparative advantage, which suggested that nations should specialize in production of goods or services at which they are the most efficient at producing and trade for other goods and services at which they're not, with this system of exchange being global welfare-maximizing. But China fundamentally rejects the theory of comparative advantage, instead seeking *absolute advantage* in virtually all industries, especially in advanced technology products, such as aerospace, high-speed rail, semiconductors, telecommunications equipment, biotechnology, robotics, and clean-energy technology platforms such as wind turbines, solar panels, and electric batteries and vehicles.[6] Unfortunately, China's goal of absolute advantage runs counter to the effective functioning of the global trading system, which is grounded in the notion of competitive advantage: nations finding what they are good at or can be good at and exporting products and services in these areas to pay for the imports of goods and services they are not as good at producing.

But it's not only that China seeks absolute advantage in virtually all advanced technology industries, it's that the manner in which China has elected to compete in these industries is not (only) through "good" innovation policies such as investing in research and development (R&D), skills, and digital and physical infrastructure (policies that increase the global stock of knowledge and innovation), but increasingly through a wide-range of zero-sum "innovation mercantilist" practices.

Indeed, the nature of Chinese economic and trade policy—such as showering massive subsidies on domestic companies, manipulating its currency to gain unfair price advantage in foreign markets, obtaining massive amounts of foreign IP without paying for it, restricting or limiting Chinese market access to foreign firms in digital industries, etc.—represent extremely distortionary and unfair practices.[7] These and other such policies (see Table 1) have conferred an unfair advantage upon Chinese companies—which on average are significantly less innovative than their foreign competitors, the very reason China embarked on its "innovation mercantilist" efforts. China's "innovation mercantilist" polices have created such intense competitive pressures that many foreign companies have either closed or cut back, including on their R&D expenditures and other innovative activities, not only in China's market but in their home markets as well.

Academic Studies of the Impact of Chinese Mercantilism on Innovation

Indeed, when Chinese subsidies prop up enterprises that would not be genuinely competitive on a market basis, these firms can sell their products on less-than-market terms and so draw market share from more-innovative companies, depriving those enterprises of revenues needed to recoup investments and fund future generations of innovation. This is why virtually all academic studies have found a negative impact from China's mercantilist policies on U.S. and global innovation.

For instance, 2017 research by Autor, Dorn, Hanson, Pisano, and Shu examined the impact of Chinese competition on U.S. patents from 1975 to March 2013. The authors:

> Document a robust, negative impact of rising Chinese competition on firm-level and technology class-level patent production. Accompanying this fall in innovation, global employment, sales, profitability, and R&D expenditure all decline within trade-exposed firms.[8]

They also find that "accelerating import competition from China during the 2000s can explain about 40% of the slowdown in patenting in 1999–2007 relative to 1991–1999."[9] On average, Autor et al. find that firms reduce R&D investment when they belong to industries that are exposed to more import competition from China.

A number of other studies have found similar results for the U.S. economy. Akcigit, Ates, and Impullitti looked at the impact of China on U.S. innovation and found that, "Even a relatively very advanced economy might experience a reduction in aggregate innovation, if it has an enough number of sectors that are getting discouraged by foreign competition."[10] They went on to note "foreign technological catching-up hurts U.S. welfare by stealing away business and profits of U.S. firms."[11] Hombert and Matray found similar results, observing, "[R]ising imports lead to slower sales growth and lower profitability for firms in import competing industries."[12] However, this effect is significantly smaller for firms that have invested large amounts in R&D, thanks to more generous state R&D tax credit policies.

Studies of the impact of Chinese competition on the Canadian innovation system have reached similar findings. Kim studied whether Chinese competition could help explain both the decline in business enterprise R&D and total factor productivity (TFP) in Canada after 2000 (China was accepted into WTO in December 2001). Myeong Wan Kim used Canadian firm-level data to explore the impact of rising Chinese import competition on Canadian firm R&D. Chinese imports as a share of domestic production increased from around 2 percent in 2000 to around 8 percent in 2010. The study found "increasing Chinese import competition reduced R&D" within Canadian firms.[13] Another study analyzing the impacts on Canadian innovation found similar results. Keung, Li, and Yang found "the 4-percentage-point increase in Chinese import share between 1999 and 2005 led to the exit of 4.2% of the firms sampled in 1999 over that period, which is very large relative to the 17% overall exit rate of these firms."[14] Moreover, surviving firms had lower profits than otherwise would have been the case.[15]

The evidence with regard to the impact on Europe is mixed. One highly cited study on the effect of Chinese trade on a number of northern European economies found Chinese trade stimulated innovation. Bloom, Draca, and Van Reenen studied the impact of Chinese trade on EU innovation from 2000 to 2007 and concluded, "China appeared to account for almost 15% of the increase in patenting, IT, and productivity."[16] They found, "Chinese import competition reduces employment and survival probabilities in low-tech firms."[17] In addition, "Firms with lower levels of patents or TFP shrink and exit much more rapidly than high-tech firms in response to Chinese competition." However, "Chinese import competition increases innovation *within* surviving firms," especially firms that are more high-tech (higher patenting rates). One key question the authors failed to answer, in part because it is methodologically difficult, is whether these firms that went out of business are less innovative than their Chinese counterparts.

However, in a more recent, 2019, paper, Douglas Campbell and Karsten Mau reached a different conclusion, finding:

> [T]he apparent positive impact of Chinese competition on European patenting [that Bloom et al. find] disappears once one controls for richer sectoral trends, the lagged level of patents, or switches to Chinese import penetration instead of the Chinese share of imports… Thus, we believe we have partially solved the puzzle of why the rise of China ostensibly had a negative impact on patents in the US (or, others have found no impact on R&D for the US), but a positive impact in Europe—the latter results appear to be spurious.[18]

Indeed, Karsten and Mau conclude, "When controlling for lagged patents and outsourcing, and using Chinese penetration, one is more likely to get negative and significant coefficients."[19] The authors reached this finding in part because they used more robust methods, including more controls for spurious correlation, such as lagged patents trends and pretreatment levels.

Industry-level Case Studies of Chinese Innovation Mercantilism

In 2021, ITIF undertook to examine the impact of Chinese innovation mercantilist policies on five U.S. industries: solar panels, high-speed rail, telecom equipment, semiconductors, and biopharmaceutical products. In each case, ITIF's economic models suggested significant negative impact on global R&D and patenting from China's innovation mercantilist polices.[20]

For instance, ITIF's report, "Moore's Law Under Attack: The Impact of China's Policies on Global Semiconductor Innovation," found that "China's innovation mercantilist practices in the semiconductor sector have included excessive ownership and subsidization of state-owned or state-supported enterprises; direct provision of equity or provision of financing at below-market terms; state-directed or state-enabled acquisition (or attempted acquisition) of foreign semiconductor companies; IP theft; forced or compelled technology transfer, especially through mandated joint ventures; and manipulation of technology standards, alongside a variety of other market-access restrictions or impediments that seek to advantage Chinese players in this sector to the detriment of foreign competitors."[21]

In the semiconductor sector, perhaps China's most pernicious mercantilist practice has been aggressively industrial subsidization, largely channeled through the country's $170 billion National Integrated Circuit (IC) Fund. A 2019 Organization for Economic Cooperation and Development (OECD) report examined government funding support for 21 international semiconductor firms from 2014 to 2018, finding that Chinese companies received 86 percent of the below-market equity provided by nations' governments over that period.[22] With regard to China's largest semiconductor player, Semiconductor Manufacturing International Corporation (SMIC), the OECD found that state subsidies accounted for slightly over 40 percent of the company's revenues from 2014 to 2018 (state subsidies also accounted for 30 percent of Tsinghua Unigroup, and 22 percent of Hua Hong, revenues over this period).[23]

Of particular import, the OECD study found that there "notably appears to be a direct connection between equity injections by China's government funds and the construction of new semiconductor

fabs in the country."[24] Such subsidies are an important part of the explanation why China's share of global semiconductor manufacturing capacity, which was barely 1 percent in 2000, increased to 11 percent by 2010, 15 percent by 2020, and is forecast to increase to 24 percent by 2030.[25] China's subsidies in the semiconductor space are especially pronounced in the memory chip part of the market. For instance, Yangtze Memory Technologies Co. (YMTC) is a Chinese state-controlled joint venture stood up from whole cloth by the National IC Industry Investment Fund, the state university-controlled fabless semiconductor firm Tsinghua Unigroup, and the Hubei Science and Technology Investment Group, supported by $24 billion in initial government funding allocated for its initial Wuhan factory alone.[26] In effect, YMTC is China's state-owned national champion for memory chips, especially those used in solid-state hard drives and USB flash drives. By year-end 2020, YMTC announced it would triple production to 60,000 wafers per month, equivalent to 5 percent of global output. As the Hinrich Foundation's Alex Capri wrote about these investments, "As China's memory chip production is based on government output targets and other strategic, non-market driven goals, then the possibility of an over-supply of NAND and DRAM chips would seem likely, at some point, which would drive down global market prices. None of this bodes well for the world's existing players in this space."[27]

In other words, Chinese subsidies (and other mercantilist practices) are propping up inferior, less-innovative Chinese semiconductor enterprises at the expense of U.S. and other foreign competitors. To wit, ITIF's analysis found that non-Chinse semiconductor firms had a patent intensity (patents as a share of sales) four times greater than Chinese semiconductor firms. Factoring in these firms' lower patent intensity and assuming that without unfair Chinese government policies these firms' global market share would be one-third of what it is today, ITIF calculated that the cost of these policies was a significant reduction in global patenting. ITIF concluded that, in 2019, Chinese innovation mercantilism led to approximately 5,100 fewer U.S. semiconductor patents awarded than would otherwise be the case (out of a total of about 19,500 issued).[28]

ITIF found similar effects when it examined China's policies toward developing its tele-communications equipment industry. As ITIF found, there's no question that, without unfair innovation mercantilist policies and programs, China would lack a globally competitive telecom equipment industry. Neither Huawei nor ZTE, China's two national champions, would have more than de minimis market shares, even in China. Nor is there any question that Chinese market-share gains have come at the expense of innovative telecom equipment providers based in other nations. In the 2000s, Chinese innovation mercantilism contributed to the demise of Canada's Nortel and America's Lucent, the world's two most-innovative telecom equipment producers in the late 1990s. And since then, China's rise has come at the expense of global market share and profits for Europe's Ericsson and Nokia, the number two and number three players in the industry, respectively.[29]

Just as with semiconductors, Chinese telecommunications firms benefitted from massive industrial subsidization. For instance, the *Wall Street Journal* reported that: "Huawei had access to as much as US$75 billion in state support over the past 25 years, including grants ($1.6 billion), credit facilities ($46.3 billion), tax breaks ($25 billion), and subsidized land purchases ($2 billion)."[30] The company's sales were also bolstered by generous export credit support, with *The Washington Post* reporting in May 2019 that, "state-owned Chinese banks have made a $100 billion line of credit available to Huawei

customers." As the article noted, "[Though] less than 10 percent has been used, even $10 billion dwarfs the $200 million in new loans the U.S. Export-Import Bank granted to all customers in 2017."[31]

And, as with semiconductors, ITIF finds the evidence suggests there would be even more innovation in the industry today if Huawei and ZTE did not exist: a greater number of innovative, non-Chinese firms would have more revenue to support more productive R&D. ITIF estimated that if Ericsson and Nokia took all of Huawei and ZTE's telecom equipment sales, global telecom equipment R&D would increase 20 percent, 5G standards contributions would increase 18 percent, and essential 5G patents would increase 75 percent. In short, Chinese policies, and Chinese telecom equipment firms, on net, are a drag on global innovation.[32]

Solar panels represent another instance of massive Chinese industrial subsidization, with Chinese firms receiving $42 billion in subsidies for solar photovoltaic (PV) cells from 2010 to 2012 alone.[33] Those subsidies helped China's global share of production of PV cells, the industry's core technology, surge from 14 to 60 percent between 2006 and 2013.[34] The effect of this surge was to knock some 200 to 300 U.S. solar start-up companies out of business. The decimation of PV manufacturing outside China drove many innovative firms out of the business entirely, in large part because they could not match the predatory prices offered by government-subsidized Chinese competitors (indeed, Chinese crystalline solar PV prices decreased by 85 percent from 2009 to 2017), with China exporting 38 percent of the world's solar panels in 2018.[35] There is evidence China's new PV giants have innovated in important ways, especially through process innovation that moved the industry's dominant technology rapidly down a steep experience curve. However, the prospect of shifting to better, cheaper PV products with the potential for even-greater emissions reductions over the long run has been deferred or even lost.

Lastly, a similar story has emerged in high-speed rail, where China's state-directed bid for a leadership position in the high-speed rail sector has distorted the global market with massive subsidization, mandated mergers, forced technology transfers, and other mercantilist practices.[36] State-supported financing has allowed China's national champion, CRRC, to offer abnormally low bids—often 20 to 30 percent lower than foreign competitors—for procurement contracts. ITIF estimates that in the absence of these unfair Chinese policies, greater market share would have provided foreign rail firms with the revenue to invest an additional $1.06 billion in R&D from 2015 to 2019, which would represent a 164 percent increase over their actual R&D spending.

While those provide just a few industry-level case studies, the reality is that Chinese mercantilist practices, especially aggressive industrial subsidization, are pervasive across virtually all industries. In fact, since China joined the WTO in 2001, subsidies have annually financed about 20 percent of China's manufacturing capacity. And Fang et al. find that 95 percent of Chinese firms in tech industries received R&D subsidies in 2015, with those subsidies accounting for 22 percent of firms' R&D investments.[37]

Chinese enterprises also of course benefit from rampant intellectual property theft, much of it state-sponsored or instigated, the result of "long-running state espionage programs targeting Western firms and research centers" that has carried over into cyberspace.[38] In 2017, the Commission on the Theft

of American Intellectual Property estimated that China's IP theft may cost the U.S. economy as much as $600 billion annually.[39] By 2019, a *CNBC* Global CFO Council report found that one in five North American corporations had their IP stolen in China within the past year.[40] Despite Chinese promises to curtail IP theft, the practice continues largely unabated.

Nor has the extent of forced technology transfer substantially abated in China, in sharp contradistinction to China's promise upon joining the WTO that:

> The allocation, permission, or rights for importation and investment would not be conditional upon performance requirements set by national or sub-national authorities, or subject to secondary conditions covering, for example, the conduct of research, the provision of offsets or other forms of industrial compensation including specified types or volumes of business opportunities, the use of local inputs or the transfer of technology.[41]

In reality, Chinese technology transfer requirements are a continuing feature of Chinese policy. In 2012, 23 percent of the value of all foreign direct investment (FDI) projects were joint ventures.[42] In 2015, 6,000 new international joint ventures, amounting to $27.8 billion of FDI inflows, were established in China.[43]

Because such conditions contravene China's WTO commitments, officials are careful not to put such requirements in writing. Instead, they often resort to oral communications to pressure foreign firms to transfer technology, although recent decisions of the WTO Appellate Body have made it clear these unwritten measures can also be challenged.[44] The United States Trade Representative's Office (USTR) 2018 Special 301 report comprehensively documents how industrial plans such as Made in China 2025 apply foreign ownership restrictions, including formal and informal joint venture requirements, "to require or pressure technology transfer from U.S. companies to Chinese entities.[45]

China's forced technology transfer practices persist across a range of industries, from semiconductors and cloud computing to automotives and biotechnology. For instance, China pressures foreign biopharmaceutical companies to form joint ventures if they want their products included on the government list of drugs that qualify for reimbursement.[46] Likewise, the Chinese government requires that all drugs sold in China go through Chinese clinical trials, even if they have already been approved in the United States, which can extend the waiting time for a company to sell a drug by as much as eight years. Likewise, China's ongoing requirement for 100 percent Chinese-owned technology in many rail procurement contracts, combined with the requirement that foreign firms engage via majority-Chinese owned JVs in order to submit a bid, amounts to an ongoing de facto mandate to transfer technology to local partners.

China also requires companies running cloud-computing operations to be locally controlled.[47] This means that if a company such as Amazon Web Services or Microsoft wants to serve the rapidly growing Chinese market, it must partner with a Chinese company and sell their services under the Chinese company brand. The partnership includes the expectation for the foreign cloud provider to provide the Chinese firm with technology and know-how.[48] Chinese cloud providers such as Aliyun—

the cloud services unit of Alibaba—can establish their own data centers in the United States without any similar requirements.

China's forced joint venture and technology transfer practices not only continue but may be getting worse. In May 2019 the *Wall Street Journal* reported on the increasing frequency of forced technology transfers between European firms in China to local firms.[49] That same year, the European Chamber of Commerce found that more than twice as many firms felt compelled to undertake technology transfer in China as they did in 2017. European companies in high-value, cutting-edge industries felt more pressure than usual, the Chamber reported. Some 30 percent of chemicals and petroleum companies, 28 percent of medical-device companies, 27 percent of pharmaceutical companies, and 21 percent of automotive companies reported such transfers.[50]

To be sure, there can be circumstances when the innovation policies of China (or other nations) can be beneficial to the U.S. and broader global economy. (See Table 1). For instance, when China supports science, technology, engineering, or mathematics (STEM) education, this produces scientists and researchers who help Chinese enterprises more-effectively innovate, but it also contributes to the stock of global knowledge and intelligence that is helpful toward advancing global innovation. The same would go for when China supports more rapid broadband rollouts, including 5G or 6G cell sites.

Investment into basic R&D also falls into this category (because it creates knowledge that represents a global public good), but unfortunately more often than not China's R&D investments are focused on applied R&D that seeks to predominantly benefit Chinese enterprises.[51] For instance, one report noted, "China is expected to invest up to twice as much as the United States, or $658 billion (4.5 trillion yuan), in the back end of the R&D chain by 2018, focusing on translating basic and applied research into commercial products and new manufacturing processes."[52] But China intends to go well beyond this. In March 2021, Chinese Premier Li Keqiang announced that China intends to significantly increase its R&D spending over the next five years in a push to make "major breakthroughs" in technology. The comments came during a speech at China's annual parliamentary "Two Sessions" meeting, as Beijing laid out its priorities for the coming years. Accordingly, China's R&D spending will increase by more than 7 percent per year between now and 2025. R&D will subsequently account for a higher percentage of China's gross domestic product (GDP) than in the previous five years.[53]

More often, the impact of China's policies on global innovation are at best neutral, particularly because many innovation-incenting Chinese policies are available predominantly (or only) to Chinese enterprises, such as preferential R&D tax incentives, R&D subsidies, or low-cost financing mechanisms. But, as noted, the vast majority of China's innovation mercantilist policies are injurious to U.S. and global innovation.

Economic Impact of Chinese Innovation Mercantilism

The impact of China's innovation mercantilist practices, and especially subsides, on the global economy has been profound. China's share of global output of high-technology manufacturing industries has increased from 8 percent in 2003 to 27 percent in 2018.[54] China has now become the world's largest high-technology goods exporter, with about a one-quarter global share.[55] And it's not

just low-value-added goods, a recent University of Sussex study finds that that the average value China adds to its exports is 76 percent (the European Union's (EU) is 87 percent).[56]

China's share of global GDP has skyrocketed from around 3 percent in 1995 to 18 percent by 2018, and although this is due primarily to faster productivity growth and faster population growth, it's also been abetted by China's extensive mercantilist practices. Chinese economic practices have also led to rapid growth in rather unbalanced trade with the United States. In fact, from 2001 to 2020, China accrued a $6.82 trillion surplus in trade in goods with the United States.[57] Nor is this confined to labor-intense, lower-value-added goods such as toys or apparel. The United States has run a trade deficit in advanced technology products (ATP) with China in every year since 2001, with the United States accruing a $1.65 trillion deficit with China in ATP trade from 2001 to 2020.[58]

China's massive trade surpluses with the United States (and the rest of the world) have swelled its foreign-currency reserves. In fact, China's stock of foreign-currency reserves grew from a meager $212 billion in 2000 to $4 trillion by August 2015, and stands at slightly over $3.2 trillion today.[59] China's dramatically larger economy and base of reserves confers the ability to pursue a wide range of national security and diplomatic objectives, from a large increase in the size of its military to efforts to curry favor and investment opportunity with foreign nations through efforts like the One Belt One Road (OBOR) and Digital Silk Road (DSR) initiatives. In total, China's wealth and influence has expanded dramatically over the past two decades, in not insubstantial part through the application of economic and trade practices that are fundamentally not consonant with the WTO's principles of private enterprise-led, market-based, rules-governed trade in accordance with the fundamental tenets of reciprocity, national treatment, fairness, and non-discrimination.

RESPONDING TO CHINESE INNOVATION MERCANTILISM

The U.S. response to China's innovation mercantilism must be manifold and include a wide variety of both unilateral responses—notably to bolster its own innovation capacity and to deploy trade instruments at its disposal to contest Chinese unfair trade practices—and ones undertaken in collaboration with likeminded nations, across a range of plurilateral and multilateral forums.

Domestic Responses to Chinese Innovation Mercantilism

America's domestic response to Chinese innovation mercantilism should include a set of policies designed to bolster U.S. industrial competitiveness and another set that strengthens the resources and toolset available to respond directly to Chinese mercantilist practices.

Strengthening U.S. Competitiveness

The first step the United States must take is to bolster the capacity of its enterprises and industries to flourish in global competition. Here, the most important step the United States can take in this moment is for Congress to pass out of conference, and for President Biden to sign, an integrated version of the Senate's U.S. Innovation and Competition Act (USICA)/the House's America COMPETES Act. ITIF prefers the Senate's USICA legislation, which would include more-robust programs and investments to foster technology-driven U.S. economic growth. Notably, USICA would provide $81 billion in R&D investment over the next five years, including $29 billion that would go toward research and technology development in key technology focus areas, such as artificial

intelligence and quantum science, in order to strengthen the global leadership of the United States in innovation through a new Technology and Innovation Directorate at the National Science Foundation (NSF). Other important aspects of the legislation include $52 billion to enhance the competitiveness of America's semiconductor industry, $8 billion for regional technology hubs, $2.4 billion for the Manufacturing Extension Partnership (MEP) program, and $1.2 billion for Manufacturing USA.[60] Passage of this legislation is essential to ensure sustained U.S. industrial competitiveness. To achieve the maximum impact of such investments, the U.S. government needs to continue to articulate and implement strategic plans to support U.S. competitiveness, such as one announced by the Department of Commerce on March 29, 2022 that seeks "to drive U.S. innovation and global competitiveness" including through "strategic objectives" like revitalizing U.S. manufacturing to improve domestic supply chains, developing and deploying emerging technologies, enhancing trade enforcement, protecting intellectual property rights, and improving cybersecurity.[61]

Strengthening Organizational Capabilities Within the Federal Government

The United States needs to further strengthen its organizational capabilities within the federal government to confront unfair foreign trade and economic practices.[62] Here, the president should establish and staff a new National Industrial Intelligence Unit (an "NIIU," which could be housed within the existing National Intelligence Council) charged with developing a better process and structure to understand the specifics and long-term implications of other nations' economic development strategies, particularly China's, so that the United States can respond more effectively.[63] This group would develop a better process and structure to understand the long-term implications of China's economic development strategy on U.S. competitiveness. The NIIU would produce a report every other year detailing the extent to which Chinese innovation mercantilist policies have contributed to the outsourcing of manufacturing and other activities to China and is leading to the hollowing out of the U.S. defense industrial base.

Elsewhere, Congressional legislation has directed USTR to appoint a Deputy USTR in charge of Innovation and IP. This position can become, by dent of rank, the highest-ranking person in the U.S. government solely devoted to innovation and IP, because it would be at a Deputy Secretary level, whereas leaders at the National Institute of Standards and Technology (NIST) and the U.S. Patent and Trademark Office (USPTO) are at the undersecretary level.

However, the Biden administration has yet to signal any action toward making such an appointment. This lacuna, coupled with open leadership appointments at other key federal agencies focused on innovation and IP, such as USPTO and NIST, shortchange the role of IP and innovation in U.S. trade policymaking. These gaps should be addressed as part of a broader effort to elevate the focus on technology, innovation, and IP in U.S. trade policymaking.[64]

Another idea would be to establish a cadre of U.S. tech diplomats. These officials would be the vanguard for implementing the international aspects of American industrial policies including cooperative research agreements, human capital exchanges, infrastructure development, and export controls.

Revoke China's PNTR and Renegotiate Market Access Schedules for Chinese Goods and Services at the WTO

The United States decides, at its discretion, which nations to extend permanent normal trade relations (PNTR) to. Indeed, the Biden administration and U.S. Congress are considering revoking Russia's PNTR with the United States.[65] The WTO operates on the most-favored nation (MFN) principle. Essentially, this means that countries cannot discriminate among their trading partners and their best offer (e.g., a lower tariff rate on a product) must be offered to all other member nations.[66] Outside of the WTO, nations may elect to confer MFN status on other trade partners at their own discretion.

For instance, the United States suspended China's MFN status in 1951 and conditionally restored it in 1980 (in accordance with the 1974 Trade Act, but amended by Jackson-Vanik freedom-of-emigration provisions). The United States renewed China's MFN status on an annual basis until January 2002, when legislation (P.L. 104-286) was enacted granting permanent normal trade relations to China, following its accession to the WTO.[67]

In other words, before China's WTO accession in 2001, and since 1951, the United States applied MFN conditionally to China and other communist regimes. This is an important distinction, because annual congressional debates on MFN renewal have led to sustained pressure on China on issues such as human rights and unfair trade practices.

The following is an example of explicit Congressional attention on human rights in the 2000 legislation conferring PNTR status upon China:

> The human rights record of the People's Republic of China is a matter of very serious concern to the Congress. The Congress notes that the Department of State's 1999 Country Reports on Human Rights Practices for the People's Republic of China finds that "[t]he Government's poor human rights record deteriorated markedly throughout the year, as the Government intensified efforts to suppress dissent, particularly organized dissent."[68]

It is time for the United States to rethink its grant of PNTR to China. The United States could return to the practice of annually applying MFN "conditionally," with a link to labor rights and environmental protections. In fact, Senators Cotton (R-AR), Inhofe (R-OK), and Scott (R-FL) have proposed the China Trade Relations Act, which would revoke China's permanent most-favored-nation status and return to the pre-2001 status quo, whereby China's MFN status must be renewed each year by presidential decision.[69]

Furthermore, if China consistently refuses to adhere to MFN commitments, the United States and its allies should consider renegotiating market access levels for goods and services at the WTO. This would create a more meaningful difference between the preferential rates for allied trading partners and those for non-favored countries such as China. Put simply, the WTO is for market-oriented economies that actually implement its foundational principles and clear obligations; if China decides to develop an alternative economic system that is not compatible with existing multilateral rules, then it shouldn't be in the WTO—or at least it shouldn't enjoy the same benefits as countries that respect agreed-upon rules. To be clear, the preferrable outcome would be for China to fully embrace the WTO

responsibilities it has committed to, but if this continues not to be the case, in ITIF's view the United States needs to consider more serious policy options, such as revoking China's PNTR, to deal with a challenge that not only has not abated but has in fact deepened over the past decade.

Self-Initiate More WTO Cases

The president should direct USTR to self-initiate more cases against China at the WTO. The egregiousness of China's innovation mercantilist practices means that cases brought before the WTO are often likely to be successful. Since its accession to the WTO, China has been a defendant in 44 cases. Six have been settled or terminated, while 12 are still in consultation. Of the remaining 26 cases, 21 have been adjudicated while 5 are pending. Of the 21 cases that have been adjudicated before the WTO's Dispute Settlement Board, China has lost every single one.[70]

Unfortunately, the U.S. approach in bringing cases before the WTO has generally been for industry to lead in making a complaint and engaging USTR to formally bring the dispute up with a trade partner or before the WTO. But USTR could be bringing a number of cases against China without waiting for industry. Consider China's unbalanced technology import-export regulations (TIER) licensing. That law was passed in November 2001, a month before China entered the WTO. It took 16 years before the United States brought a WTO case against China over the practice, which it won. When China or another nation implements a law that substantially contravenes the WTO and is likely to harm U.S. industry, USTR should proactively file a dispute rather than wait for industry to lead the charge.

The USTR has other options too. For instance, the WTO requires that "cases of general applicability be published"—in other words, countries must publish their court decisions. However, often this is not the case for China.[71]

Similarly, Article 270 of China's Civil Procedure Law puts China in violation of the WTO. Essentially, it states that for foreign litigants bringing any form of civil case, the amount of time the courts have to make a ruling is unlimited. If it is a domestic case, rulings must be made in six months.[72] This disparity gives Chinese courts free reign on how long they may take to decide a foreign case, which can and has been strategically used against foreign firms—and this again represents a national treatment violation.

Coordinated, Allied Responses to Chinese Innovation Mercantilism

While the United States can and should, where possible and necessary, undertake unilateral steps to combat Chinese innovation mercantilism, collaboration with allied, likeminded countries will be essential to containing and then rolling back Chinese mercantilism and restoring a genuine market- and rules-based global trading system. In particular, it's time for the European Union, Japan, and the United States to band together in a stronger trilateral framework to address the various ways China rigs, manipulates, and distorts markets.

This section examines how likeminded countries can collaborate on: documenting China's innovation mercantilism; developing stronger structures to stand together against it; coordinating better with regard to investment screening and export control regimes; developing stronger rules prohibiting

forced technology transfers and market-distorting subsidies; and collaborating more in bringing WTO cases.

Amend, and Use, Section 301 to Target Digital, Services, and Other Modern Trade Barriers in China

The Biden administration should update its main trade defense tool—the Trade Act of 1974—to better reflect the type of digital and services trade barriers that China has enacted. Section 301 is a powerful tool when there is an administration that is willing to fully use it. With few exceptions, the United States has only ever used its prescription for tariffs. The United States has never used its services trade-related provisions.

Section 301's traditional use of tariffs makes it easy to apply to 20th century trade in goods, but it needs to be amended to create new legal and administrative mechanisms and tools to target service providers. Section 301 mentions fees and restrictions on services. It could be amended to detail the mechanism (in terms of responsible agency) and process (in terms of the action, such as licensing, certification, or legal judgement) whereby the administration imposes specific retaliatory measures on a foreign service provider. For example, it could be amended to create a reciprocal joint venture requirement. Chinese tech firms would be forced to setup local joint ventures with equivalent ownership and control restrictions that U.S. firms have had to setup in their respective countries.

Pursue a Specific Section 301 Investigation Into China's Cloud, Cyber, and Other Digital Trade Restrictions

The Biden administration could use Section 301 to initiate an investigation of China's cloud services restrictions and other digital trade restrictions as these are among the most clearly egregious examples whereby China targets U.S. firms. An investigation could be broad and include other Chinese digital/cyber sovereignty initiatives, such as discriminatory cybersecurity regulations. If used, the Biden administration could enact retaliation via tariffs on imported goods (the traditional use of Section 301), taxes, or restrictions on Chinese digital service companies doing business in the United States (a new use of Section 301), and restrictions on other Chinese service providers, such as accounting firms, air carriers, automotive companies, aerospace companies, and others.

Collaborate to Document and Share Information on Chinese Unfair Trade Practices

Likeminded countries should coordinate to create a collective "bill of particulars" that enumerates the vast extent of Chinese innovation-mercantilist policies—in great detail. This should not be about recycling USTR's annual report to Congress on China's WTO compliance, the China chapter from the annual USTR National Trade Estimate report, or the submissions countries make during China's trade policy review at WTO.[73] This would be a useful exercise to conduct together, as past experience—and current Chinese practices—creates a difficult evidentiary hurdle to clear for a WTO dispute case, as much of the information and evidence needed to support a claim, particularly one based on unwritten rules or practices (which is common in China), can be difficult to obtain.

Likeminded countries can also collaborate in advocating for improved transparency and surveillance at the WTO, which matters because the lack of transparency in Chinese trade-related policymaking acts as a considerable, and growing, nontariff barrier to trade. China's governance system is

notoriously opaque, complex, and multilayered, with overlapping and often inconsistent national, provincial, and municipal government policies. The rules-based multilateral trading system was founded on transparency and predictability, which is why WTO members must insist upon strong and enforceable compliance and notification obligations. To enhance this, the United States has coordinated and presented, together with the EU and Japan, a joint set of proposals—the first in November 2018, and the second in June 2019.[74] The proposal includes some basic steps that should already be in place: to "name and shame" those members not complying with WTO transparency and reporting requirements, administrative penalties for members failing to meet transparency obligations, and for WTO's trade policy review to include a specific, standardized focus on members' compliance with transparency requirements in their reviews.

Likeminded countries should establish formal meetings between relevant agencies to discuss and exchange information related to the respective defensive mechanisms they've implemented to address predatory, nonmarket-driven, Chinese trade and economic activity, mainly with regard to investment screening, export controls, countering IP theft, and controlling access to financial markets. Such countries should work together to ensure they're on the same page and that their relevant countermeasures are working as necessary to prevent Chinese state-directed, predatory economic activity.

These meetings would report to respective leaders and ministers/senior officials on:

- Cooperation and information exchanges on foreign investment screening frameworks and cases, including Chinese venture-capital-backed investment;
- Cooperation and information exchanges on export control frameworks and cases; and
- Cooperation on developing domestic measures to identify and prevent the cyber-theft of commercial trade secrets and measures to target and respond to Chinese firms that benefit from stolen IP.[75]

Create a "DATO" for Trade

Allied nations should form a new "NATO for trade" to combat Chinese trade aggression. Allied nations should form a pact wherein they agree to come to the aid of each other when economically threatened by the CCP.[76] The new organization, a DATO, would be governed by a council of participating countries, and if any individual nation were threatened or attacked, the DATO would quickly convene and potentially agree to take joint action to defend the nation attacked. For example, if China threatened to expel a given nation's students, DATO nations could agree to ban Chinese students in return. If China threatened to put a country's firms on its "unreliable list," the DATO nations could agree to limit imports from Chinese firms. Any democratic nation would be welcome to join DATO, including Taiwan, but should any nation not take the steps needed to respect after a DATO decision, they would lose the right to be a member.[77]

Further, in a "DATO" likeminded nations could develop a comprehensive list of enterprises, entities, and individuals who have attempted or effected IP theft, and develop mechanisms to restrict such firms and individuals from competing in likeminded nations' markets. Second, likeminded nations should enhance information-sharing efforts to combat foreign economic espionage and

IP/technology/trade secret theft. Here, likeminded nations could work to expand the Five Eyes partnership.[78] The alliance provides mutual access between members regarding intelligence activities, including cybersecurity, and promotes greater levels of military interoperability. There has been discussion about possibly bringing Germany and Japan into the framework.[79] To be sure, there is a significant defense component to the Five Eyes Alliance, so another, potentially broader, approach would be for the United States to lead likeminded nations in developing a broader Five Eyes-like alliance specifically focused on combatting state-sponsored economic espionage in advanced-technology industries.

Form a Global Strategic Supply Chain Alliance

A related approach some have called for would be for likeminded nations to come together to form a Global Strategic Supply Chain Alliance (GSSCA) that could collectively address security needs with respect to critical strategic items.[80] Such a GSSCA would organize certain key industries for the benefit of its member states, with members agreeing to develop supply chains within the GSSCA to the exclusion of similar items from non-member states. Such an alliance could be organized around particular items or products, such as 5G networks, rare earth metals, active pharmaceutical ingredients, or perhaps a key tool or component in the semiconductor supply chain. The theory behind the GSCCA structure would be "an economically oriented calculus that combines risk assessment at a supply chain level with a strategic overlay."[81] Such a structure could become necessary in the future should some nation(s) seek to corner certain key inputs or supplies to the detriment of the international supply chain or other nations.

Aligned and Complementary Frameworks for Foreign Direct Investment Screening

The United States should work with likeminded nations to align foreign investment screening practices and to exchange information when it appears other nations are trying to use unfair practices in making foreign investments, such as heavily state-subsidized SOEs attempting to purchase foreign enterprises in advanced-technology industries.[82] This matters especially when, by December 2020, Chinese-government-guided strategic technology investment funds controlled more than RMB 4 trillion ($610 billion) in capital, much of which was earmarked for foreign technology acquisition.[83] For instance, since 2014, Chinese businesses have made at least $56.8 billion in technology-related investments abroad, of which $36.7 billion (65 percent) was invested outside the United States.[84] The largest allied destinations of Chinese tech-related FDI outside the United States have been the United Kingdom, the Netherlands, Germany, France, and Singapore.[85] The Foreign Investment Risk Review Modernization Act (FIRRMA) instructs the Committee on Foreign Investment in the United States (CFIUS) to "establish a formal process to share information with foreign allied governments and coordinate and cooperate on investment security issues."[86]

The EU was initially slow to realize its high-tech firms were being picked off by nonmarket-based, Chinese government-supported investment acquisitions, but were spurred into action as China's acquisitions of European high-tech firms increased in 2016 and 2017, in part, as Europe presented an easier target after the United States had increased scrutiny of foreign investment.[87] Indeed, European high-tech firms like German robotics manufacturer Kuka were going for a song. EU nations make their own FDI screening rules, but in April 2019, the European Union's new framework for the screening of FDI went into force. It will provide a better instrument to detect and raise awareness of

foreign investment in critical assets, technologies, and infrastructure in the EU. The central feature of the EU framework is it sets minimum requirements for national screening mechanisms and aims to enhance cooperation and information sharing between the commission and member states on specific foreign investments likely to affect security and public order in member states and in the whole EU. However, it neither harmonizes investment screening mechanisms that are currently in place in member states, nor replaces them with an EU-level mechanism.[88]

Likeminded countries should use a formal meeting and cooperation arrangement to help each other build a more comprehensive picture of foreign investors of concern, their intentions, their products, and the potential impact on the host or a third-party country and sector. This is critical because the Chinese government, often through SOEs operating under CCP dictates, funnels money in nontransparent ways to obfuscate the fact that the real investor is the Chinese government. Each of the trilateral parties should also provide semiannual and annual reports covering relevant FDI and transactions to help them identify trends and changes. The parties should be able to provide feedback (on a confidential basis) as to whether they think a particular transaction in a given country would affect their own economic or military security or public order, and why. In a way, this would formalize the connection between respective agencies involved in a shared case of concern. For example, when the CFIUS review rejected China's Fujian Grand Chip Investment Fund's attempted acquisition of the semiconductor equipment supplier Aixtron (headquartered in Germany, with assets in the United States) in December 2016, German regulators withdrew their approval because of security concerns.[89]

Lastly, Australia, Canada, and the United Kingdom are the countries currently on CFIUS's white list, which exempts foreign investors from filing requirements for their non-controlling investments in "TID" U.S. businesses—those that operate or manage critical technologies, critical infrastructure, or sensitive personal data.[90] The United States should consider expanding its list of "excepted foreign states" to include countries such as France, Germany, the Netherlands, Italy, Japan, and South Korea (among others). As a recent Brookings Institution report concurs, "The United Kingdom, Germany, Netherlands, France, Italy, and Japan are optimal partners for the United States to prevent the transfer of sensitive technical information through investments," adding that the United States should work to bring in Austria, Finland, and New Zealand as well. As that report concludes, "Allies are vital if the United States is to establish comprehensive, data-driven screening procedures based on the risk of technology transfer."[91]

Aligned Export Control Rules With Allies

Just as with investment screening, likeminded countries should ensure their export control regimes are comparably defined and applied so as to be compatible. Export control rules should also be updated on a regular basis, and allow the parties to share information relevant to cases of shared concern. While not always explicitly identified in relevant policies and debates, China is the main country of concern given the extent of its trade in high-tech goods. However, updated export-control regimes are going to be especially challenging given the task of managing emerging technologies (such as AI) that may have some specific defense-related dual uses. This is critical because, unless likeminded countries can come up with fairly aligned export control regimes of the kind designed to limit technology access to, say, the former Soviet Union, China will simply play off companies and countries against each other, few of which can resist the lure of sales in the Chinese market.

Many countries, including the European Union, Japan, and United States as part of the trilateral trade ministers' working group have modernized—or are currently modernizing—their export control regimes. Besides recent changes concerning South Korea, Japan has also updated its export control regime in recent years.[92] The European Commission submitted a proposal to modernize the EU's export control regime, which included cybersecurity and surveillance technology.[93] In June 2019, the president of the European Council was given a mandate to negotiate with the European Parliament on a new export control regime.[94] Earlier, on August 18, 2018, the Export Control Reform Act (ECRA) was signed into law in the United States. A critical part of this was the requirement for the U.S. Commerce Department's Bureau of Industry and Security (BIS) to develop rulemaking regarding extending export controls to an enlarged set of emerging and foundational technologies (EFTs): new or foundational technologies that in some narrow cases are essential to national security and are not currently covered by existing export control rules.[95]

Export control cooperation among likeminded countries could include:

- Participating parties setting up periodic meetings between agencies involved in their respective export control regimes, including defense, law enforcement, commerce, and trade agencies.
- Whether part of this or separate (given sensitivities), participating parties should ensure their respective intelligence and related agencies are able to discuss and share intelligence related to export control issues.
- Participating parties should discuss efforts to identify a narrow and specific set of EFTs that would be subject to export controls, specifically, those products that provide a unique, identifiable, and qualitative military advantage. This could involve efforts to ensure similar definitions/terminology. As ITIF has argued, how export control regimes cover new EFTs will remain a challenging task given the potential dual use of many new technologies; and in many sectors, what constitutes "state of the art" changes too rapidly for export rules to reliably and readily adapt.[96] This is important to ensure export controls only target very specific EFTs (such as preventing the spread of AI-enabled advanced weapons systems), but are not overly broad in how they define and restrict other emerging technologies.[97]
- Ideally, participating parties would develop a joint regime to sanction Chinese firms where there is clear, compelling, and agreed upon evidence of IP theft from any of the three parties' economies and their firms. In these cases, participating parties should implement a coordinated export control regime applied to the firm committing the violation. In line with this, the Biden administration should consider ways to blacklist Chinese companies that steal American IP from doing business in the United States (and indeed in the markets of likeminded countries as well).[98]
- Participating parties should exchange information to help identify the actual end user of a potentially concerning transaction (as this is the most important question in export control). Where cases or questions arise, respective agencies from participating nations should have a mechanism in place that allows them to query their counterparts on certain potential buyers in order to, given China's extensive use of opaque ownership structures and vehicles, gain a better idea of whom is involved.
- Each party should address not just product exports but also technology transfer (such as technical know-how in joint ventures, technology licensing, etc.) to organizations (e.g., private

companies, SOEs, and government organizations) from nations such as China that continue to make coerced technology transfer a central component of their economic development strategies.[99]

- Export controls are most successful when they are coordinated internationally, so participating countries should engage (either collectively or separately) with other key countries on this issue, and encourage convergence toward a similar export control model and item coverage. Related to this outreach is the scenario whereby each party's respective export control authority assesses where else foreign entities could obtain particularly sensitive technology, and engage their export control counterparts in these third countries.

Collective, aligned, and proactive efforts to prevent the export of defense-related products and technical knowledge are necessary to protect national security. In addition, a joint export-control regime can be an effective tool to punish Chinese firms that engage in serious IP theft. Joint efforts are critical, as export controls need regular updating in order to reflect the global state of play in advanced technology industries (and hence, require greater international cooperation) as well as the changing ways in which countries and their firms are trying to acquire access to prohibited defense-related products. A coordinated approach is also necessary to avoid firms from one party being put at a competitive disadvantage to their competitors in the EU, Japan, or the United States, as in the case whereby one party blocks the export of a particular technology, but the others don't.

New, Stronger Rules Prohibiting Forced Technology Transfers and Market-Distorting Subsidies

Since its formation in December 2017, the trilateral trade ministers' grouping from the European Union, Japan, and the United States have been working to develop new rules to target China's extensive use of market-distorting industrial subsidies for its private firms and state-owned enterprises, particularly those that lead to overcapacity.[100] The types of practices they're trying to target are bank lending incompatible with a company's creditworthiness; government or government-controlled funds making equity investment on noncommercial terms; subsidies to insolvent companies; and noncommercial debt-to-equity swaps. The three parties are also working on new rules to enhance transparency in subsidies and the operations of SOEs, including new remedies to increase the costs of transparency and notification failures.[101] Rules should obligate the subsidizing country to prove that a given subsidy does not inflict harm on others. Likeminded nations should focus on achieving a significant increase in global subsidies transparency, including insisting upon timely and complete notification of subsidies and establishing a presumption of prejudice toward subsides not timely notified.[102]

As part of text-based negotiations, experts have also reportedly been negotiating language around the critical issue of how to define a "public body," which is a critical part of this issue, as ownership and control of banks and other entities in China is not clear, and China has used this lack of clarity in WTO trade law to provide massive amounts of capital to firms in select high-tech industries. For example, it is common in China for a bank (notionally private, but partly government owned) to provide (rather than receive) a subsidy (e.g., a loan on a preferential basis) to another Chinese entity in a particular industry.[103] Likewise, China's investment fund to subsidize Chinese semiconductor companies was designed to skirt WTO subsidy rules by appearing to be a private investment enterprise. In fact, it was organized by China's Ministry of Industry and Information Technology

(MIIT) and staffed by former MIIT employees. And it was funded in large part by SOEs that were presumably told by the state-owned Assets Supervision and Administration Commission of the State Council they had to "invest" in the fund. This is for all intents and purposes money laundering to minimize the risk of WTO action.

Beyond this, the three parties should discuss and develop some new legislative and policy tools. One should be to create a way for joint antitrust exemptions for companies to cooperate against forced tech transfers and investment in China.[104] If companies in a similar industry can agree that none of them will transfer technology to China in order to gain market access, then the Chinese government will have much less leverage over them. Another should be for the three parties to ensure their own government procurement processes don't inadvertently buy from—and thereby support—these subsidized Chinese firms.

Collaborate to Bring a Non-violation Nullification and Impairment Case Against China at the WTO

Article XXIII of the General Agreement on Tariffs and Trade (GATT) addresses dispute-settlement provisions and includes a "non-violation" clause that provides a legal cause of action against measures that do not explicitly violate the treaty but nevertheless upset the reasonable expectations of the parties and which can be aimed at policies that might otherwise be beyond the reach of the GATT/WTO agreements.[105] Such a "non-violation nullification and impairment" claim would assert that the United States—and other likeminded nations that might join the case—is being denied the benefits of reasonably expected market access. China's manifold mercantilist policies, it can be argued, undermine the benefits and rights that the United States expected when it assented to China joining the WTO.[106]

Indeed, as the Council on Foreign Relations' Jennifer Hillman writes, "It is exactly for this type of situation [i.e., China's innovation mercantilism] that the non-violation nullification and impairment clause was drafted." Hillman further elaborated, regarding WTO members' expectations of China:

> That it would achieve a discernable separation between its government and its private sector, that private property rights and an understanding of who controls and makes decisions in major enterprises would be clear, that subsidies would be curtailed, that theft of IP rights would be punished and diminished in amount, that SOEs would make purchases based on commercial considerations, that the CCP would not, by fiat, occupy critical seats within major "private" enterprises and that standards and regulations would be published for all to see.… Addressing these cross-cutting, systemic problems is the only way to correct for the collective failures of both the rules-based trading system and China.[107]

Observations on the EU-U.S. Trade and Technology Council

ITIF views the EU-U.S. Trade and Technology Council (TTC) as a useful vehicle for a pragmatic and cooperative agenda and applaud the efforts of policymakers on both sides of the Atlantic to build a better, stronger, and broader transatlantic economic relationship. But ITIF believe four core principles should guide the effort.

First, the overriding principle guiding the initiative should not simply be to promote the values of innovation, progress, and growth. Rather, efforts should focus especially on promoting the power of

the digital economy to transform industries, enterprises, and human lives in a positive, constructive, and impactful way.[108] Here, in our view, too often European digital policy focuses on the information and communications technology (ICT)-producing sectors of the economy and not enough on where the power of ICT really lies: in transforming the productivity and innovation potential of every downstream sector of the economy that uses it: from agriculture and manufacturing to finance and hospitality. A focus more on adoption and uptake is critical to bolstering sagging productivity on both sides of the Atlantic, especially considering that well over 80 percent of the benefits of ICTs to an economy come from their adoption, nor their production.

Second, we need more formal EU-U.S. technology policy cooperation in order to collaboratively bolster the competitiveness of our respective technology sectors. For instance as ITIF wrote in a recent report titled "An Allied Approach to Semiconductor Leadership," in our respective U.S. CHIPS and European CHIPS Act, we could coinvest to solve challenges identified in the Decadal Plan for Semiconductors such as embedding security features in the chip, reducing power consumption, and increasing computational efficiency. Moreover, as EU and U.S. governments roll out or expand specialized technology programs in technologies like 6G, energy storage, battery technology, autonomous systems, and quantum computing, there should be joint collaboration between U.S. and EU firms, universities, and governments. Here, each region should allow the others' enterprises to participate in government-funded industry research programs, like the EU's Horizon 2020 program and similar U.S. programs that agencies like NSF operate. We can also work on easier migration for technically skilled workers, eliminating regulatory barriers to science and technology cooperation, and data sharing for AI, particularly in key public interest areas such as smart cities and health care.

Third, we should recognize that the TTC's goal should not be harmonization but interoperability when it comes to digital regulations. There is no reason why there should not be different U.S. and EU regimes for most digital issues, as long as they are broadly aligned and do not violate WTO rules. The numerous references in the joint statement that both sides "should respect the different legal systems in both jurisdictions" should dispel any expectation that the United States would simply accept EU regulations and base discussions on data privacy, AI, and platform regulation around them. It would not be in the U.S. interest to harmonize regulations with the EU, nor is it necessary. Indeed, there is no reason why there should not be different U.S. and EU regimes for most digital issues, as long as they are broadly aligned. Regulations don't need to be carbon copies to have a broadly similar effect. After all, Europe and the United States are unlikely to agree on a privacy framework or how to regulate AI. This is not to say that the two sides should not work toward common principles and regulations, but they should not expect to achieve complete convergence.[109]

Lastly, we need to recognize that the biggest challenge to the global economy, and to our respective economies, is China. Thus, a key task of the TTC should be to cooperate both defensively and offensively with regard to China. As noted, this can include with regard to 5G equipment and systems, investment screening, joint WTO cases against China, updating WTO rules to address China's massive industrial subsidies, cooperation on cyberhacking and IP theft, supply-chain cooperation, cooperative export controls, and cooperation in international forums related to the digital economy.[110]

CONCLUSION

There is much talk about "decoupling" between China and the United States. As one report notes, "China has launched an intensified effort to "de-Americanize" its supply chains."[111] The report continues, "For many in the leadership who always wanted to make China less dependent on others, the U.S. trade war and Huawei sanctions [initiated by the Trump administration] have arguably given decision-makers in Beijing the necessary cover for something it has long desired."[112] But in ITIF's view, this gets it wrong: China's desire for absolute advantage and autarky means *it has long sought* these goals. Indeed, that was the mission behind a seminal document called the "National Medium- and Long-Term Program for Science and Technology Development (2006-2020)," the so-called "MLP," which called on China to master 402 core technologies, everything from intelligent automobiles to semiconductors and high-performance computers.[113] Of course, China later updated its MLP with its Made in China 2025 strategy, which sought to establish Chinese leadership across 10 critical emerging technologies. Across these 10 industries, China developed a series of national and provincial funds to progress Chinese firms toward three key strategic goals: 1) "localize and indigenize," meaning "to indigenize R&D and control segments of global supply chains"; 2) "substitute," meaning to replace foreign suppliers with domestic sourcing wherever possible in value chains toward the production of final products; and 3) "capture global market share," meaning to "go out into the world" and compete.[114]

So certainly the Trump administration's actions, including its Special 301 investigation, imposition of tariffs, and entity listings for firms like Huawei and others since (while likely certainly a wake-up call for China) did very little to animate goals that China has already long desired.[115] That this is clear is so from a review of China's National Integrated Circuit Plan, which seeks for 70 percent of the semiconductor chips used by companies operating in China to be domestically produced by the year 2025.[116] Such a clear import substitution goal is worrisome when about 36 percent of U.S. semiconductor company revenues, or $75 billion, in 2018 resulted from sales to China.[117] This dependence upon China for foreign sales creates a long-term vulnerability for the industry (and many other high-tech ones), as noted in the 100-Day Biden administration supply chain review report.[118]

The point is that it is China, not the United States, that seeks decoupling in advanced-technology industries: from aerospace to solar panels to clean energy, China will trade with the world up until the point it has capable domestic suppliers in advanced-technology industries, at which point its intent will be to close off, or severely restrict, its market to foreign competitors, while still enjoying the opportunity WTO membership gives the country to sell its goods in international markets. For instance, China's so-called "De-IOE" initiative sought to reduce China's reliance on IBM, Oracle, and EMC in large business and government environments, and has helped drive Alibaba's cloud business. (Indeed, De-IOE might be better termed De-IOEAWS to include Amazon Web Services.)[119] In fact, examining the economic impact of market access restrictions and other constrains like forced joint ventures that China has imposed on U.S. cloud providers, ITIF conservatively estimates (based on market-share comparisons) that Google, which withdrew from the Chinese market in 2010, subsequently lost $32.5 billion in search revenue from 2013 to 2019, while Amazon and Microsoft's cloud services (IaaS, which is restricted in China) lost a combined $1.6 billion over the two-year period from 2017 to 2018.[120] Indeed, if COMAC could produce commercially viable civilian jet aircraft,

Airbus and Boeing's market share in the country would crater rapidly.[121] This is fundamentally not consonant with the commitments China made in joining the WTO.

Of course, prevailing upon China to come into full and immediate compliance with its WTO commitments is the optimal solution, and every instrument the United States and likeminded countries can bring to bear to make that a reality is the preferred outcome. But that can't be the only option pursued. The United States and likeminded countries need to make a concerned effort to build up the technology ecosystems in a wide range of countries and regions, from East Asia to South America, from Africa to India, to Europe itself, to diversify global supply chains in information technology and other advanced-technology industries, so that collective dependence on the Chinese market is lessened, and indeed the economies of likeminded, rule-of-law, democratic free-market economies are strengthened. Here, there's great opportunity for collaboration among countries involved in the Indo-Pacific Economic Framework.[122] Further, the United States must extract greater leverage from the U.S. International Development Finance Corporation (DFC), created by the Better Utilization of Investments Leading to Development (BUILD) Act in 2018, which will be providing $60 billion in development financing to attract more private-sector investment into global emerging markets, especially by more-effectively connecting DFC with similar agencies from likeminded countries. Indeed, the United States and likeminded countries need to collaborate to develop more-sophisticated and holistic responses to China's One Belt One Road and Digital Silk Road Initiatives. This should include collaborative export credit offerings, mutual investments in development initiatives, and greater collaboration around digital technology infrastructure development projects (i.e., smart cities, smart grids, intelligent transportation systems, high-speed rail, etc.) in developing countries.

There's a battle being fought now for the soul of the global trade and economic system; it's imperative that likeminded nations collaborate to emerge victorious in it.

GRAPHS AND TABLES

Figure 1: U.S. goods trade deficit with China, 2001–2020 (US$ billions)

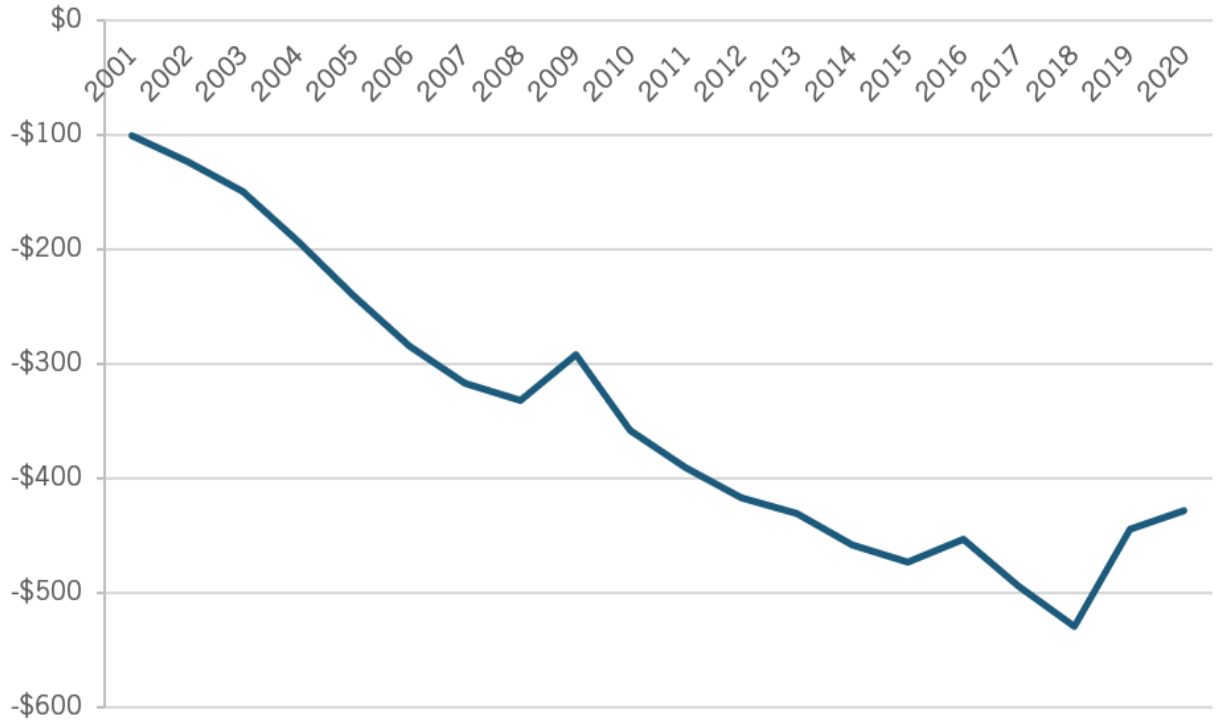

Figure 2: U.S. trade balances with China in advanced technology products, 2002–2020 (US$ millions)

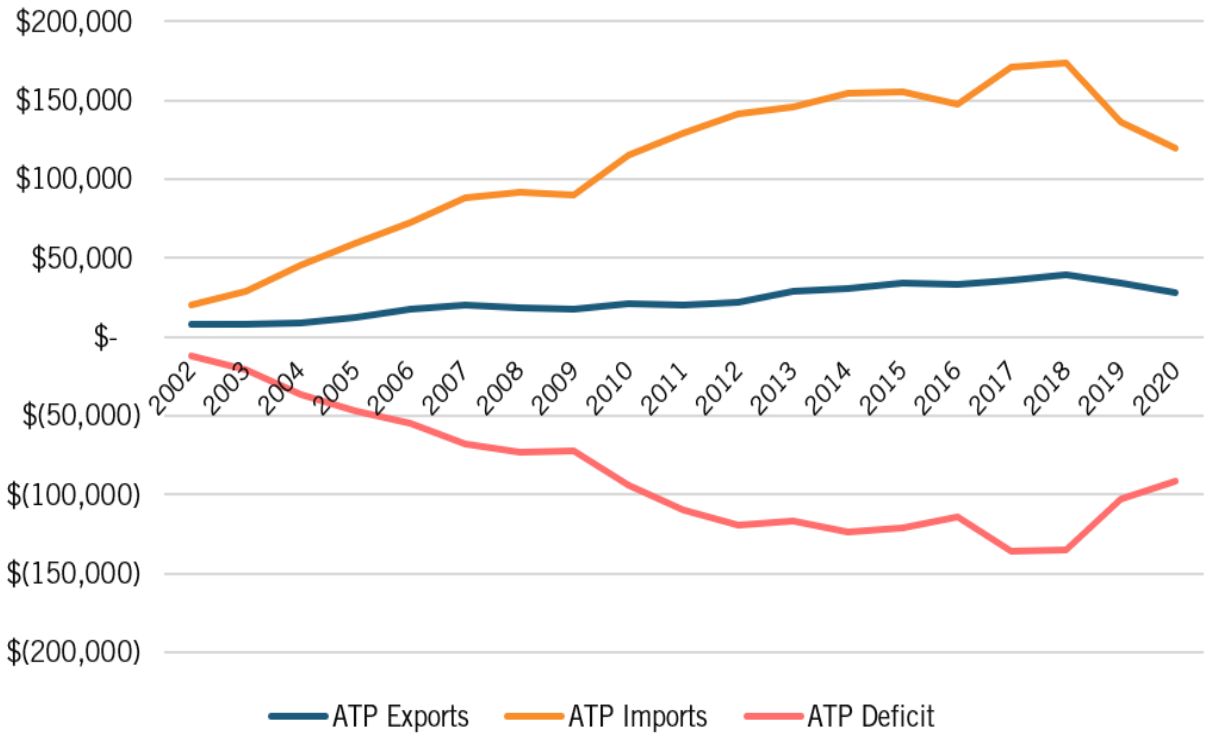

Table 1: Assessing China's innovation policies on global innovation

Type of Policy	Impact on Global Innovation
Funding and sharing of technology development with Chinese firms	Harmful
Forced technology transfer	Harmful
Intellectual property theft	Harmful
Currency manipulation	Harmful
Export financing above OECD guideline levels	Harmful
Tariffs	Harmful
Government-allocated domestic market shares to Chinese firms	Harmful
Political hardball for access to foreign markets	Harmful
Support of foreign corrupt business practices	Harmful
R&D tax incentives (favorable to Chinese firms)	Neutral
R&D subsidies (favorable to Chinese firms)	Neutral
Low-cost financing (for Chinese firms only)	Neutral
Limited export control regime	Neutral
Support of STEM education	Helpful
Support for more rapid wireless 5G and 6G and broadband rollout	Helpful

ENDNOTES

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122. Nigel Cory, "Comments to the U.S. Commerce Department on the Indo-Pacific Economic Framework" (ITIF, March 2022), https://itif.org/publications/2022/03/21/comments-us-commerce-department-indo-pacific-economic-framework.

OPENING STATEMENT OF MARK COHEN, SENIOR FELLOW AND DIRECTOR, BERKELEY COLLEGE OF LAW AND TECHNOLOGY ASIA INTELLECTUAL PROPERTY PROJECT

MR. COHEN: Thank you very much. It's an honor to be here again before the Commission and to speak with my colleagues on this panel.

The opinions expressed are my own and are not those of any client or individual. They all have been discussed previously on my blog and other writings.

I'm going to briefly elaborate here on some of the systemic deficiencies of the Phase One agreement, and also some of the domestic initiatives that undermine our ability to advance good IP protection for companies involving China.

Regarding systemic deficiencies, while the Phase One agreement had many notable accomplishments, there were several elements that failed to address structural challenges faced by U.S. companies.

One of them is China's vast administrative apparatus for the enforcement of intellectual property. Improving administrative IP enforcement is a misguided, long-term U.S.-China IPS that has continued to persist.

Administrative enforcement utilizes state-managed tools without declaring compensation. Rather than empowering rights holders to intake compensation, it results in an administrative order to stop infringement.

It's inconsistent with American values regarding the role of the market and the role of civil systems generally.

As one example related to technology, the Phase One agreement, with regard to earlier efforts at opaque software audits by administrative agencies, to address software end-user piracy, according to a GAL count, this was at least the 23rd unsuccessful trade-related commitment to address software piracy.

Why not try the courts?

By contrast, Microsoft has won every one of the 63 public civil software cases that it filed from 2006 to 2019. Moreover, the overall foreign win rate was over 85 percent.

One weakness of the courts, however, is the transparency of judicial decision-making. Absent greater transparency, it will be difficult to judge whether any of the positive changes made by the Phase One agreement, whether a civil or administrative enforcement, has its desired impact.

This would have been a structural change. And it's still a critical issue. I agree with Steve Ezell in this respect, on non-compatibility of WTO principles with China's innovation regime. And we see this in some of the asks we've made of the Chinese government over the years.

Let me also say that WTO measures have not been completely ineffective on IP, the most recent one being the Trump administration case on technology transfer in 2018 that was resolved in 2019. I believe we can still have a similar impact if we bring more WTO cases, or at least raise these cases, multilaterally, in the civil regime.

My second concern is the international implications of our domestic actions. There are several examples of this, some of them in my testimony. And I'd like to just note a few.

One is that we need to fix our patent eligibility doctrine to ensure that cutting edge innovations and new technologies are protectable in the United States.

Several recent U.S. Supreme Court precedents have undercut the scope of patent-eligible subject matter, making it difficult to obtain patents in AI, fintech, medical diagnostics, and other key areas.

It is easier to obtain these patents now in China. And this may be part of the reason that Mr. Ezell's comments talked about declining patent protection for U.S. semiconductor companies, because patent eligibility is that much more difficult.

Second, we need to ensure that, in the name of important social goals, such as addressing public health, we do not weaken the IP-related ecosystem in our own country.

President Biden took the unprecedented step to negotiate a waiver of pharmaceutical rights in the context of WTO negotiations. The TRIPS waiver continues to raise concerns over whether the United States will be forced to hand over leading-edge American technology in China, in an area specifically designated as core and made-in-China 2025.

Third, we need to consider international consequences of our domestic measures. Congress and the FTC are both attempting to narrow the scope of non-compete agreements and employment contracts in the U.S.

That may be a laudable goal. Unless consideration, however, is given to the international impact of such a ban, the remedies available to address trade secret protection for U.S. companies in China will narrow considerably.

American companies rely on non-compete agreements, which are far easier to enforce than trade secret matters, to protect their trade secrets in China. But we continue to ignore these international implications.

A similar evidence of this is a recent DOJ policy proposal on availability of injunctive relief for cases involving standard essential patents.

In that policy statement, the Department of Justice and other agencies failed to mention any international impact.

However, the vast majority of commenters on that proposed policy statement noted that DOJ, NIST, and PTO, should consider how this policy would affect our ability to compete in China, by making it more difficult to obtain injunctions in the United States.

Lastly, I would like to discuss the U.S. domestic legal system and how it may be abused by foreign litigants, particularly those from China and involving IP.

There are several issues of concern to me. One of them is that China's increasing use of anti-suit injunctions against litigants in China, including against U.S. litigants and U.S. companies.

This was done in order to enable its courts to set global rates for lawsuits typically involving standards essential patents.

To a certain extent, China has learned from commonwealth countries, like the U.S., in adopting anti-suit injunction measures.

However, the Chinese legal system appears to be using these measures for its own mercantilist purposes, and has been aggressively asserting jurisdiction in set matters and essential patent matters, with approval from the highest levels of the Chinese government. And the courts seem to have very little sense of how to minimize friction with other courts.

Another area of concern is the ability of litigants in China to compel discovery from U.S. courts, and I kid you not, under 18 U.S.C., Section 1782.

This statute authorizes U.S. courts, on a non-reciprocal basis, to provide information to foreign courts, largely on the basis of whether such courts would accept the requested information.

Compliance with these requests raises important concerns about reciprocity, but also whether the business or technical information being delivered would be adequately protected.

In other words, U.S. courts may contribute to trade secret misappropriation in China through this measure.

Together, these two areas are examples of the important area left out of the Phase One agreement: how U.S. courts should handle international legal issues involving illiberal legal systems.

Many scholars believe that this is becoming an increasingly critical area for reform that extends well beyond IP, and we also saw this recently in the ascorbic acid antitrust case at the U.S. Supreme Court.

In conclusion, I'd like to note that Ms. Kilcrease and I share many similar approaches, analytic capacity in the U.S. government I think is quite fraught, and I think there's a great need for greater coordination and concentration and utilization of empirical information.

As China becomes increasingly influential in global litigation, we need to have a broader discussion and a more informed discussion around IP innovation, of what we can do in this area. Thank you for your attention.

Also, my apologies if I was sourced to the feedback loop. In any event, the constant echo chamber has been symbolic of many of our trade policies. I hope I have helped to break through that chamber, at least with regard to intellectual property. Thank you very much.

PREPARED STATEMENT OF MARK COHEN, SENIOR FELLOW AND DIRECTOR, BERKELEY COLLEGE OF LAW AND TECHNOLOGY ASIA INTELLECTUAL PROPERTY PROJECT

"US Responses to China's Changing IP Regime"

Testimony Before the US-China Economic and Security Commission

April 14, 2022

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It is an honor and a pleasure to be here again before the Commission at this important moment in time. This is my third appearance before this body. I regret that due to a family emergency I am not able to appear in person and that my written statement was not filed in a timely fashion.

At my first appearance on January 28, 2015, I discussed the relationship between IP and Antitrust.[1] At my second appearance on June 15, 2018, I discussed how best to engage China on intellectual property issues. In that most recent appearance, I also included a list of 17 different action items that the United States should consider undertaking.[2] My focus today is on "US Responses to China's Changing IP System." This topic was also part of my 2018 testimony. In the spirit of monitoring developments, I have also updated an earlier list of action items as an attachment to this Statement.

There have been several IP and technology related developments in China since my 2018 testimony. We concluded a "Phase 1 Trade Agreement" in January 2020 that, in my view, was an important initial step to resolve technology and IP issues. Several United States self-strengthening efforts are also underway. The 2018 National Defense Authorization Act was a notable accomplishment in helping to shore up our export control and foreign investment review programs. The Federal Bureau of Investigation also launched the "China Initiative" in November 2018 to address the theft of information and technology by China. Fortunately, the Department of Justice has announced that the China Initiative has been restructured due to racial profiling concerns. The United States also filed a successful WTO case against China regarding its technology transfer regime, which was suspended on June 3, 2019, after China amended the offending laws.[3] This was also a remarkable accomplishment for the Trump Administration, which generally did not support multilateral tools, such as WTO disputes.

[1] Mark Cohen testimony.pdf (uscc.gov) .
[2] Mark Cohen uscc testimony.pdf .
[3] https://www.reuters.com/article/us-usa-trade-china-wto-idUSKCN1TF1ER.

Perhaps due to the administration's disinterest in the WTO, the successful conclusion of that case was hardly publicized.

The Biden administration has thus far generally maintained Trump administration approaches to technology and IP outward policies with China, engaging only when it perceives that engagement to be in our mutual interest, such as on clean energy technology. Having previously worked for the USPTO, which dissented from US government support for clean energy technology cooperation in China on the basis that the US government poorly understood and monitored outcomes from such cooperation, I am wary of such efforts, although I recognize that collaboration can bring significant benefits to our two countries and the world and I am also concerned about the harm to US innovation if collaboration with China continues to be imperiled.[4]

Domestically, the Biden Administration is now seeking to strengthen the US innovation environment through such efforts as the COMPETES Act, the CHIPS Act and the recently passed American Cybersecurity Act of 2022. The Biden administration has a so pursued a more aggressive domestic competition agenda involving "big tech" through the Executive Order on Promoting Competition in the American Economy (July 9, 2021). It has also sought to refocus the trade agenda on labor and the needs of small and medium enterprises.[5] I personally applaud the focus on labor and SME's, which I think also has potentially profound implications for US domestic IP policy as well.

The Senate Foreign Relations Committee also took the initiative to elevate the diplomatic status of USPTO IP Attaches in December 2018. An IP Attaché represents the US Patent and Trademark Office in US missions overseas. I served as the first IP Attaché in China. It was a position that I had helped create with then-Ambassador Clark T. Randt, III. Until December 2018, the diplomatic rank of the US IP Attaché was at a "First Secretary" level in diplomatic hierarchy. This was a lower rank than, for example, the Chinese IP officer that is posted to the United States.[6] That situation is now largely resolved with the elevation to "Counselor" status of four attaches who are resident in four of our largest embassies: Beijing, New Delhi, Thailand and the European Union.[7]

In the remainder of my presentation, I shall briefly describe: (a) the systemic deficiencies of the Phase 1 Agreement as I view them; (b) challenges the US government faces regarding intellectual property and trade and (c) domestic initiatives that may undermine our ability to compete in emerging technologies.

A. Systemic Deficiencies of the Phase 1 Agreement

[4] U.S.-China Cooperation: Bilateral Clean Energy Programs Show Some Results but Should Enhance Their Performance Monitoring | U.S. GAO.
[5] FACT SHEET: Executive Order on Promoting Competition in the American Economy | The White House.
[6] Fall-2020-Diplomatic-List1.pdf (state.gov) at p. 66 (Ms. Ning Yu, Counselor).
[7] Four USPTO intellectual property attachés elevated to rank of "Counselor" | USPTO .

While the Phase 1 Agreement in IP had many notable accomplishments, there were few elements that addressed structural challenges faced by US companies. Moreover, there has been some recent backsliding in structural concerns that were overlooked. My view is that "the reforms in the Agreement hardly total up to addressing a problem of that magnitude [of addressing structural changes]."[8] Scott Kennedy of the Center for Strategic and International Studies (CSIS) has more generally noted that, as a result of the Phase 1 Agreement, "China has been able to preserve its mercantilist economic system and continue its discriminatory industrial policies at the expense of China's trading partners and the global economy."

A good place to start on the missing structural issues of the Phase 1 is its support of China's vast administrative apparatus for the enforcement of intellectual property. This administrative system can act either on an ex parte basis or by filing a complaint against an entity that infringes an IP right. The administrative agency will then typically impose a fine and/or issue an order to stop infringement. The US government has long been critical of China's administrative system. USTR noted in 2006 that "China's enforcement authorities rely instead on toothless administrative enforcement, which primarily results in small fines, administrative injunctions and other minor inconveniences for infringers."[9] There is also a significant body of academic literature showing that administrative enforcement in China is rarely deterrent or effective.[10] Nonetheless, improving administrative IP enforcement is a US-China IP "ask" that has continued to persist, including in several articles of the Phase 1 Agreement.[11]

In the Phase 1 Agreement, the United States agreed to five separate several campaigns and a unique administrative enforcement approach to pharmaceutical patent protection. The Phase 1 Agreement also continues age-old proposals to revoke business licenses for IP infringers, which had previously been shown to be of little success.[12] The administrative system also tends to be much less transparent than the judicial support. To address that issue, the Phase 1 Agreement required certain reports on required administrative efforts. However, I am unaware whether any of the required reports on the campaigns have been forthcoming.[13]

[8] A Fragile and Costly US-China Trade Peace.

[9] USTR, 2006 Report to Congress on China's WTo Compliance, available atxe asset_upload_file688_10223.pdf (ustr.gov) at page 70.

[10] Martin K. Dimitrov, Piracy and the State (2009), see also Mark Cohen, David Kappos and Randal Rader, Faux Amis: China-US Administrative Enforcement Comparison", in both English, and Chinese (形似神异：中美专利行政执法制度对比) (2016) at http://www.cpt.cn/uploadfiles/20170220103128979.pdf .

[11] See The Phase 1 IP Agreement: Its Fans and Discontents – China IPR – Intellectual Property Developments in China. The blog written by this author also notes that the timing of the various reports on these administrative campaigns appeared to be timed in conjunction with US Presidential election milestones.

[12] See 国务院办公厅关于印发打击侵犯知识产权和 制售假冒伪劣商品专项行动方案的通知 (State Council Working Office Notice on Publication of Strategies to Strategies Relating to IP infringement and Production or Sales of Counterfeit and Substandard Products_ (Nov. 10, 2010) http://www.gov.cn/zwgk/2010-11/05/content_1739089.htm .

[13] The Phase 1 IP Agreement: Its Fans and Discontents – China IPR – Intellectual Property Developments in China.

There are several reasons why administrative enforcement has long been attractive to foreign countries in negotiating an IP "deliverable" with China. These can include a lack of understanding of the role of civil enforcement of IP in China, a desire for quick results, a belief that the Chinese government could stop IP infringement if it so chose, and support for political solutions to problems that some believe are primarily political in nature. The administrative system has also often served foreign rightsholders well when used to address more readily ascertainable forms of infringement, such as trademark counterfeiting in open markets. However, on a "structural level" administrative enforcement utilizes state-managed tools without deterrent compensation, rather than empowering rightsholders to obtain fair and equitable compensation from the courts for their losses. It is thus inconsistent with American economic values, or – alternatively – reflects an IP regime with "Chinese characteristics."

As one example of misuse of administrative enforcement mechanisms, the Phase 1 Agreement revives earlier efforts at opaque software audits run by administrative agencies to address software end-user piracy in China (Sec.1.23). Based on a 2014 GAO report, this would, at a minimum, constitute the 23rd such trade-related commitment to address software piracy.[14] By contrast, recent analyses show that foreign companies have become highly successful at bringing civil lawsuits to address software piracy. Microsoft, for example, has won every one of the 63 published civil software copyright infringement cases that it filed in China from 2006-2019. Moreover, the overall foreign win rate of foreigners is over 85%.[15]

China's civil IP judiciary, which many foreigners know well, has shown considerable promise. While the trade war was progressing, China launched a new national appellate IP court, new internet courts, as well as local specialized IP courts at the intermediate level. The courts, however, do not publish all cases or important interim decisions. Thus, transparency of judicial decision making remains an important structural goal. Absent greater judicial transparency, it will also be difficult to judge whether the positive legislative changes in civil litigation mandated by the Phase 1 Agreement are having their desired effect. In fact, there appears to be some backsliding in the transparency of China's legal system generally in the past several years, with courts being told to withdraw cases from publication.[16]

Declining transparency is also evident in legislative drafting. Currently implementing regulations for two laws – China's Copyright Law and China's Patent Law -- are long overdue. I have heard that drafts are being provided to Chinese lawyers and experts, but no draft has been made available to foreign businesses. This is a departure from prior transparency practices where foreign companies and lawyers have often had robust opportunities to provide

[14] GAO-14-102, U.S. - CHINA TRADE: United States Has Secured Commitments in Key Bilateral Dialogues, but U.S. Agency Reporting on Status Should Be Improved.
[15] An Update on Data-Driven Reports on China's IP Enforcement Environment – China IPR – Intellectual Property Developments in China.
[16] Millions of court rulings removed from official Chinese database | South China Morning Post (scmp.com)

comments on draft legislation. I do not know if drafts are being provided to foreign governments or well-connected foreign businesses operating in China.[17]

China's emerging role in multinational IP litigation, which I raised in my 2018 Statement, is an increasingly pressing concern. The European Union's recent WTO consultation request regarding China's use of anti-suit injunctions (ASI's) in standards-essential patent litigation and its failure to publish those decisions affecting foreigners is evidence of this.[18] By way of background, ASI's are orders issued by a court to prohibit litigants from pursuing parallel litigation in other countries. The orders are often accompanied by the threat of judicial fines for their violation. China recently started granted ASI's of its own and has since become a major user of this remedy. In addition, Chinese courts are increasingly seeking to establish global royalty rates for cases it adjudicates, thereby potentially undercutting foreign courts and technology rate setting by non-Chinese courts. The growth in ASI's in China is attributable to several factors, including: (a) the inherent conflict between the territorial nature of patents and the need of licensors of patents used in international standards to license their patents on a global basis; (b) the desire by Chinese courts and the Chinese government to drive down royalty rates for Chinese licensees; and (c) an increasingly aggressive Chinese judiciary which has limited experience in considering how to minimize international judicial friction, and seeks to assert itself in international disputes and establish global norms. Several Senators have also recently proposed legislation to address Chinese interference in US patent litigation using ASI's (S. 3772).[19] The Phase 1 Agreement did not address this and other cross-border litigation issues.

Another structural problem is the continual challenge that China faces in striking the proper balance between public remedies (administrative/criminal) and private remedies (civil enforcement/arbitration). With its focus on "IP Theft", including its demand for increased punitive damages, stronger criminal enforcement and improved criminal trade secret enforcement, the US government has traditionally demonstrated a continuing "criminal bias" or public remedy approach to IP diplomacy with China.[20] The Phase 1 Agreement is no different. As I stated in a recent article published by the National Bureau for Asian research:

> A balance between civil and criminal remedies was at one time inherent in U.S. policy and in foundational international treaties. The standing policy of the Department of Justice accords a primacy to civil remedies. The Department of Justice manual "Prosecuting Intellectual Property Crimes" states that "prosecutors should consider the availability and use of private civil remedies in deciding whether to prosecute an

[17] Transitioning to China's New Patent and Copyright Laws on June 1: Where Have All the Implementing Regulations Gone? – China IPR – Intellectual Property Developments in China.
[18] EU Files Request for Consultations on Chinese Judicial SEP Practices – China IPR – Intellectual Property Developments in China.
[19] https://www.govinfo.gov/content/pkg/BILLS-117s3772is/html/BILLS-117s3772is.htm.
[20] https://www.nbr.org/publication/the-criminal-bias-in-u-s-intellectual-property-diplomacy/ .

infringer criminally." U.S. data on IP enforcement aligns well with this policy. In the United States, criminal convictions for IP are often 1% or less of civil decisions. In 2018, the last year for which reliable data is available, there were 68 criminal cases charged in the United States at the federal level, mostly for trademark infringement. In 2020, there were 12,192 civil IP cases (excepting trademark) in the federal courts. By comparison, China brings an average of 67 times as many criminal cases per year than the United States. Data from both countries also shows a wide discrepancy between the small number of criminal cases and the much higher number of civil cases.

One way to strengthen the civil system might be to bring more WTO cases against China. The TRIPS Agreement generally imposes more detailed requirements on civil enforcement than criminal or administrative remedies. We have only filed two significant WTO cases against China involving IP since China joined the WTO, neither of which significantly implicated civil remedies. One case focused on criminal IP enforcement and customs remedies. The second case focused on technology transfer. I believe that there are aspects of China's civil procedures and remedies that are worth considering for WTO dispute resolution.[21]

(b) Challenges that the US Government Faces in IP and Trade

Today, the US government also has an excess of coordinators on IP issues, including: USTR on trade-related IP issues, USPTO on all IP issues pursuant to the American Inventors Protection Act,[22] the White House IP Enforcement Coordinator or "Czar",[23] the IP office within the International Trade Administration,[24], the State Department Office on International Intellectual Property Enforcement,[25] the DOJ Computer Crimes and Intellectual Property Section[26] and the National Intellectual Property Rights Coordination Center.[27] Sometimes these agencies have a degree of overlapping functions which mandate coordination of some kind. The USPTO and the Copyright Office, for example, share responsibility for copyright policies. USPTO and the Copyright Office also actively support USTR on trade-related IP negotiations. However, even when these agencies have more discrete functions, they may also do a poor job at leveraging the resources of other agencies to better advance priority US interests. By creating expertise in their modestly staffed agency structure and not entering into shared workload arrangements with others, they risk encouraging duplication of agency efforts with others, as well as shallower engagement on increasingly complex issues that demand more of an "all of government approach." A less siloed government structure would be especially helpful in

[21] The WTO IP Cases That Weren't – China IPR – Intellectual Property Developments in China.
[22] 35 USC Sec. 3.
[23] https://trumpwhitehouse.archives.gov/omb/office-u-s-intellectual-property-enforcement-coordinator-ipec/.
[24] https://www.stopfakes.gov/Contact-Us.
[25] https://www.state.gov/intellectual-property-enforcement/.
[26] https://www.justice.gov/criminal-ccips.
[27] https://www.iprcenter.gov/.

handling complex technology and IP issues originating from China, which may demand expertise on trade law, IP, technology, national security, criminal law, civil law and other areas. Industrial sector-specific support might also be obtained through closer coordination with academics and businesses. There are also institutions that may not have the resources or interest to continuously immerse themselves in this area, such as the Labor Department or Small Business Administration, that could also benefit from a new team approach involving more sharing of information and resources, including shared training.

Today, in the Biden Administration, as far as I can tell, two of the leading IP enforcement coordination positions have not yet been fully confirmed: the Deputy USTR for IP and Innovation, and the IP Enforcement Coordinator at the White House.[28] The USPTO Director was confirmed by the Senate earlier this month, based on a nomination that was sent by the President in November 2021, or about one year into the Biden Administration.

The highest-ranking individual on IP and innovation in the government today is arguably the Deputy USTR for IP and Innovation. Mr. Christopher Wilson is the nominee for this position. He is an experienced USTR official with over twenty years' experience as a trade and IP diplomat. He has a degree from Georgetown in diplomacy. His position is equivalent to a Deputy Secretary. He was nominated in 2021 after Senators Leahy and Tillis sent a letter to the White House asking the President to prioritize appointment of IP officials in the Executive Branch. If Mr. Wilson is confirmed, he will be in charge of IP and innovation for a powerful but very lean trade agency.

By comparison, Ms. Vidal, the recently confirmed attorney, will serve as Director of the USPTO and Undersecretary of the Department of Commerce for Intellectual Property. She holds BS and MS degrees in addition to her law degree. She is well known in the legal community, and has over 25 years' experience in intellectual property, including having clerked on our national appellate patent court and served as a partner in a major IP practice in an international law firm. Her credentials, like Mr. Wilson's are stellar. Ms. Vidal will be in charge of a diverse agency consisting of over 10,000 people, including scientists, engineers and lawyers. She will also oversee an overseas diplomatic corps of IP Attachés and serve as the lead agency of the US government to the World Intellectual Property Agency, as well as a number of other plurilateral IP organizations.

As the differing background of these two leaders suggest, the disparities in resources and capacity between USPTO leadership and USTR leadership can make for sub-optimal engagements with China unless there are conscious efforts to leverage the differing resources of each agency. One significant disadvantage that USPTO faces is the relatively late appointment of a USPTO official compared to cabinet level officials, such as US Trade Representative Tai, that are already engaged on IP issues.

[28] See also https://www.jdsupra.com/legalnews/senators-ask-president-to-prioritize-9059749/.

Currently, the agency with the greater resources on IP (including Chinese IP) and the larger budget is USPTO. However, USTR is the agency with the greater political authority. USPTO's training budget, its extensive human resources and its dependence on user fees, do however permits it to exercise softer forms of long-term diplomacy in many jurisdictions, including China. The US Trade Representative, by contrast, is a Cabinet-level position. She has the authority to negotiate trade agreements, bring trade disputes and seek remedies to address unfair acts.

As an example of how the agencies can coordinate, the successful WTO case filed by the United States on technology licensing by the Trump administration was preceded by three separate USPTO training programs on technology licensing with China, and a larger program on IP licensing hosted at USPTO headquarters. Deeper integration of training into USTR's current toolbox, as well as active participation of USTR in these training programs, would be helpful to both agencies. Also, in the current structure, important generalist agencies such as State and Treasury often play a leading role particularly in the early stages of an administration. Generalist diplomats leading complex negotiations with Chinese counterparts can, however, be a fraught exercise, as their expert Chinese counterparts may have a deeper understanding of US IP law than they do, and they often perceive the relative lack of expertise of their US counterparts. An added problem is that agencies with deep technical depth, such as USPTO, may not have a high-ranking political appointee who can devote most of her time to international affairs. This can contribute to less expert officials leading negotiations even after an Administration's IP team is fully in place.

In this environment of individuals with vastly different backgrounds, agencies can lead by respectfully working together, or, alternatively, be silo-bound to the detriment of all.

The differences in expertise between USTR and PTO are also evident on the staff level. Recently USTR posted for a position "serving as lead negotiator on innovation and intellectual property issues in trade agreement negotiations and in other bilateral engagements with foreign governments."[29] The posting specifically notes that the job "does not have an education qualification requirement." One year of experience in trade negotiations is the minimum professional experience.

USPTO IP Attachés, by contrast, are required to have both a law degree and a general knowledge of IP. Foreign language fluency "may be an advantage."[30] Generally speaking, five years of prior experience are required to serve as an IP Attaché. The three pathways to becoming an IP attaché include being a federal attorney, a patent examiner or a private firm attorney.[31] Currently, there are three IP Attaches with such qualifications in China who work with a complement of US-based officials and Chinese attorneys. When I served at our embassy

[29] USAJOBS - Job Announcement.
[30] IP attaché careers | USPTO.
[31] Become_An_IPAttache_infographic_2020.pdf (uspto.gov).

in Beijing, I believe that the USPTO offices in China also had the largest contingent of attorneys of any unit in the US mission to China, with 3 foreign attorneys and 5 Chinese attorneys. Being a relatively weak agency at the Under Secretary level, we often worked best by training and empowering other agencies.

Here are some examples of challenges in allocation of resources in Chinese IP policy making:

The Section 301 legislation mandates composition of the Section 301 Committee by representatives of interested agencies, but it does not require consideration of composition by expertise.[32] As implemented, PTO employees may only have one shared seat utilizing a revolving Commerce Department seat if the Commerce Department is viewed as "one agency."[33] By comparison, agencies with less IP expertise, such as the Small Business Administration, may occupy one seat continuously if they are viewed as one agency. The structure also tends to favor more agencies or sub-agencies with more higher-ranking officials. Leveraging diverse interests and expertise requires considerable coordination.

As far as I can observe there was also no IP official in the room at this signing of the Phase 1 Agreement, nor in Buenos Aires (respectively, below):

[32] https://ustr.gov/sites/default/files/enforcement/301Investigations/China%20Technology%20Transfer%20Hearing%20Transcript.pdf at pp. 8-9.
[33] See 15 C.F.R. Sec. 2003.

Training and research would also benefit from better coordination. The US government has often failed to understand Chinese law and the (non) binding nature of many of its agreements. Jamie Horsley, a former Commerce Department official based in Beijing who is now at the Brookings Institution, has noted:

> [A] better understanding [of Chinese law] will facilitate more effective resolution of bilateral disagreements and help ensure that bilateral agreements are enforceable under Chinese law. …Deeper understanding of Chinese law could help U.S. authorities avoid adopting policies and targeting issues that are based on misapprehension…[34].

Regarding research, the US government has yet to utilize the increasingly extensive public data sources available on China's IP regime. Chinese data sources are often dismissed as propaganda, yet many of these sources provide important critical insights into China's IP system and can help aid in drafting impactful trade and IP protection strategies. Increasingly, Chinese and non-Chinese lawyers and academics are using these data sources. For example, the official Chinese government website of court cases had approximately 84.3 billion hits as of April 10, 2022. It also had 80.9 million legal documents.[35] PTO, to its credit, has recently undertaken to prepare data-driven reports on IP issues, which have generally been well received.[36]

I believe that we need to undertake a two – pronged approach to improving our analytics – (a) we need to use available trade tools to encourage greater transparency and reliability in China's IP system, and (b) the US government and others need to undertake additional data-driven analyses to develop their own perspectives of IP challenges in China, including developing forward-looking strategies. Collaboration among agencies and with academia and business could be helpful to these tasks.

[34] Jamie Horsley, Revitalizing Law and Governance Collaboration with China, available at Revitalizing law and governance collaboration with China (brookings.edu) (2020), at 5
[35] http://wenshu.court.gov.cn, viewed on April 10, 2022.
[36] Trademarks and Patents in China (uspto.gov); Patenting activity by companies developing 5G USPTO.

US government coordination issues are more likely to arise when government institutions become bigger and more insular. China-related IP issues have mushroomed in quantity and quality over the past decade and necessitate a more coordinated and rationalized approach. Divisions along party lines have often made such collaboration more difficult, particularly in Congress. The pandemic has not helped. However, there are also some simple remedies. One example: an award or incentives for an agency employee to enhance another agency's competencies through work sharing, offloading, joint projects or training could help advance the importance of coordination as a shared goal. Another remedy is thoughtful oversight by Congress and others.

There are some useful past precedents. The TRIPS Agreement itself was negotiated by Michael Kirk, an experienced USPTO patent lawyer who ran its office of international affairs. He passed the gavel to USTR to represent the United States at the WTO when those treaty negotiations were concluded.[37] During my early years at the USPTO, I also had the pleasure of working with many individuals who took the time to skillfully coordinate interagency resources. One of them was Joe Papovich at USTR. Joe was an expert at marshalling and coordinating interagency resources on China IP issues after China joined the WTO.

(c) United States Initiatives That Undermine Our IP System

We should also not lose sight of the international implications of the self-inflicted wounds that the US has inflicted on its own IP regime.

Kathleen O'Malley, a recently retired judge from the US Court of Appeals for the Federal Circuit, our national "patent court," has recently noted:

> I believe that there's a lot wrong with our IP system, and that there are a lot of things that we could try to fix and make it stronger, more robust for everybody, both patent holders and accused infringers, so that people have a more clear sense of what their obligations are or what their rights are. We'd have a stronger position in the international community. I've done a lot of international work and I have a lot of friends in the international space, especially other judges. Their perception is that we've gone from the strongest IP jurisdiction to just about the weakest. That's not right.[38]

US weakness is in marked contrast to China's efforts. Many of the improvements that China has undertaken to improve its IP system have been taking place contemporaneously with measures by the United States to weaken its own regime. Here are three examples of this US weakening IP protection, often while China maintains or strengthens its protections in the same area:

Issue 1: *We need to fix our patent eligibility doctrine to ensure that cutting edge inventions in new technologies are protected in the United States*. Several recent US Supreme Court

[37] Michael Kirk – iphalloffame.
[38] Judge Kathleen O'Malley reveals inner thoughts on 101, PTAB reforms, patent injunctions and more - IAM (iam-media.com).

precedents have undercut the scope of patent eligible subject matter, making it difficult to obtains patents on US inventions in such key areas of AI, fintech and medical diagnostics. By the same token it is easier to obtain these patents in Europe, Japan, Korea and China.[39] China has been expanding its patent eligible subject matter in these areas at the same time as the US has retreated.[40] In the words of one leading academic, the US patent system has "turned gold to lead" with its declining scope of patent protection.[41] The rules articulated by the Supreme Court are also difficult to apply in practice. In describing the instability and irrationality of these new approaches when she was a sitting judge, Judge O'Malley has noted of patent eligibility doctrine: "Have you ever seen all 12 active judges on a single circuit beg the Supreme Court for guidance, and the Supreme Court say no? It's absurd."[42]

These deficiencies and uncertainties may also have national security implications. According to the report of the National Security Commission on Artificial Intelligence:

> U.S. courts have severely restricted what types of computer-implemented and biotech-related inventions can be protected under U.S. patent law. Critical AI and biotech-related inventions have been denied patent protection since 2010. Facing uncertainty in obtaining and retaining patent protection, inventors pursue trade secret protection. Trade secrets do not readily promote innovation markets, because trade secrets, unlike patents, do not contribute to accessible technical knowledge in the public domain. While these impacts might not be immediate, the long-term effects on AI and other emerging technology developments and competitiveness are concerning.[43]

Issue 2. *We need to ensure that in the name of important social goals such as addressing public health or supporting a more competitive economy, we do not weaken the IP-related ecosystem that enable us to develop the technology that will resolve these problems.*

In order to help address the global pandemic, President Biden took the unprecedented step of agreeing to negotiate a further waiver of pharmaceutical IP rights in the context of WTO negotiations.[44] We did this without the support of our European allies. Of course, improving its biotechnology industry is a national priority in China. It is also part of Made in China 2025.[45] The TRIPS waiver continues to concerns over whether the United States will be forced to "hand

[39] Microsoft Word - 5200719_4.doc (senate.gov).
[40] Liaoteng Wang et al, A Comparative Look at Patent Subject Matter Eligibility Standards: China Versus the United States, https://www.ipwatchdog.com/2020/06/12/comparative-look-patent-subject-matter-eligibility-standards-china-versus-united-states/id=122339/.
[41] https://www.law.gmu.edu/pubs/papers/17_16.
[42] Judge O'Malley: "Absurd" that Supreme Court Won't Address Section 101 Patent Eligibility | Insights | Holland & Knight (hklaw.com).
[43] https://www.nscai.gov/wp-content/uploads/2021/03/Full-Report-Digital-1.pdf at p. 12.
[44] QUAD's tentative agreement on TRIPS and COVID 19 - Knowledge Ecology International (keionline.org).
[4545] https://www.uscc.gov/sites/default/files/Research/US-China%20Biotech%20Report.pdf

over leading-edge American technology to our competitors and cripple our ability to respond to future challenges."[46]

Issue 3: *We need to consider the international consequences of weakening our IP system.* I offer three examples including: our efforts to weaken non-compete agreements; the limiting of injunctive relief for IP infringement; and our continued prioritization of consumer interests in antitrust matters. My points here are limited to the international impacts of US domestic policy; not on the wisdom of their application in a purely domestic context.

Congress and the FTC are both attempting to narrow the use of non-compete agreements in employment contracts in the United States.[47] Unless consideration is given to the international impact of such a ban, the remedies available to address trade secret protection for US companies in China will narrow considerably. Employers in China often rely on non-compete agreements to protect trade secrets in China, as they are easier to enforce than trade secret law.[48] California employers, where non-compete agreements are generally illegal, have occasionally found that they are left with ineffective remedies when their employees leave their US jobs for competitors in China.[49] A more nuanced approach that protects non-compete agreements overseas may reduce the risks posed by this policy.[50]

In *eBay, Inc. v Mercantile Exchange L.L.C.*, 547 US 388 (2006), the US Supreme Court weakened the availability of injunctive relief for IP infringement cases in the United States. Prior to that time, injunctions were granted as a matter of right if the court has made an affirmative determination of infringement. This is the general principle that still applies in other leading IP jurisdictions, including China. There was no serious consideration at the time of that decision of the international consequences of this decision in terms of its making China and other markets more attractive destinations for IP litigation while weakening the US system. I again quote Judge O'Malley:

> One of the things that they think is the craziest was the *eBay* decision. The Constitution provides the right to exclude and if you don't have the right to exclude, then what does the right really mean? In the absence of the threat of an injunction, then several things happen. One is that there is no incentive to not engage in what some would call efficient infringement. Why enter a license if at the end of the day, the worst that can happen to you is you pay exactly what you would have paid without losing your money or without

[46] Op-Ed: Sacrificing efficiency, science, and multilateralism for virtue-signaling – The perils of the Biden WTO Waiver | Opinion | thecentersquare.com.
[47] The Future Of Restrictive Covenants According to the FTC (natlawreview.com).
[48] Benjamin Bai and Steve Adkins "Protecting Trade Secrets in China: Tips and Lessons Learned" (2013), available at https://www.uschina.org/sites/default/files/tradesecrets.pdf .
[4949] Semiconductor Patent Litigation Part 2: Nationalism, Transparency and Rule of Law – China IPR – Intellectual Property Developments in China.
[50] See Jacob Lahana, "Open to a Fault: How China can Take Advantage of California's Prohibition on NonCompete Agreements, and How California Can Fix It" (Unpublished paper at University of California at Berkeley, December 2019), available from the author.

losing developing your business in the interim? Having lived pre-*eBay* as a district court judge – it was much easier to settle cases because everybody had something big to lose.[51]

An insular approach to international consequences is also evident in a draft USDOJ/NIST/USPTO policy proposal on availability of injunctive relief for SEP cases, which omitted any consideration of the overseas impact of denying injunctive relief in the United States when it is readily available overseas. Nonetheless, over one half of the commentors on the proposed policy raised concerns regarding the impact of this policy on our ability to compete with China.[52]

We also need to begin recognizing the impact of dynamic technological competition in assessing competitive challenges. In my first appearance before the Commission, I expressed serious concerns regarding China's enforcement of its antitrust laws to advance its own industrial champions and its industrial policies. I believe the consumer-oriented focus of US antitrust investigations does not adequately account for dynamic models of innovation that support rapid technological evolution in a range of technology fields. United States technology leaders have enabled new industries to develop through outbound licensing of proprietary technology or development of open-source collaborative ecosystems. These technologies are often licensed to efficient downstream manufacturers. If we are to remain competitive, we need to ensure that Chinese antitrust agencies, courts and other regulatory authorities also do not undermine our research ecosystem through aggressive regulation such as by determining global royalty rates in licensing standards essential patents. The consumer-oriented approach also may not adequately reflect the role of the United States as an innovation and research dependent economy, or as a contributor to standardized technology. At a risk of stating the obvious, the Chinese government has long been more concerned with reducing the cost of US technology to its manufacturers than with supporting US innovation. These concerns have become more acute in an era of decoupling.

In summary, we should be wary of trade approaches to IP in China that support more intervention by the Chinese government. It is natural for government negotiators to think first of what the government can do to resolve problems. Certain types of enforcement, such as criminal enforcement or antitrust regulation, are largely the domain of the government. Government officials may also have limited experience in licensing or monetizing IP. Enhancing government intervention to the detriment or private enforcement or market-oriented mechanisms may not adequately reflect our social, economic, and technological interests.

CONCLUSION

The campus of the USPTO in Arlington Virginia named its buildings after some of its former directors. Among those who were formerly in charge of the US patent office and had buildings named after them are Presidents Jefferson and Madison. In downtown DC, the Old Patent

[51] O'Malley interview, id.
[52] China in the DOJ Draft Policy: A Summary of the Comments – China IPR – Intellectual Property Developments in China.

Office now houses the National Portrait Gallery. It was the site of President Lincoln's first inaugural ball. Lincoln was an early adopter of technology, a firm believer in the value of patents, and the only president who was also a patentee. Washington's first inaugural address called for adoption of a patent system. Today, we have several monuments in Washington, DC dedicated to those who were proponents of the IP system, such as the Lincoln and Jefferson Memorials, as well as the Washington Monument. There are also other monuments in DC to inventors, patent examiners and innovators, such as the statute of Albert Einstein, who once worked in the Swiss Patent Office and was also a patentee, and the monument to Daguerre near the National Portrait Gallery. In a sense, our nation's capital is physical proof that IP is core to our national economic identity and international security.

While we may agree that we face significant competitive challenges from China, we nonetheless talk with two voices: one for external consumption and one for domestic policy. There are also very few incentives in the US government to support enhanced coordination. Today, erosion of strong IP protections on the domestic front may ultimately weaken both our credibility in negotiating strong IP outcomes as well as the strength of our domestic IP regime. "A lot of my friends around the world," Judge O'Malley has noted, "think that we have gone crazy in terms of the way we deal with IP issues."[53]

We need to return to core values in how we approach the issues and the kinds of policies we want for ourselves and the world.

Thank you for your attention to my observations.

[53] O'Malley interview, id.

APPENDIX: ACTION ITEMS AND THEIR FUFILLMENT (UPDATED FROM 2018 TESTIMONY)

USG Internal Prioritization Efforts:

1. Congress should optimize USG engagement on innovation and IP by providing more direct oversight, attention to actual coordination undertaken by agencies, and through personnel and agency awards for coordination of tasks and for agency/academic/industry collaboration. OBSERVATION: NOT ACCOMPLISHED/HIGHLY URGENT.

2. Increased resources may be directed to law enforcement, including Customs, to support outreach and cases involving theft of trade secrets or imports into the US with stolen IP. Mechanisms should be established to facilitate increased sharing of data among companies and the government to form comprehensive risk assessments. OBSERVATION: LIMITED IMPROVEMENTS/URGENT.

3. USPTO IP Attachés should enjoy diplomatic rank commensurate with their importance, experience and roles. OBSERVATION: RESOLVED.

4. More empirical and forward-looking analyses should be conducted to ensure that USG policy is sufficiently forward-looking and geared to China's plans and policies. Competitive threats should be analyzed as policy decisions are made. Initiatives such as the USPTO's China IP Resource Center should be well-funded, work with counterpart offices in other agencies, and become a durable part of our engagement with China. OBSERVATION: PARTIALLY ACCOMPLISHED, BUT MORE WORK NEEDS TO BE DONE.

5. We need to require more continuous and coordinated training within USG on China's legal and innovation regime so that our engagement is fact-based and well-informed and the expertise of all agencies is fully exploited. USPTO has provided such training annually, but on a purely voluntary basis. OBSERVATION: I AM UNAWARE OF ANY EFFORTS CURRENTLY UNDERWAY IN THIS AREA. THE 2021 NTE REPORT FROM USTR DID FLAG RULE OF LAW ISSUES.[54]

6. USG Coordination with Affected Businesses: Additional support should be given to small and medium-sized enterprises that are seeking to enforce their rights, such as through Section 337 actions, or assisting companies and individuals that are experiencing retaliation in the Chinese market. OBSERVATION: NO NEW DEVELOPMENTS THAT I AM AWARE OF.

[54] https://chinaipr.com/2021/04/05/the-nte-report-on-chinese-ip-and-its-relationships-to-chinese-legal-developments/ .

7. We should increase sharing of data and training among companies to develop comprehensive risk assessments. China has "early warning" systems to help its companies assess IP risks overseas; we should look at providing similar support for our companies. OBSERVATION: ADDITIONAL WORK IS NEEDED INCLUDING COORDINATION WITH ACADEMICS.

8. We should make USG comments on proposed legislation public, in whole or redacted form, absent compelling reasons not to share, so that USG positions are aligned with industry and well-understood, indeed, even by the Chinese people. OBSERVATION: THIS ISSUE HAS BECOME MORE URGENT IN LIGHT OF DECLINING CHINESE TRANSPARENCY.[55]

9. The US should insist on reciprocity in licensing terms with China. As Chinese law imposes onerous discriminatory licensing terms, USG may consider enacting reciprocal legislation to address China's unfair acts. We might encourage our trading partners to do the same. OBSERVATION: THIS ISSUE MAY HAVE BEEN ADDRESSED THROUGH THE US WTO CASE. ADDITIONAL MONITORING WOULD BE HELPFUL.

10. We should amend the antidumping laws to recognize that the failure to treat IP as a private right is a factor in considering whether a country should be considered a non-market economy. Currently, the market orientation of a country's IP regime is not a specifically enumerated factor in determining whether it is a non-market economy, notwithstanding that the TRIPS Agreement requires that IP be treated as a private right. OBSERVATION: THIS ISSUE IS STILL OUTSTANDING, ALTHOUGH ITS CURRENT IMPORTANCE MAY BE LESS IN LIGHT OF THE INCREASING UNDERSTANDING OF THE INVOLVEMENT OF THE CHINESE STATE IN IP PROTECTION.

11. USG should extend reciprocal treatment for IP legal services between the United States and China involving IP. As China does not permit foreign lawyers to take the Chinese bar, and foreign law firms in China cannot hire licensed Chinese lawyers, US government agencies, including the USPTO, might insist that Chinese companies hire US admitted lawyers who are also US nationals or green card holders, if consistent with our international commitments. This could be a modest but important first step in improving the market for legal services by foreign law firms in China, as well as insuring accountability of counsel appearing before US government agencies. OBSERVATION: THIS ISSUE REMAINS UNCHANGED.

12. We should equip our courts, law enforcement and our lawyers with more legal tools to fairly adjudicate disputes with Chinese entities. Adverse inferences might be taken from

[55] https://chinaipr.com/2021/05/28/transitioning-to-chinas-new-patent-and-copyright-laws-on-june-1-where-have-all-the-implementing-regulations-gone/ .

unnecessary delays in collecting evidence overseas through judicial channels. We might also demand more cooperation from Chinese law enforcement on IP issues of common interest. In addition, denials of due process, threats to the freedom of US litigants or their counsel in China, lack of transparency in court proceedings and retaliation against appropriate use of legal process, etc. should all be vigorously opposed. OBSERVATION: THESE ISSUES HAVE BECOME MORE URGENT. ANOTHER CONCERN IS USE OF 18 USC SEC. 1782 TO COMPEL DISCOVERY IN THE UNITED STATES FOR CHINESE COURTS. CHINESE COURTS DO NOT RECIPROCATE ON THESE REQUESTS. MOREOVER, THE REQUESTS MAY PLACE TRADE SECRETS AT RISK. ADDITIONAL CONCERNS HAVE ALSO ARISEN OVER USE OF ANTI-SUIT INJUNCTIONS.

13. We should not give up the battle for the Chinese media. Any significant policy effort undertaken with respect to China that encourages market reform and rule of law should have adequate media outreach in Chinese. Such efforts are critical to cutting through the negative propaganda that often surrounds US trade efforts to encourage Chinese reforms. OBSERVATION: UNCLEAR IF THERE HAVE BEEN IMPROVEMENTS.

14. We should actively monitor our government-to-government technological cooperation and support state government and university-level reviews to ensure that the anticipated benefits of such cooperation are in fact obtained. OBSERVATION: TECHNOLOGY MANAGEMENT CONTINUES TO BE OF CONCERN, INCLUDING MANAGEMENT OF COLLABORATIVE RESEARCH.

15. We should revise the law regarding the Committee on Foreign Investment in the United States (CFIUS) to provide greater coverage over technological threats. At the same time, CFIUS needs to cooperate more deeply with science and technical agencies, including the USPTO to ensure its technical analyses are fact-based, well-founded, up to date and that appropriate investment and collaboration are welcomed. OBSERVATION: CHANGES IN THE LAW IN 2018 HAVE PARTIALLY ADDRESSED THESE CONCERNS. ADDITIONAL CONTROLS OVER US INVESTMENT IN CHINA (“REVERSE CFIUS”) ARE NOW UNDER CONSIDERATION.

16. We should amend our antitrust laws address to address such state-directed technology practices as mandatory pricing terms for Chinese sales, purchases of technology or technology-intensive items, or use of “act of state” or “sovereign immunity” defenses. OBSERVATION: OUR CONSUMER-ORIENTED APPROACH TO ANTI-TRUST SHOULD ALSO TAKE INTO CONSIDERATION THE IMPORTANCE OF UPSTREAM TECHNOLOGY DEVELOPMENT AND LICENSING TO THE US ECONOMY.

17. We should closely coordinate with like-minded trading partners on trade-related negotiations, law enforcement and domestic legal changes that could provide a more level

global playing field with China. OBSERVATION: THERE CONTINUES TO BE CONSIDERABLE RHETORIC ON THIS ISSUE – BUT CONCRETE ACTIONS APPEAR RELATIVELY FEW.

COMMISSIONER CLEVELAND: Thank you, Mr. Cohen. And whoever is responsible for the feedback loop will remain anonymous. Chairman Wong.

CHAIRMAN WONG: Thank you. My question's for Mr. Ezell.

You shared some thoughts on the TTC in your written testimony and had some recommendations or how to frame how the EU and the U.S. should think about promotion of technology and digital innovation, as well as how they should, or whether they should, harmonize certain regulations as far as the digital economy.

Now the Biden Administration is pursuing, or at the beginning of pursuing a digital trade agreement in the Indo Pacific because they're talking a lot about it, and I want to see if you had thoughts with that pursuit.

You know, while we have this arrangement with the EU, it's the Indo Pacific that is the main region of competition, even though the digital trade agreement I don't think is explicitly aimed at China.

Is there an approach there or provisions or how to frame this that you would recommend to blunt some of the malign technology practices of the PRC?

MR. EZELL: Well, you know, I'll start by noting that when we talk about the commanding heights of an economy which, you know, India considered to be steel back in the '70s, but the commanding heights today is ICT and it's digital, right?

Studied by IDC, a research firm estimates that by the end of this decade, fully 60 percent of the value created in the global economy will be created digitally by extracting real-time actionable insight and intelligence from the data, right?

So that makes getting the rules that are governing digital trade right so very important to innovative countries. When it comes to the TTC, I think two principles should be paramount.

First, countries should recognize that, you know, the biggest challenge to the global economy and our respective economies is China, so we need to put aside disputes we have and try to work together. And in particular, on digital.

You know, there's a view that we need to harmonize regulations on data privacy on examining algorithms, and the important thing is not to harmonize all these things, but to focus on interoperability so we can enable the digital economy to flourish between the U.S. and Europe.

And then to the point about IPEF, what I would say is there are a lot of new high standard digital tables we've developed especially in the USMCA. This is things like protections for source code, technical protection measures, protection for algorithms.

There's a lot of good work that exists to create high standard tables for digital trade, and while we would prefer IPEF to be more ambitious and more expansive, and especially to include Taiwan, I think there's an early harvest we can get out of IPEF if we apply digital tables. We have successfully created other agreements within that framework.

CHAIRMAN WONG: I'm sorry, I missed that last part. There's limited value in getting the IPEF of --

MR. EZELL: No. No, well, I was saying there's a good early harvest in applying the digital trade rules we have successfully developed elsewhere, such as in the USMCA within the IPEF framework.

CHAIRMAN WONG: And from the strategic standpoint, if we take those trade rules, or

some version of them, and let's take your recommendation and apply it broadly to various economies in the region, whether it's Taiwan, including the ASEAN nations, and accept this, what -- strategically, how does that help us through this competition, if at all, and help these countries in competition with China?

MR. EZELL: So I think fundamentally there's a battle being fought for the sole of the global trading system right now, and the question is about which countries are going to step up and are going to be the leaders and framing those rule sets in a way that are beneficial for the capacity of their companies to compete, and with the digital being important, you know, not just to Google and Facebook, to every single part of the economy.

You know, 75 percent of the value of data flows over the internet accrues through traditional industries, like finance or manufacturing or agriculture, so to the extent we're creating strong digital trade rules within IPEF or APAC, or such an Asian platform, then we are creating a collective ecosystem or empowering our innovative companies to compete more effectively. And that's why it's important.

CHAIRMAN WONG: Thank you.

COMMISSIONER WESSEL: Thank you all for testifying, and it will be very helpful, not only to our report writing, but I think the depth of the analysis, you know, will be much more broadly impactful, so thank you.

First of all, I want to just go on the last issue because our next panel will be talking about regional issues, including IPAF digital trade, et cetera, but all of this crosscut, and certainly for the technology sector, what happens in those rules is key.

I want to go back to an issue that underlies a lot of this, which is how the definition of national security is evolving. And that we are still in many ways hamstringing ourselves by having an outdated definition limit our ability to advance U.S. interests.

During the debate about FIRRMA, there was a discussion about whether national security should include economic security as well. We at this commission have looked at the issue back then, and also, for example, Canada and Australia have investment regimes that allow for a net economic benefit test.

But to our witnesses, you know, here we are talking about in many ways continuing to try and develop the indictment on Chinese policies when everyone seems to agree that what they are doing is disadvantaging undermining U.S. interests, and it's time to act.

If we spend our time trying to develop a case and then litigating it as a WTO, three to five years if in fact we have a working WTO, China will be past made in China 2025 deadlines, and approaching 2030 and 2035 deadlines.

What should we do right now to respond to China? We've heard about -- from Ms. Kilcrease about export controls, and I think this goes -- I believe it was to -- it was Schriver's comments, what are the most -- or, what would you do right now?

Is it time to stop worrying about the indictment and start acting, and what are the actions that you would suggest we take right now? And Mr. Ezell, do you want to start?

MR. EZELL: Sure. Thank you, Commissioner.

You know, you mention the eight -- the advanced technology products trade deficit, but you know, if you roll the tape back to the year 2000, since then the United States has accrued an aggregate $6,800,000,000,000 goods trade deficit with China, and a 1,600,000,000,000 trade deficit in advanced technology products.

Now, over this time period, China's foreign currency reserves have grown from just $200,000,000,000 to $3,200,000,000,000.

Unbalanced China U.S. trade and trade with the rest of the world has equipped China with the financial largesse it now deploys to pursue diplomatic and national security goals around the world, such as the One Belt One Road Digital Silk Road Initiative, right?

So, in my view, the grand strategy of the United States should fundamentally be to constrain and denude China's ability to exert its economic and national security heft in the world because we are standing collectively with ally nations to diversify the extent of global production.

So as I said, in ten years, we can imagine --

COMMISSIONER WESSEL: Agreed. Let's stipulate that we all agree to what you just said.

(Simultaneous speaking.)

MR. EZELL: So, in my view, then the most fundamental thing would be to create this DATO I mentioned, and to create a platform where like-minded nations can stand together and affirmatively say, if you're a Chinese company that has benefitted from billions of dollars of subsidies, you can't sell your solar panels, et cetera, in these markets.

If it's IP -- if it's a product or an enterprise benefitting from innovation mercantilism practices, let's shut down Chinese enterprises' ability to sell those products into like-minded community markets.

COMMISSIONER WESSEL: And would the entities you work with, ITIF and beyond, would your company support cutting off all sales to those entities in civ-mil fusion, et cetera, to deny them the wherewithal to advance their interests?

I mean, you know, again, the problem we've had in export controls, et cetera, is that there are companies here in the U.S. that want to sell to China and profit from it, and again, that's the -- you know, that's an appropriate motive, but are we willing to cut off without full decoupling, are your companies willing to support just a much stricter export control regime, full harmonization, and greater definitional control of what can be sold?

MR. EZELL: You know, I'm not going to speak for companies' right to supporters per se, I'll share my views, our organization's views, which is that, you know, we need to be able to effectively differentiate between the types of products we're selling into China, right?

If it's a semiconductor that is going into an air conditioner or a refrigerator, we should allow our companies to be able to sell that product because it is important to recognize that every $1.00 of sales that we make in China is a $1.00 of sales that the Chinese enterprise is not making, and those are in fact important dollars then to reinvest in future generations of R&D and Innovation.

In our view that's different than say, a critical piece of electrical EUV lithography equipment that China could take to, you know, build their own semiconductor manufacturing sector.

So I do think it's important that our export controls discriminate between the types of products and technologies that are foundational to China, meaning its long-term strategic goals needs Made in China 2025 Industries -- should be less concerned about a toaster oven than we are about a semiconductor plant.

COMMISSIONER WESSEL: Well, I see my time is lapsing. You know, we're having trouble defining what foundational is and emerging here, I don't know whether we can do it in terms of China, but if there's another round of questions, we'll come back to that. Thank -

COMMISSIONER CLEVELAND: Mr. Scissors, do you have a question?

COMMISSIONER SCISSORS: I actually have a question. It's for Mark. Mark, I want

to have you focus on guiding the Congress because that's our clients.

We can't directly influence the courts, which in my case is a really good thing. I should not have any influence over the courts. And we're not really supposed to be talking to the administration.

When I talk to members the argument I make is, look, there's a battle in the U.S. over how to sustain innovation while spreading its benefits as widely as possible, but if you -- this is -- I don't want to put words in your mouth, I'm echoing you I think, but I'm going to ask for your correction if I don't -- but if you let the Chinese take the innovation, not only is there no benefits to distribute any way in the United States, they're going to take the innovation, come back, and hurt the people that you think you want to help with revisions to IP practices in the U.S. by scaling up their production and driving firms out of business.

So I try to make this argument where I try to tie the domestic IP debate we have here to China by saying it's not just losing IP benefits, it's not just losing innovation benefits, the production is going to come back and, you know, drive American companies and workers out of business.

First of all, I'd like to hear your version of that, whether you say, well that's perfect, that would be great, but if you -- how you would change it or extend it, but more important, I want instead of saying the court should -- which I understand why you said that, give us guidance on what Congress should do to influence the courts and the administration because that's what we -- what we're trying to do here.

We cannot directly influence the courts or the administration, so I need you to help us on what congressional action should be taken.

MR. COHEN: Great question, and thank you for asking it. No, I try to be agnostic sitting in Silicon Valley about domestic IP controversies. I feel like there's a lot of people and a lot of money thrown at those issues.

What concerns me is the consequence of those policy decisions, which are largely insular, on the ability of U.S. companies to compete and protect their IP in China.

And I -- I'm afraid that the insularity of U.S. policy decisions has had a demonstrable adverse impact on our IP system, it's attractiveness as well as a leader, and a long-term impact on our ability to innovate.

One thing I didn't mention in my testimony, for example, I think we're going to see a lot of soft influence from China's courts. We try to docket, that's about 40 times the size of the U.S. in IP.

Simply because they're tackling increasingly complex IP issues, and the U.S. sometimes is not addressing those, or we're ill-equipped to address them because of frankly the respect for IP.

That's been on the decline domestically in the U.S., and I realize I'm speaking to a China commission, I'm not speaking to the judiciary committee, which you probably well understand what I'm saying because they've been trying to address things like declining protection for AI, for FinTech, for medical diagnostics, for pharma products, for genetic inventions, and the like.

These are impairing our leadership and have impaired our leadership. This is not news, and they're making it more attractive to invest in China, or do technology transfer in China, or to raise capital in China. The list goes on and on.

My one request of Congress really is that look at the impact on our international competitiveness, particularly in China.

It is remarkable, to those of us who follow both jurisdictions, how some of the Supreme

Court decisions that have weakened our system have occurred almost exactly the same time as China deciding to strengthen its system in the same areas, in those same technology areas I mentioned.

But the list goes beyond that. It includes I think getting the solicitor general, in particular, to be engaged on some of the legal matters. The solicitor general did appear in the ascorbic acid case.

You're absolutely right, Mr. Scissors, that, you know, we have a balance of power system in the U.S., but I think Congress can encourage through oversight and through legislation, our courts to think about the international implications of what they do, particularly when they're dealing with an illiberal system.

Are the laws in China enforced the way they're written? We know not, but I think U.S. judges generally will assume that, so that's another area.

I would like to see, for example, the same burden imposed on Chinese companies that is imposed on U.S. companies when they file a patent with government funding. In the United States, a U.S. inventor has to disclose that there's been government funding.

If a Huawei gets government funding to file a patent in the United States, it does not have to disclose that Chinese government funding.

So at least like to see an equality of burdens imposed between the U.S. and China, and ideally that the disadvantages that are being imposed on our companies are minimized.

The other example I gave, of course, was non-compete agreements. This is the first recourse in China when you have trade secret theft, yet the administration and the FTC have said, these are anti-competitive. Fine. I stop there in discussing the domestic environment.

Look at the international implications and there have been cases -- well, I think there were two involving applied materials where a U.S. employee goes off to compete in China and there's no remedy in the U.S. available because in California, non-compete agreements are illegal, and that's going to be taken -- you know, expanded more broadly.

So, the real, you know, underlying policy that I'm asking for is to consider the international impact. We're in the middle of some very heavy debates around our IP system. Most of those debates have failed to account for the international impact, and a lot of people are very concerned about that.

COMMISSIONER CLEVELAND: Thank you. Commissioner Schriver?

COMMISSIONER SCHRIVER: Thank you. And thanks to the witnesses for contributing your expertise.

I wanted to ask a question about something I don't think has been raised by any of the witnesses, and therefore I'm not sure necessarily who to direct it to, but you know, we've talked about the risks associated with Chinese investment in the U.S., outbound investment, different ways of acquiring IP, but I don't think anybody's mentioned talent recruitment and the efforts to recruit people through a variety of means of -- the Thousand Talents program I think is the most well known -- by affiliations with Chinese government-associated research organizations, or even just private sector, what would look like a normal hire of somebody with subject matter expertise.

Now I know one's knowledge is controlled under export control laws, if it's of a classified nature, and I know that some of -- there's been high profile cases from the Justice Department about individuals, but as a general matter, would you say this is a problem that's fully understood, or are we underappreciating it?

Are there things to be done with respect to Chinese efforts to recruit talent and have a

better awareness and tracking of that? So again, I -- nobody mentioned it, so I don't know if anybody would want to jump in.

MS. KILCREASE: I'm happy to start with an answer, but we welcome feedback from my colleagues, as well. And thank you Commissioner Schriver for the question. It is an important one.

You know, I think in D.C. in our policy circles where we focus really intensely on concerns associated with China, it is a well known issue.

There is more work to do to fully scope and understand the extent of the problem, but where I fear there's not as much understanding or a shared understanding of the right solution to this is actually in the academic environments, in the -- kind of the -- outside of the D.C. bubble where these interactions are actually happening, I think awareness is increasing, but when we think about the appropriate solutions, we're talking about usually academic environments that are open by nature, and we want them to be open by nature.

They don't really have a compliance culture the way that, for example, a high tech company would.

And so we need to think quite carefully about the right balance of approaches here to make sure that we're maintaining kind of openness and innovation, which is to our benefit, while also putting in place some specific protections to guard against what are very real threats.

I think here transparency, I think direct engagement with academic leaders is going to be a really important first step to getting at a right solution here.

MR. COHEN: So let me just add to Emily's excellent comments.

I -- I'm part of a group that's been actively trying to work through some of these issues, and we had our first meeting and one of the persons there said that this is the thorniest issue to resolve because the cost of a less open system could be enormous, and the benefits may not be as great as people anticipate, particularly if we over-regulate the research in the academic research environment.

But of course this comes from an academic -- I'm also an academic, we have our biases, but I've also been in the government. I know that the risks are real.

All right. I think there are some things that can be done and should be done as soon as possible. One is we need to have much better risk assessments, and simply, you know, bringing cases that have little merit, as was often the case with the China Initiative, just creates a scare and makes it difficult for -- to get good researchers on board.

Recent data has shown that if the U.S. did not have Chinese collaboration in the science and technology publications, we would've sunk to number two. So collaborative research is really extremely, extremely important.

And also the vast majority of Chinese PhD candidates in the U.S. want to remain in the U.S., and I hope for legitimate reasons. We have to realize, these people are making a tremendous contribution to our innovative ecosystem, and we have to be very careful of scaring off the ones who are really helping us do the right thing, and I think most of them are.

All right. The other thing is, in terms of risk assessments -- and I'm going back in part to Emily's observation about analytics -- I really think the lack of an interoperable nomenclature on technology issues in the U.S. makes it very difficult to correlate CFIUS, export controls, trade flows, standard industrial classifications, et cetera, and including patents, and I've been trying to encourage consideration of use of the cooperative patent classification system used by the PTO, which, all right, the subcategories is technology into 260,000 different technical areas.

And if we started applying them to these disparate areas, including the Chinese five-year

plans, we may be at a -- be able to come up with a much better risk assessment than where China's headed, how fast they're headed, what's being manufactured, what needs to be controlled under our export control CFIUS regime, or any inbound investment regime.

Right now we lack that nomenclature. I'd mentioned the PTO system because there already are concordances to the tariff schedules and standards industrial classifications, and it's in use by Europe and well known to many other countries, so already has a degree of harmonization behind it.

But right now it's very hard to talk about the full scope of threats at the operators because the data is not interoperable.

MR. EZELL: If I might have one sentence?

I would just say also that Congress should mandate standardized disclosure requirements for federally funded research that requires comprehensive disclosure of conflicts of interest, conflicts of commitments, and all outside foreign support, and that should be strengthened by a standardization and unification of grant application and documentation processes across federal government agencies.

COMMISSIONER CLEVELAND: Thank you. Commissioner Mann?

COMMISSIONER MANN: Thank you. A question for Emily Kilcrease. You spoke very interestingly of the -- of a new regime and the possibilities opened by the actions taken against Russia with respect to Ukraine.

But I have to ask on that -- and we all talk loosely about the importance of working with allies -- how are you going to sell a new regime, including the export controls, to the Germans who were -- are -- have been bulky on Russia, here's China, many, many thousands of miles further away -- this is not a war situation with them, one hopes -- and they sell a lot more to China than they do to Russia. So how -- that's the specific question.

I guess the broader one is, how much of the new regime is -- can you see persuading the allies to join in, or which parts of it?

MS. KILCREASE: Thank you for that question. It is an ambitious recommendation. I did not say it would be an easy thing to implement for sure. You know, in terms of the Russia context, yes, of course.

I think the massive set of unprecedented export controls and other sanctioning instruments that were used against Russia were driven by the clarity of purpose, the urgency of mission, and just the black and white situation of a horrific invasion, and so that's motivated leaders to do what in ordinary circumstances they would not.

And so for that reason, and also because of China's greater economic integration with most of these countries -- not all of these countries -- it will be much more complicated to take a similarly ambitious and coordinated action on export controls and investment restrictions with respect to China.

Absolutely it will be harder. But it's not less important to do so. You know, when it comes to Germany and other European countries, I do think we perhaps will continue to see more hardening of their views towards China.

They have been much more willing to work collaboratively with China as an economic partner. That's why there was the comprehensive agreement on investment.

You know, they were much more willing to pursue stability and peace through economic integration. I think they're questioning that strategy broadly right now to be candid, and I think China's support of Russia will cause them to continue to question that strategy when it comes to China specifically.

And so I do think we are in a bit of a different geopolitical moment now.

Having said that, it is still incumbent upon the United States to actively make the case for why a new regime is necessary, and I think to do that, we need to be quite clear about what sorts of economic activities should be covered, how we're defining national security risks, and to really engage in conversations recognizing the vulnerabilities and interests that each partner country has.

We can't assume that they're going to view China exactly how we do. They have different economic relationships, they have different vulnerabilities that they will need to take account of, and we need to respect that.

I think we start small, I think we start with Five Eyes, and a couple of EU countries, and Japan, those countries that have shown that they are willing to be strong on China, and to work with us on investment screening, on export controls, and I do think we talk about outbound investment in this context as well.

All of these are getting at the same set of issues and there needs to be that stronger coordination amongst our closest allies, and so it is not easy, but I do think it's imperative. Thank you for the question.

COMMISSIONER MANN: Mr. Ezell, do you have any thoughts on that, on working with allies, how easy that will be?

MR. EZELL: Well I think the moment we're in, given the conflict in Eurasia, gives us a new platform to, you know, proceed with the very nice vision that Emily laid out of a new -- a multilateral framework on export controls and investment screening. I think it's an opportunity to be ceased by the administration.

And to make clear that the structures and the geopolitical and the economic objectives of a Russia/China alliance are likely not consonant with a western vision of a liberal, democratic order, and it's time to listen to Franklin's words that, surely, we must stand together or shall be hung.

COMMISSIONER MANN: Thanks.

COMMISSIONER CLEVELAND: Thank you. Commissioner Goodwin?

COMMISSIONER GOODWIN: Thank you, Madam Chair.

Mr. Cohen, I'd like to talk with you about this weaponization of the Chinese judiciary and the increase in these anti-suit injunctions in which global anti-suit injunctions are put in place to join other jurisdictions, other courts from wading into these disputes regarding standard essential patents, royalties, licenses, and the like.

And in response to which courts have been asked, and litigants are going to courts, to issue anti anti-suit injunctions to adjoin the injunction.

And it seems like a model and a trend that isn't sustainable and really begs for a more comprehensive overhaul of how we resolve these sorts of disputes.

In the meantime, I saw where one commentator suggested what needs to be done is that should voluntarily stand down, and that is, although not mandated by law or treaty obligations, exercise judicial restraint in weighing into these dispute -- wading into these disputes, and limit their rulings solely to patents from the jurisdictions of which those courts sit.

I want to get your reaction to that, your thoughts about the ramifications if U.S. courts started voluntarily doing that, what it would do with regard to the development of a patchwork of royalty rates from jurisdiction to jurisdiction, and then more broadly, how do we solve this problem?

MR. COHEN: Yeah. Great question. That's an extremely thorny issue. And it's also

widely misunderstood, so in a limited time, let me just bring out a few points.

First of all, last year, China was the largest issuer of anti-suit injunctions in the world.

Now that being said, there aren't that many of them, and for the most part actually, the standardization system proceeds pretty well and people voluntarily taking licenses and litigation, although it attracts a lot of attention, isn't that extensive, and you have roughly 120,000 patents that read on 5G telephony.

So to give you an idea of the amount at stake, the amount of patenting and innovation that goes on, the United States, the Court of Appeals and the Federal Circuit has an old case that basically says U.S. courts absent consent do not sit in judgment on the patent infringement or validity issues of foreign courts.

So basically absent consent, U.S. courts should only decide the case at issue involving U.S. infringement and validity of a U.S. patent. The problem is sometimes consent gets implied and there have been several cases in the U.S. where courts have assumed consent for the court to adjudicate a global rate.

China has taken a slightly different approach, and it's very important to note this is coming from the highest levels of the Chinese government.

This is not the chief of justice of the Supreme Court. This is Xi Jinping himself in a speech that was published in Qiushi. All right.

When he says that the courts, basically in your words, and I agree with those words, have to be weaponized to deal with foreign anti-suit injunctions, and he -- after that the Chinese courts changed the application of this, so the procedure law, and they started first of all enjoining litigants from pursuing cases in their own country -- and if you want to see a livid judicial opinion that I think is not inconsistent with the problem posed, look at the decision of the New Delhi High Court involving a Delaware company, and through digital, when -- and the reaction of the judge there to being enjoined from hearing a case involving Indian patents in an Indian court.

Quite more livid I think than Judge Gilstrap in Texas who was facing the same thing from a court in China involving Ericsson and Samsung who basically decided I'm going to decide my case, and he issued what he called a non-interference order, basically saying Chinese court, you can't interfere in my court.

In my view, Judge Gilstrap did not go far enough, and in a sense I applaud him for it, and this goes back to my earlier comments because I think U.S. judges are not well positioned to deal with these international disputes involving how they should handle court cases in other countries, and naturally are supposed to defer to the other courts for matters before them.

How did Judge Gilstrap not go far enough? He might have said, and I think he should have said, at least that I am concerned that a Chinese court wants to take global jurisdiction over a matter in addition to taking away my jurisdiction because this is all about money.

This is about Chinese courts driving down royalty rates, and we need to find a way first of all to empower U.S. courts to deal with this issue, and second of all, to look at multilateral or plurilateral mechanisms to deal with them.

The Europeans are quite incensed about this, the U.K. courts have found their own way. It's affecting even, you know, smaller courts in other jurisdictions, whether India or Brazil or Romania, and we need to find both plurilateral mechanisms, but my first recourse is really the domestic effort.

Congress has proposed legislation in this area at least as a step to having a discussion around the issue, but it's going to ultimately, in terms of how it affects U.S. courts, it's going to

be decided by U.S. judges, and I think we need to direct them a little bit and considering the impact of their decisions on what is a global controversy.

COMMISSIONER GOODWIN: Thank you.

COMMISSIONER CLEVELAND: Thank you. Commissioner -- Vice Chair Glas?

VICE CHAIR GLAS: Thank you. Appreciate all our witnesses here this afternoon detailing these very complex issues.

Mr. Ezell, I'm going to start with you, and then Mr. Cohen, I'm going to come to you.

You know, in your testimony, you outline in great detail the patent situation in the United States slowing down, U.S. firms slowing down, and their application of patenting, and what's happening in China for a variety of reasons, offshoring of particular industries, trade sensitive industries in the United States, you know, not pursuing patents in R&D.

Then you go into discussions about appointing a deputy USTR on innovation and changes that we should be making to the application of Section 301 tariffs, and new tools in the toolbox.

Can you talk about that more? Because you talk about creating a deputy USTR for innovation position, which I think Congress has also recommended to the administration.

And Mr. Cohen, in your testimony, you provide -- and I thought this was very helpful -- an appendix of what's been happening with respect to USPTO since I think 2018 and other recommendations of the U.S. government.

Of the things on this list that are currently in process, what is the most important so that when the commission's thinking about recommendations to the hill at the end of this year, on this list, what is -- what rises to the top in terms of your perspective? I'll start with you, Mr. Ezell, and then I'll go to Mr. Cohen.

MR. EZELL: Well commissioner, thanks for your question. And actually I am mostly going to defer to Mr. Cohen on the point about recommending a deputy USTR in charge of innovation and IP because when I wrote my report, false promises 2, looking at 20 years of China and the WTO in a conversation with Dr. Cohen, he was the one that recommended that policy recommendation.

VICE CHAIR GLAS: All right.

MR. EZELL: But I will just say that. Obviously just given from the excellent testimony that Dr. Cohen's offered, looking at the complexity of the IP issues, even looking more recently with the administration reimagining of the FRAND commitments around standards and patents, the complexities of this IP issue is really demand individuals with the skills and the competencies to interpret and understand them at USTR and that specific set of disciplines has been missing.

And it's also important to note that if such a deputy USTR would be established there, that this position could become by dint of rank, the highest ranking person in the U.S. government solely devoted to innovation and IP because it'd actually be at a level that's above the USPTO level, so more expertise is needed at USTR.

VICE CHAIR GLAS: Okay. Dr. Cohen?

MR. COHEN: Yeah, well, thank you Steve for the kind comments, and thank you for the question.

My written submission I think articulates in some detail about the need for increased coordination and the problem of disparate rank and disparate expertise with the U.S. government agencies and IP and innovation.

And I think -- I've been saying this for a dozen or so years -- I think it's especially acute

in technology related intellectual property areas. Everybody knows what theft is, everybody knows what counterfeiting is more or less.

We -- there are issues at the margins, but the technology issues demand a whole of government approach where people are really encouraged to collaborate.

And frankly, I'm agnostic over what agency does that, whether it's in Emily's vision of a greater intelligence on technology issues, or a deputy USTR, or an additional deputy to the USPTO dealing with international issues, it doesn't matter really who is there as long as there are mandates to collaborate and share information and create a common vision of how to work together.

There is so much overlap and inefficiency in the current system. I'd like to also give a shout out to Kathi Vidal who's recently confirmed as the USPTO director.

She's exactly the kind of person to handle some of these FRAND and other issues, 25 years of experience, two STEM degrees, a partner in a leading law firm, and I think as she gets used to her job, and hopefully she'll be there for a while. I think she can bring a lot of intelligence to the system, particularly if USPTO is involved in those deliberations on policy issues.

But frequently PTO is left out, even though when we talk about particularly civil technology, civil military technology, it's the only agency I think in the U.S. government that has 13,000 STEM educated individuals looking at intellectual property, and USTR has about 200.

So you're looking at a difference in scale in an agency that is usually not weaponized, and frankly it shouldn't be weaponized, but it can lend itself to I think important and important, complex technical issues involving emerging technologies.

I think what is most important to get back to that original question, are two things. One is, I can't underscore enough the importance of better analytics and better information.

I think the more I talk to other people, I realize I'm not saying this in isolation. Emily's not the only one to say it, many others are saying it, we really need a much better grasp on these issues. It can't exist nearly in an OSTP or a USTR.

Those agencies are too small. It really has to draw the complete resources of the U.S. government.

These are enormously complicated issues that really demand a whole range of disciplines, and there are important sources of information, both within China despite the problems with Chinese data, and outside of China, about where China's headed that can be used. A lot of it in the open source world.

The second thing is domestic litigation, and I always believe that the first thing we should try to do is that we should appeal ourselves because it's the one thing that we don't have to depend on China to do, it's only based on our own inefficiency if we don't move forward.

So, the domestic IP and litigation system and how it helps U.S. or foreign companies protect their IP in the United States, and its continuing role as a model for the world, which I think is in serious jeopardy, is really critical, and that includes addressing the anti-suit injunction issues, that includes addressing non-compete issues, that includes addressing Chinese patenting practices, that includes empowering our agencies to do better analytics.

USPTO did two great reports last year, but it was only two subsidies of patents and trademarks and another one on U.S. role in 5G patenting. We need more of those studies, we need to better shape our policies. So, the domestic system and better analytics would be my keys.

VICE CHAIR GLAS: Wow. Commissioner Friedberg?

COMMISSIONER FRIEDBERG: Thank you very much. I'd like to pursue a line of questioning with Ms. Kilcrease that Commissioner Mann opened about the dimensions of a new export control regime and obstacles to it.

First, just a quick question. Am I right in understanding that what you're describing is in fact something that wouldn't just be an export control regime like CoCom, but would also have these inbound and outbound investment pieces as well?

MS. KILCREASE: Yes, that's exactly right, and thank you for the question.

Each of those tools would look a little bit different under a new regime, I think, just because of how each national level regulator implements its various authorities, but the basic idea is that they are all designed to protect U.S. and ally technological leads, and to protect the same sort of strategic technologies.

In the United States, we try to make sure that these processes are coordinated between the CIFUS and the export control process, and so it just seems to make good sense to kind of carry that approach into the multilateral context, so we're identifying the same sort of shared technologies and developing common approaches to protecting them and protecting our technological lead in these technologies that we agree are of shared strategic importance.

COMMISSIONER FRIEDBERG: Okay, so then the next question is about how broad the participation in such a mechanism would have to be for it to be effective?

So we can imagine at one extreme in the ideal world, we'd recreate -- maybe we would recreate something that looked like CoCom. I don't know if that's ideal, but it would be broad in its membership, and also in its mandate. But there may be obstacles to that.

There would almost certainly be obstacles to that. We know we have objections in this country to some of the measures that we're talking about, and presumably there are in other countries as well. So I'm wondering if -- is the -- is it possible the best may be the enemy of the good, and are there other groupings that might be short of that that could be useful?

So at one extreme, one of the witnesses in our previous session made the argument that in some cases, the United States should simply go ahead and impose unilateral controls and that our friends and allies will follow along. I guess first I wondered what you thought about that?

Secondly, is it possible that it would make sense to focus on particular technologies, and that there might be groupings, coalitions around particular technologies, that would have a converging interest in slowing their spread?

And what I'm thinking here is that the high-end semiconductor manufacturing equipment case seems to be one where you had in effect, an informal coalition of a small number of countries that possessed this technology converging out of their own self interest to slow down its spread to China, the technology spread to China.

I wonder if there might be other areas where if you got two, three, four, five countries to participate, you could achieve a lot of what you're trying to achieve?

MS. KILCREASE: Yeah. Lots to unpack there. So let me start with the question about unilateral controls. United States should always reserve the ability to impose unilateral controls when it needs to.

But I would argue that those tend to be the least effective if we don't control all of the sources of that technology. Technology will get to where it wants to go if it's not controlled on a more comprehensive basis, and that's also true for investment, which is why I think we need to deal with the investment issues on a multilateral basis.

So we should reserve the right to use those tools but use them pretty sparingly. You know, moving away from that, then there's -- I think there is a spectrum of formations and

groupings that can be quite effective.

We can and should use ad hoc groupings centered around choke point technologies. I think that is a good idea, that is something that we can do right now, and we should continue to do that sort of advocacy with other producer nations to start to impose higher fences around some of those true choke point technologies.

But when we think about a new regime, you know, it's helpful to think about who's in the current regimes, right? So under the Wassenaar Arrangement, which is our primary mechanism on a multilateral basis for controlling dual-use technology, that's got Russia in it, I mean, so that's clearly unsustainable, right? So Russia's not in any new regime.

In terms of who should be, it's really important to get the countries that have that production capability, the have that technology advantage, and they also have a high level of ambition and they're willing to agree to a high standard agreement.

One can always grow an agreement or grow a regime once it's in place, but you want something that is high standard and is really going to meet the strategic challenge with China, and so you need countries that are going to be ambitious.

So I do think you start with countries that have already shown that they have that ambition, and that they have these technological capabilities. I do think it's Five Eyes, it's Japan, if we can get South Korea and Taiwan, I think that's fantastic, some of the key European nations, absolutely, if not the EU as a whole. I think that's the group that you start with.

You do then look at countries like India who we want to work with on technology cooperation, and candidly, I think we're all just disappointed with how they've responded to Russia right now.

And so those are harder conversations when you get to some of those countries that aren't entirely aligned with us right now. But I think you start small, you start with a tight group so you can have a very high standard regime.

COMMISSIONER FRIEDBERG: Okay. Thank you very much.

COMMISSIONER CLEVELAND: Thank you. Commissioner Fiedler?

COMMISSIONER FIEDLER: I have a quick factual question of Mark and Steve. Is there a database of companies that have -- Chinese companies that have stolen U.S. technology?

MR. COHEN: Yeah, I don't know of a single database. I -- it's possible to get, you know, U.S. court data and foreign court data because some of this occurs outside the U.S., and it's also possible to get Chinese court data, although Chinese court data is highly deficient in this area because generally trade secret cases are not published whether they contain business or technology because they contain confidential information.

But, you know, you can do rough assessments on the damages caused by trade secret theft by comparing civil litigation numbers in the U.S., how many of them involved Chinese defendants and other parties.

Actually China doesn't come out so bad in that analysis, but if you're trying to determine, in terms of for risk assessment purposes, where the likely threats are to U.S. technology, I think most of this is pretty open in terms of five year plans and the like.

COMMISSIONER FIEDLER: Yeah, and I -- no, I'm not there yet, hold on.

MR. COHEN: Yeah.

COMMISSIONER FIEDLER: I'm looking to punish thieves first.

MR. COHEN: Right.

COMMISSIONER FIEDLER: Okay? In other words, a company -- a Chinese company steals U.S. technology, and we don't let them do business in the United States period, end of

story.

MR. COHEN: Right, so you know --

(Simultaneous speaking.)

COMMISSIONER FIEDLER: Forever. Not for five years. You've stolen something, we don't -- you're not doing business with us again.

MR. COHEN: The closest we came to that was the Fujian Jinhua case with Micron where we put Fujian Jinhua on the entity list.

It raises some serious procedural issues because I don't know if BIS is well equipped to determine trade secret or patent infringement, and both those cases were involved in that, but, and of course it was a one-off. I don't know of another instance where an IP dispute was resolved, and in this case, it was resolved through an entity list designation.

We need another way of handling that if we want to deal with the magnitude of the problem.

COMMISSIONER FIEDLER: No, it also seems that litigation is a terrible way to handle it because the U.S. potential litigate, right, is -- lost its technology and is now out of business and can't afford the lawyers much --

MR. COHEN: Right.

COMMISSIONER FIEDLER: And the time it takes to go through the U.S. legal process certainly doesn't bring a benefit to the aggrieved.

MR. COHEN: Right. Let me just add a minor thing. It's not -- it doesn't address your big question, but it is something that's -- I find very irksome, which is the Chinese patent office permits you to file a patent anonymously. It's right on the application form.

So this means what you can do is steal a trade secret from the U.S., and this has appeared in at least one criminal case in the U.S. You steal it, and you get a patent in China, so now you have a double whammy.

You've disclosed the information in a patent and you could assert the patent against the U.S. company if they try to sell to market, sell it to the Chinese market. And this process of permitting an anonymous patent filing I think has no legitimate useful purpose. It should just stop.

COMMISSIONER FIEDLER: I'm cynical that they're not going to stop stealing our technology whenever they can. Right?

I mean, they've hacked all of our weapon systems, they've done all kinds of other stuff. Why would they stop? Okay? Unless there was very severe punishment.

Now, Emily, let me ask -- let me change the subject. Do you think private equity companies in the United States should disclose to the U.S. government and to the American people their investments in high tech industries that we have deemed to be important to us? Whether they have military applications or not.

I mean, there's a bunch of bio tech stuff that could be dangerous, there's all kinds of -- and most of these investments are not by necessarily all publicly traded U.S. companies, right, but are private equity, and we seem to have missed private equity in this equation and outbound restrictions.

MS. KILCREASE: I would agree with that, and I assume you're including venture capital as part of that --

COMMISSIONER FIEDLER: Oh yeah.

MS. KILCREASE: Yeah. I mean, clearly part of the problem in scoping inappropriate outbound investment control is that we don't have good visibility into the details of the problem.

We know enough to know that there is a problem. We don't have sufficient data on the specific transactions that you're talking about.

COMMISSIONER FIEDLER: And there's an important thing that is also missing, is that that is because we don't have the information we cannot see if that private equity company is investing in the United States in that same technology as well as China.

MS. KILCREASE: That's right.

COMMISSIONER FIEDLER: And to me, that is a super problem of national security ultimately because this is where the latest technology is happening, all the development is in venture capital in private equity.

MS. KILCREASE: Yes, I would agree with that.

COMMISSIONER FIEDLER: Okay.

MR. EZELL: And commissioner, if I might just add that that was exactly the intent of our recommendation for a democratically aligned trade organization that we would have the capacity to create that kind of dataset to understand which Chinese entities and actors, you know, are engaging in this systematic, you know, IP theft and have a mechanism to shut it down among like-minded countries.

COMMISSIONER FIEDLER: Thank you.

COMMISSIONER CLEVELAND: Thank you. In the interest of time, I'll defer Commissioner Borochoff.

COMMISSIONER BOROCHOFF: I'm still reeling from the idea of an anonymous patent. Thank you for telling us about that. It set me in a completely different direction.

In my own personal history have had some experience with the U.S. Patent and Trade Office a fair amount in both trademarks and patents, and I share your comments about the fact that they have some 2 -- I didn't know it was 260,000 different descriptions, but that opens up this whole conversation we've had throughout this panel, and a little bit in the earlier one, about the fact that we have to get our own house in order before we can possibly do anything about what's going on in China, and I -- I'm -- I think all of you are saying in some manner or form that until we identify what the very first question asked by Commissioner Wessel today was, what is a national security risk, we really can't enforce it.

So I'm interested first from you, Mr. Cohen, when you talked about that a little bit, do you -- and I guess two of you have mentioned the differences between the USTR and the USPTO, and I -- and I'm also agnostic as to who does it, but are you of the opinion that those I think you said 15 or 17,000 folks that are dealing everyday, could identify all of those different descriptions in a way that it would directly affect outbound and inbound investment, because if we required everyone to specifically describe what they were doing and had someone actually overseeing that to make sure it was done right, do you think that would have an impact on this whole question of what is important to us?

MR. COHEN: Yeah. It's a great question, and you know, and I have to say that I -- you know, I kind of bite my tongue when I say this because I don't think the proper role of a PTO is to get involved in these kinds of policy issues, but on the other hand I don't know where else there are the human resources.

We did an experiment when I was at the PTO looking at Chinese U.S. patent filings with U.S. government money where there was fund -- where there was a Chinese collaborator based in China.

And we wanted to see whether the Chinese collaborator also filed patents in China, and it was an interesting exercise in both determining the magnitude of IP theft using U.S. government

funds, and also in determining how U.S. PTO resources could be applied to determine what technologies are being misappropriated.

And I -- you know, having four bilingual PhDs analyze Chinese and U.S. patent filings was expensive to an agency that depends on user fees, but also very productive and very authoritative.

So the answer is a qualified yes, that there are the resources there and there's -- it's the only U.S. government agency I think that has the full range of civil and military knowledge, as well as the knowledge of where the cutting edge is. And it could be applied I think with the right coordinating mechanism, whether in USPTO, USTR, or another agency entirely.

I think too long, despite how much we've all griped today about the technology situation, the U.S. has not really woken up to the technology threat posed by China until relatively recently. And we really need to look at how agencies need to be restructured and coordinate better, and encourage to coordinate in order to address this issue.

You know, when I was getting ready to go to China some folks at my home agency said, why are you going off to work with USTR or whatever? You should know where you're -- who's paying you?

And I felt like that was not the right response. I feel like we need clear incentives in U.S. government if we're going to be siloed to encourage people and to recognize when those people go out and help other agencies in addressing these issues.

And I think when I was at the PTO I only got one phone call from CFIUS on patents. And I was in charge of the China team. And I remember that phone call quite well because the issue isn't the patents, because -- and I think the CFIUS individual didn't understand that patents are fully disclosed documents.

The issue is that the technology underlying the patents and whether there's something proprietary in nature. So there's a lot of need for cross training as well. How do you use patent data? What does it suggest? How do you leverage that with science and technology data and publications?

How do you integrate that with trade data, and who is manufacturing what, and technology flows, and offshoring? There's a lot of need for cross training, as well as on legal matters. What is the significance of a Chinese law and how do you interpret its significance?

COMMISSIONER BOROCHOFF: Oh, I'm completely out of time. I -- I'll just say that I can -- I -- perhaps your one comment about not wanting to weaponize the patent office is a good -- great one, and maybe it would just be the best place for the data to come from, and then go to whatever new regime, new department, whole of government.

I don't know, but that's how it strikes me, that that's where the data should reside. It's just the perfect place. Thank you for that.

COMMISSIONER CLEVELAND: Thank you. Commissioner Bartholomew?

COMMISSIONER BARTHOLOMEW: Thanks very much, and thank you to all of our witnesses for interesting and helpful testimony.

I'm always struck when we're talking about these issues that technology moves quickly and government moves slowly, and I just would like -- you know, several of you of course have worked inside the government, you're very talented, you have left, and I just wondered, you know, since we advise Congress, can you give us some suggestions on what you think needs to be done to increase the ability of our U.S. government agencies to have the talent and the expertise they need to address these challenges?

So some of it is bureaucracy, and bureaucracy moves slowly, but do we have the talent

that we need? How do we attract the talent we need, especially in a sector where people can make a lot more money outside of government? What can we do to help make the government better at this?

MR. COHEN: If I may, I'll briefly address some of that. It's a great question. One thing which I didn't mention in my presentation -- perhaps I mentioned it several years ago -- is bring back OTA in Congress.

The Office of Technology Assessment, I think I'd speak at a couple hundred people. They did a great report, I think it was 1988, on technology transfer to China. If you read it in conjunction with the 301 report in 2018, you'll say, gee, well not much has changed.

And the folks on that report, including Pete Sutmeyer, Craig Allen, the Alumni Club is magnificent. I'm sorry I was not part of that report, it's really -- but OTA was responsible to Congress, and I think having an organization like OTA in place would be extremely helpful.

I'm probably one of the few people that looks at U.S. -- usajobs.gov to get a sense of where U.S. policy is going because I look at CFIUS help wanted ads, BIS help wanted ads, PTO help wanted ads, USTR.

Some of that is in my written testimony. Most of them, with exception to PTO, do not ask for a STEM background to do STEM challenging work. Getting STEM educated people in these other positions is extremely important.

At one time, I would say that the key to that is work-life balance because they're going to take a pay cut.

PTO has been pretty good at doing that because they've had to have STEM educated people so they had a work at home program for the -- a remote working program for the longest time, including working outside of Washington, D.C., in satellite offices and elsewhere, but we need to find a way to increase the talent pool in the U.S. government on both the STEM educated side, and I would also say the Chinese language side.

I used to follow that very carefully as well. I remember back about eight or nine years or so ago, I polled various agencies. The number of people who spoke Chinese in key areas dealing with trade and technology was very, very few.

In fact, when I was at the embassy -- at the U.S. Embassy, and the ambassador was looking for people to engage the Chinese media on hot issues -- it was a proposal of Condoleezza Rice and Secretary Rice -- there were only five or six people out of about 300 officers who could speak Chinese at an adequate level to engage the Chinese media. I was one of them, so I took on that issue on IP related matters.

So we really need to bring that talent in place. I'm not so sure that training mid-level state department folks in another year or two of language, which is extraordinarily expensive, is the optimal way.

I was a benefit of the National Defense Foreign Language Program and I think getting young people in the system earlier is really critical to having them understand Chinese language and other skills that are necessary both for the private and public sector.

COMMISSIONER BARTHOLOMEW: Ms. Kilcrease?

MS. KILCREASE: Yeah, I would agree with all of that, and I would also add, it's really important for these agencies to have people whose only job is to do long-term strategic thinking.

And most agencies do not have that, or they'll have a couple of people in the secretary's office who get to do this, but then they end up writing speeches, and coordinate -- you know, there's just an intense need for somebody to think long-term strategically, pull the data, pull the analysis, talk to all the right people in the department to do strategic planning, and it's not

responsive to day-to-day implementation responsibilities, and that just doesn't happen in most agencies.

And then I would also be remiss just to not note that the hiring processes continue to be horrible across the board, and that is a huge frustration for employees at all levels.

COMMISSIONER BARTHOLOMEW: Great. Thanks very much.

MR. EZELL: Can I briefly connect that to a question asked earlier?

COMMISSIONER BARTHOLOMEW: Is there anything to add?

MR. EZELL: Yeah, I was just -- if I may, connect that to a question asked earlier about talent, because the reality is that, you know, knowledge walks on two feet as the foundation of technology, but if you look right now at students studying electrical engineering and computer science at the PhD and masters level at U.S. universities, 81 percent in electrical engineering and 79 percent in computer science are foreign born, with 70 percent of those students being from China or India.

In our view, that creates a national security vulnerability in our domestic STEM talent pipeline, for should those students from China in the future not be able to come here for whatever reason, we have a real vulnerability in our domestic capacity to support the STEM talent both needed to drive these advanced technology industries we're talking about forward, but even to support the skill sets in government that were just spoken about.

COMMISSIONER BARTHOLOMEW: Great.

COMMISSIONER CLEVELAND: I will just note personally that I think that figuring out a way to keep some of those people in this country is going to be an important way to address the -- address those challenges. But thank you very much, all of you.

COMMISSIONER WESSEL: I will ask my questions for the record. The -- thank you very much to our witnesses.

Really helpful information and I think a lot to consider. We will adjourn for a break until 1:35. Is that the -- 1:35? Yeah. Thank you.

(Whereupon, the above entitled matter went off the record at 12:54 p.m. and resumed at 1:37 p.m.)

PANEL III INTRODUCTION BY COMMISSIONER MICHAEL WESSEL

COMMISSIONER WESSEL: Okay. Our third panel will assess U.S. challenges and opportunities of economic and trade engagement in the Indo-Pacific as well as China's strategy in the region.

All four of our witnesses for this panel are newcomers to the Commission, and welcome.

First we welcome Dr. Deborah Elms, Executive Director at the Asian Trade Center. Dr. Elms will discuss the effect of RCEP implementation, China's strategy, and U.S. engagement in the region.

Next we'll hear from Wendy Cutler, Vice President of the Asia Society Policy Institute. Ms. Cutler will discuss U.S. economic objectives and digital trade in the Indo-Pacific with reference to CPTPP and RCEP.

Next we will hear from Dr. Timothy Meyer, Professor of Law at Vanderbilt University. Dr. Meyer's testimony focuses on the distributional effects of trade agreements and ways to recalibrate the U.S. trade approach.

Finally, but not lastly, we will - we welcome Lori Wallach, Director of Rethink Trade at the American Economic Liberties Project. Ms. Wallach will assess the impact of regional trade agreements on U.S. workers and potential new approaches to trade agreements.

Thank you all very much for your testimony. I'd like to remind you to keep your remarks to seven minutes.

And, Dr. Elms, we'll begin with you.

OPENING STATEMENT OF DEBORAH ELMS, EXECUTIVE DIRECTOR, ASIAN TRADE CENTRE

DR. ELMS: Thank you very, very much. It's an honor to be here. I have to cover four things very quickly, and so I will hit the highlights, and I'm more than happy to answer any questions that you have after that.

So I'm going to talk about trade and trade agreements particularly viewed from Asia, and I'm going to start with TPP briefly. I'll talk a little bit more about RCEP since I think that's of interest to this group. I'm going to discuss briefly the digital trade agreements that are going on across the region. And then I'll finish very briefly with some discussions on IPEF.

So let me start with CPTPP. So this is an agreement that, let me just say up front, I think the United States should join. And I realize that's a non-starter in this town at the moment, but I think you should reflect on why that's a non-starter and see if there's some way to get back to that. And the reason for that is that this is a regional architecture that I think is going to matter more and more.

We have, as you may be well aware, a number of countries that are applying to join the CPTPP. The U.K. is wrapping up its accession talks and plans to be done by the end of this year. We have China, Taiwan, and Ecuador all with formal applications to join, and the Koreans have promised to submit a letter by this month. So we will have new accession negotiations in progress beyond the U.K. by the end of this year. And I think it's incumbent for the United States to think about how it will respond to those questions.

And because this is the China Commission, let me just say on the Chinese application for CPTPP it is a serious application. It won't be easy for either China or for the current members, but it is a very serious application and there are good reasons I think to assume that China will be part of the CPTPP at some point, and not so far away.

And as I mention in my written testimony there are three decision points around CPTPP accession that are important: when you launch a working party, during the process of the negotiations themselves, and then at the end. And so I think the current members will probably move to allow China to start a working party. How long those negotiations take is unclear at the moment. And then what happens at the end of it also unclear. But I don't think you should assume that China will not get a working party started on CPTPP.

The other area where we have a lot of experience working with China in general in Asia is on the Regional Comprehensive Economic Partnership, or RCEP. RCEP is now in force for 8 of the - or sorry, 12 of the economies. We're still waiting for Indonesia, Philippines, and Myanmar to ratify by the end of this year.

RCEP I realize also has a very less-than-favorable view in this town, but I will tell you that this is a very meaningful agreement. It's a comprehensive trade agreement. It covers goods, services, investment, intellectual property rights, has a bad e-commerce chapter. It has a number of things that I think matter, but much more important is the benchmark that it sets for trade in Asia with Asia.

And the important thing from my perspective for non-members, which would be the United States and others, it will become increasingly difficult I think to do trade in Asia if you're not in Asia. So it will be very hard to start to supply goods, services, and investment to Asia if you sit in Iowa or Kansas or Washington, D.C. because there will be competitive advantages to Asian competitors delivering those same goods, services, and investment in Asia using RCEP.

Now it will take some time, I will say, before RCEP impact is really felt because it's got

long staging periods, it's a bit complicated. And again I'm happy to answer any questions that you have along the way.

Let me talk about China's role in the negotiations on RCEP for just a moment. China, of course one of the members of RCEP. It was an active member in RCEP, but China was not actively pushing an agenda in RCEP. The main goal that China had in this negotiation was to have an RCEP because they're already the number one or number two importer and exporter for every single market in the region. And so all they really wanted was to have an agreement.

And then once they have an agreement, then they can work within that. That gives them additional competitive advantage over what they have without an RCEP. So their goal was really just to get an RCEP done. And they allowed in this case ASEAN, the 10 members of Southeast Asia, to be in the driver's seat for the negotiations under RCEP. So China was there. They were active, but they were not pushing a particular agenda.

Once we have RCEP in force now and as we create a secretariat for RCEP, that situation may change, and I would expect that China will be much more active in the secretariat functions and in the implementation of RCEP and in the upgrading exercise that will inevitably follow in RCEP. So although they were not driving an agenda at the outset, I think if you look at China's involvement in RCEP over time there is I think strong reason to think that China will become much more active on the RCEP agenda. So this is something that definitely needs to be watched.

Another area that I think is maybe underplayed here in this part of the world but matters are all of these digital agreements. We have a number of them. Two in particular: the Digital Economy Partnership Agreement, DEPA, and then these digital economy agreements, DEAs. I'm apologizing on behalf of Asia for their lack of originality in naming things. So we have DEPA and DEAs.

They're very important because they bring together digital provisions between different countries. And I think of importance to the United States is to note what is in those. And I think my testimony in the annex shows you some of the variation between these DEPA and DEAs. And also to think about how the United States might effectively engage and remain interoperable with these digital economy agreements.

They are currently in place between a number of key markets in a number of what the United States would call like-minded partners, but they're not completely identical. And what I suspect will happen is we will end up with a network of digital agreements that is driven particularly by Singapore, increasingly by the U.K. and others, Australia as well, and we will end up with potentially overlapping, hopefully consistent, provisions in these DEPA and DEAs that will matter to the United States.

And that brings me to my last point before I conclude my opening remarks which has to do with the U.S. and the Indo-Pacific Economic Framework, of which I know digital is a key component. What I just want to mention there is that it's crucial for the United States to be engaged in Asia in an economic fashion.

I think IPEF is a very useful initiative for doing that, but it needs to be attractive to the counterparties. And I don't think you should assume that the other potential “likeminded” in - even in Asia are necessarily aligned with the United States around the agenda and the objectives that are currently imbedded in the IPEF framework.

And so you'll have to think hard about how do we create an agenda in IPEF that is both suitable for the United States and attractive enough for other members to join. And that is a very difficult circle I think to square.

And let me stop my comments there and I'm more than happy to take questions from all

of you. Thank you.

COMMISSIONER WESSEL: Thank you. Right on the button. Wendy?

PREPARED STATEMENT OF DEBORAH ELMS, EXECUTIVE DIRECTOR, ASIAN TRADE CENTRE

April 14, 2022
Dr. Deborah Elms
Executive Director, Asian Trade Centre, Singapore
Testimony before the U.S.-China Economic and Security Review Commission
Hearing on "Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators"
Panel III: Regional Economic and Trade Engagement

The trade and economic landscape in Asia is rapidly evolving. While there are many activities that I could mention, I will focus my testimony today on four regional trade arrangements: the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP); the Regional Comprehensive Economic Partnership (RCEP); a set of digital trade deals known as DEPA or DEAs; and the upcoming American-led Indo-Pacific Economic Framework (IPEF). I will attempt to explain how and why these agreements matter for Asia and describe some of the implications of this evolving regional architecture for the United States. I will conclude with a few brief suggestions about how craft an IPEF that best fits into a complex economic landscape.

Let me begin with the CPTPP. The CPTPP came into force in late December 2018 and now has eight active members: Australia, Canada, Japan, Mexico, New Zealand, Peru, Singapore, and Vietnam. The UK is in the middle of accession talks and hopes to be part of the group by the end of this year. Three additional formal letters of application were received last fall, from China, Taiwan, and Ecuador. South Korea's outgoing government pledged to submit an accession request this month.

There are three important items on the CPTPP agenda for this year: members must review the agreement; conclude accession negotiations with the UK; and decide on a process for addressing pending applications.

The original CPTPP rulebook and schedules were wrapped up in late 2015. Since then, members have embarked on a variety of other trade deals, including (as I will discuss in a moment) a range of new digital commitments. Some of these elements, particularly for digital trade, might be usefully brought into the CPTPP.

The agreement was originally designed as a "living" document, with the potential for regular updates. It has built-in commitments for reviews to help drive a process of looking at the rulebook and schedules to decide if any adjustments are needed. Although the original agreement had an ambitious and far-reaching electronic commerce chapter, for example, the rules in the CPTPP have already been incorporated into a range of other trade arrangements that now extend beyond what the CPTPP delivers. This includes topics like electronic invoicing; open government data; fintech, regtech or lawtech; and artificial intelligence. Hence there is scope for considering whether or not the CPTPP might be adjusted to incorporate some of these types of digital trade provisions (shown in the Table in the Annex).

Another area of potential adjustment might be found in the environment chapter as many CPTPP members may now be prepared to extend the scope of the coverage in this chapter to be more aligned with commitments made in other fora.

Overall, the CPTPP continues to set the benchmark for ambitious, high quality regional trade arrangements. It has delivered economic growth and provides companies with improved market access or lowered costs regardless of sector or size of company. The United States should find a way back into the agreement as quickly as possible. CPTPP benefits for members are key to understanding why other countries have already applied to join or are considering doing so.

Of all the candidate countries in line to potentially join the CPTPP, China's application has understandably sparked the greatest interest. China is serious about becoming a member. Government officials spent more than a year working on a comprehensive gap analysis and significant time in consultations with various affected ministries and agencies including visits to provincial offices.

Joining CPTPP would provide a new spark to economic growth and development within China. China-based firms would have access to member markets with better market access terms than in any other Chinese trade agreement. Chinese companies and consumers could also procure goods and services from CPTPP members more easily and, likely, at lower cost.

There are many who have argued that China "cannot" join the CPTPP because Chinese policies are too far out of alignment with CPTPP policies and practices or because other CPTPP parties will not let China into the agreement.

It is true that the CPTPP does not currently align with existing Chinese policies. However, some have argued that they want to join the agreement *precisely* because membership would force through some important reforms that might otherwise be difficult to implement. Current CPTPP members joined for similar reasons.

There are a few areas where the gap or disconnect between current Chinese practices and CPTPP rules are widest. These include digital trade rules, market access commitments particularly for all services and investment categories, state-owned enterprises (SOEs), and labor rights. This audience here today would likely add intellectual property rights protections and enforcement to this list.

While there is insufficient time to explore all these areas here today, it is perhaps important to note that even ambitious trade arrangements provide some flexibilities for members. The two key digital rules, to take one example, provide for free flow of data across borders and prevent data localization. However, these commitments also allow governments to maintain restrictions in the pursuit of legitimate public purposes.

Flexibilities like these are important for all members to have sufficient policy space to act in the national interest of their citizens. But they also can create concerns about how to

define legitimate public purposes and would, in all likelihood, create challenges for CPTPP members dealing with China as well.

Hence, the decision to allow China to move towards accession to the CPTPP is not a simple one. There are several important decision points: when members agree to open a working party to address potential Chinese entry; during the negotiations over China's specific commitments in goods, services, investment, SOEs, business mobility, and government procurement; and at the end of talks when members must decide whether or not to accept China's accession package. Under current arrangements, acceding CPTPP members are not reopening the rulebook, nor are any existing country-specific schedules adjusted.

Making decisions around Chinese accession will be challenging for CPTPP members. China is the largest or second largest importer and exporter for every member economy. It represents a formidable economic competitor. Members may hope that alignment within CPTPP rules is better than dealing with Chinese competition outside of the CPTPP.

Many CPTPP members have now also had a decade of experience working with China as part of the Regional Comprehensive Economic Partnership (RCEP). RCEP is in force for Australia, Brunei, Cambodia, China, Japan, Korea, Laos, Malaysia, New Zealand, Singapore, Thailand, and Vietnam.

RCEP is another regional trade agreement. Although many of the commitments are less deep and less broad than CPTPP, the economic impact should not be discounted. RCEP will make it much easier to send goods, services, and investment around Asia. Firms are more likely than ever to create "in Asia, for Asia" strategies as the region becomes more economically intertwined.

Given the benefits on offer, such as lower tariffs or improved access and protection for services and investment, it will increasingly be harder to compete with firms in Asia for markets in Asia. As RCEP commitments deepen and as members upgrade and expand commitments over time, this trade agreement will become even more important.

RCEP members are meant to create a Secretariat to manage the agreement. There is also considerable economic aid being deployed to ensure effective implementation, especially among ASEAN's developing country members.

A trade agreement, like CPTPP or RCEP, is designed specifically to provide benefits to members that non-members do not receive. Firms that are excluded from both megaregional trade arrangements will not have the same competitive edge in member markets. It will, especially, be hardest for smaller firms outside Asia to sell goods and services to Asia. Even in the wake of Covid, Asian growth projections remain impressive.

American firms operating in and across Asia may still be able to leverage on CPTPP or RCEP benefits from their Asian footprint. But many are increasingly concerned that their home operations could be at a disadvantage and they may need to shift up sourcing of raw materials, parts, components, and suppliers to include more Asia-based firms in the future.

As the world becomes increasingly digital, having supportive digital trade rules in place will become ever more important. Fortunately for many American companies, Asia's digital rules currently follow the templates set down through the CPTPP, as shown in the Annex.

However, these original digital provisions are quickly being supplemented. Many Asian governments, including Singapore, Australia, New Zealand, and South Korea, have been enthusiastically signing digital trade deals, known as DEPA or DEAs. Most of the digital-only provisions go beyond the relatively limited commitments from the CPTPP.

Again, space and time limitations prevent a full summary of the differences, but it may be worth noting here that these digital-only arrangements contain three types of commitments: those that embrace "hard" or binding legal obligations, those that are cooperative in nature, and those captured through a Memorandum of Understanding (MOU) which are also cooperative in nature but designed to be even more flexible and adaptive than DEA arrangements.

Asian governments, as well as like-minded external partners like the UK, are also creating networks of DEAs. These DEAs could become a digital economy framework from the bottom up, building on the contributions of forward-looking middle powers in Asia.

Asia likes trade arrangements. An outward-oriented region is now rife with regional and bilateral commitments of all sorts.

To continue to be an important part of the conversations about future economic and trade developments, the United States must participate. It is not enough to make vague promises about what might be forthcoming. Asian governments appreciate clarity.
Whatever regional approach the US decides to choose will have to be attractive to counterparts.

The Indo-Pacific Economic Framework (IPEF) has the potential to be a useful vehicle for greater economic cooperation in Asia. The biggest challenge with IPEF will be designing an approach that meets American interests while still providing sufficient benefits for others to want to join IPEF.

This means that the US will need to think hard about how to balance demands for new rules and commitments, often in areas of less concern to Asia, with potential economic benefits. Without win-win outcomes, potential members will be less enthusiastic about joining. If new market access is not forthcoming, it may be especially hard to create shared enthusiasm for a set of priorities.

Digital trade is clearly an area of strong interest in the region. But note that not all Asian governments, or even all ASEAN governments, have similar ideas about how to address digital trade and economic regulations.

An IPEF focused on digital could be a useful addition to the rapidly expanding set of digital rules in the region. It should include provisions in at least six areas: open digital markets, data flows, consumer and business safeguards, digital trade systems including digital trade

facilitation, next generation digital issues, and inclusive trade. Such a package could be attractive to some governments in Asia.

The trade and economic landscape, as noted at the outset, is already very crowded in Asia. The United States has largely been sitting on the sidelines and has opted out of one megaregional trade agreement. Re-engaging in the region is critically important, but it will not be easy. The US needs to rapidly clarify what it wants to achieve in IPEF and find ways to create win-win outcomes to draw in others. Otherwise, the United States will end up accommodating trade agreements that have already been set by others and accept a position of rule-taker rather than being an important rule-maker.

OPENING STATEMENT OF WENDY CUTLER, VICE PRESDIENT, ASIA SOCIETY POLICY INSTITUTE

MS. CUTLER: Well, thanks, Commissioner Wessel and Commissioner Cleveland, and for the opportunity to testify this afternoon.

Since the United States exited the TPP in 2017 the regional trade landscape has changed dramatically, and as we stepped back our regional partners accelerated their quest for open markets and trade agreements. China in particular has been quite active trying to position itself as the regional champion of trade liberalization and anti-protectionism.

In January 2017, Xi Jinping gave an extraordinary speech at the World Economic Forum asserting China's global economic leadership. And what started with words has not been followed with actions as China has strengthened its economic times and supply chain connectivity with countries across the region.

Now with respect to RCEP, as Ms. Elms mentioned, this is an ASEAN-led initiative, but Beijing has been a strong supporter of this agreement. The text is full of exceptions, non-binding commitments, long transition periods, and weak enforcement mechanisms, but this is not a reason to dismiss its significance.

With common rules of origin and harmonized customs forms the agreement will result in further economic integration and supply chain connectivity within Asia. Furthermore, ASEAN-led agreements are not static. They expand in scope and depth over time and with RCEP's ministerial and committee meetings its members have regular opportunities to convene to set rules on emerging issues.

And don't count on these rules necessarily being in line with U.S. interest. I always like to point to the data provisions in the e-commerce chapter in RCEP. At first reading they look okay, but then you go to a footnote which basically says anyone can do whatever they want and ignore the commitment.

While joining RCEP is not realistic nor a desirable prospect for the United States, it's an important milestone that we need to keep in mind as we plot our strategy going forward.

As Ms. Elms mentioned, this year will be a critical year in determining the future shape and direction of the CPTPP. In particular all eyes will be on how China's CPTPP application is treated. Indeed, China will have major difficulties in adhering to current CPTPP provisions on digital, labor, IPR, and state-owned enterprises, among others. However, just looking at the end game misses the larger picture.

Through the establishment of a CPTPP working group, China would be able to get its nose under the tent of this agreement and over time become a de facto member. While certain CPTPP members have serious concerns over China's application, their ability and determination to block China's entry into this agreement are far from certain. And for its part, China is on a charm offensive. It's working hard to convince CPTPP members to support its bid.

Xi Jinping indicated last November that China would take an active and open attitude in negotiations on digital, environment, industrial subsidies, and SOEs. Chinese officials have conveyed to partners that they're going to give more market access than they've ever given before in any other agreement to CPTPP partners and Chinese officials have said they're going to make every effort possible to fully meet the standards of CPTPP rules through reforms.

If China's accession negotiations move forward, it would be a game changer and it would likely and quickly become the most important trade negotiation in the region with the United

States wielding little if any influence over the process.

The trajectory of the Indo-Pacific trade landscape is clear. We've seen comprehensive agreement. Ms. Elms mentioned the digital trade activity underway in the region and existing agreements are being expanded to include new members and their provisions are being updated to reflect new realities.

So the fundamental question for the United States is whether we want to be an integral part of this regional architecture or are we prepared to forfeit our ability to help shape the future regional rules and enjoy the market access benefits provided by these agreements? And this is not an academic question. It is one of considerable urgency.

As each month passes we are being disadvantaged and frankly becoming less relevant and influential.

The most straightforward path to stepped-up engagement would be for the United States to consider rejoining the CPTPP, however the Biden administration has made it clear that it's not interested in doing so. And even if the United States were looking into this, certain adjustments would be needed to the current TPP agreement using USMCA as a guide to reflect the economic, political, and technological realities of the day.

Certain provisions like rules of origin would need to be strengthened. New provisions would need to be added to bolster the labor and environment commitments and their enforceability. Other chapters like digital trade would need to be updated. Certain areas like investor state dispute settlement and government procurement may need to be scaled back. And issues like supply chains and other emerging issues would need to be incorporated.

IPEF presents an important opportunity for the administration to step up its economic engagement in the region, but to be successful the initiative must be substantive, inclusive, coherent, impactful, and enduring, and it must promote an agenda that aligns with our national economic priorities, is responsive to the concerns of U.S. workers and the middle class, and sets up an alternative economic model to China's state-led one in an affirmative way.

In concluding, it's now been about six months since the President first raised the contours of the IPEF and over that six-month period China has ratified and implemented the RCEP, consulted with CPTPP members on its application, applied to join DEPA, updated and put into effect updates to its FTA with New Zealand, and just announced it plans to update the China-ASEAN FTA.

China's not standing still, the Indo-Pacific region is not standing still, and it's time to roll out the IPEF and make it front and center in the regional economic conversation. Thank you.

COMMISSIONER WESSEL: Thank you.

Dr. Meyer?

PREPARED STATEMENT OF WENDY CUTLER, VICE PRESIDENT, ASIA SOCIETY POLICY INSTITUTE

Testimony before the

U.S.-China Economic and Security Review Commission

Hearing on

"Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators"

Testimony by Wendy Cutler
Vice President, Asia Society Policy Institute

April 14, 2022

Commissioners Cleveland and Wessel, distinguished members of the commission and staff, thank you for the opportunity to appear before you today to share my thoughts on economic and trade engagement in the Indo-Pacific region. This is a topic of tremendous geopolitical and economic significance.

Since the United States exited the TPP in January 2017, the trade landscape in the Indo-Pacific region has undergone significant changes. We have witnessed a steady march of new trade agreements across the Indo-Pacific region that do not include the United States. Our regional partners have not slowed down in their quest for open markets and new economic opportunities. They view trade expansion as an essential path to promote economic growth, create jobs, and improve livelihoods for their citizens. China in particular has been quite active as it seeks to position itself as the regional champion of trade liberalization and anti-protectionism.

Two mega-regional trade deals – the details of which I'll discuss shortly – have entered into force over the past three years without the United States. This is stunning considering that only a decade ago, the United States was in the driver's seat on regional rulemaking. No longer are our partners waiting for us to lead. With a newfound confidence in themselves (and perhaps less confidence in us), they are working among themselves, including with China, to strengthen trade and investment ties, as well as supply chain connectivity. In turn, the United States is being cut out of reaping the benefits of these agreements and sitting outside the rooms where the future regional rules are being shaped.

These developments come at a time when the Indo-Pacific region's growth trajectory is transforming it into the center of gravity for 21st century trade. The Indo-Pacific now accounts for over 60 percent of global GDP and more than one-third of global goods trade, up from 25 percent a decade ago. As we look ahead, the region is poised to be the powerhouse of economic growth and innovation for years to come. Between 2019 and 2050, over half of global growth is expected to come from this region.

By sitting on the sidelines, the United States has left a void that China has actively sought to fill. In January 2017, the same month that the U.S. withdrew from TPP, Chinese President Xi Jinping gave an extraordinary speech at the World Economic Forum asserting China's economic leadership. Presenting China as the global guardian of the international rules-based trading system, Xi said, "We must remain committed to developing global free trade and investment, (and) promote trade and investment liberalization." What started with words has been followed up with actions, as China has strengthened economic ties with countries across the Indo-Pacific and brought them increasingly into China's economic orbit, though this does not mean China's architecture is truly intended to buttress international trade rules as we have known them.

China has emerged as the dominant player in today's Asian trade landscape. Some quick data points to help us grasp the situation:

- **Global trading partnerships**: The U.S. share of global goods trade fell by a third between 2000 and 2020 while China's share nearly quadrupled. In 2001, more than three quarters of all countries traded more with the United States than with China. By 2018, that figure fell to about one-third, with 128 countries trading more with China than with the U.S. and 90 countries trading more than twice as much with China as with the United States.
- **Asian trading partnerships:** China has surpassed the United States to become the largest trading partner to most U.S. partners and allies in Asia, often by a factor of two to one. The days when the United States was the largest trading partner to Japan, Korea, and ASEAN are gone.
- **Regional trade volumes:** Today, China's trade volumes in the Indo-Pacific region are nearly three times that of the United States. China's trade with ASEAN alone now doubles that of the United States, reaching $685 billion 2020, with the U.S. at $362 billion with the region. This is a significant change from 20 years ago, when total U.S. trade with ASEAN was $135 billion, more than three times China's trade of $40 billion.
- **Foreign investment**: China has also become the number one foreign investor in as many countries in the Indo-Pacific as Japan and the United States combined.

INDO-PACIFIC TRADE AGREEMENTS: WHAT DO THEY MEAN FOR CHINA?

There have been two major trade deals involving the Indo-Pacific concluded in the past three years without the participation of the United States. China is an active member and key architect of one – the Regional Comprehensive Economic Partnership (RCEP) Agreement, and in September 2021, China applied to join the second – the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Through these efforts, China is seeking to shape trade rules to reflect its own regulatory and policy direction, as well as its longer-term vision for the Indo-Pacific region. Moreover, under these pacts, Beijing is offering tangible market access benefits for Indo-Pacific nations to its large and growing market, promoting economic integration and deepening supply chain ties.

CHINA'S PARTICIPATION IN RCEP

Although an ASEAN-led initiative, Beijing has been a strong promoter of RCEP, a comprehensive agreement involving fifteen Asian countries. Overall, RCEP is a relatively weak agreement. The text is full of exceptions, non-binding commitments, long transition periods, weak enforcement mechanisms, and product exclusions for tariff reductions. As a result, it has led some to dismiss its economic significance, arguing that it should be viewed as more of a compilation of existing ASEAN-based trade agreements.

In my view, those observations miss the mark. With common rules of origin and harmonized paperwork for customs purposes, the agreement will result in further economic integration and supply chain connectivity. A Malaysian product, for example, now will be viewed as an RCEP product and will be more easily able to move between borders of RCEP member countries than products of non-members.

Moreover, as history has shown, ASEAN-led agreements are not static – they expand in scope and depth over time. Furthermore, with its Ministerial meetings, Committee structure, and the establishment of a Secretariat, RCEP will become a grouping for its members to set rules on emerging issues and strengthen preferential market access commitments.

As an RCEP member, China has a seat at this table as these rules of the road for trade in the Indo-Pacific are written. And the rules it seeks to promote may not be in line with U.S. interests – a case in point being the broad exception provided in RCEP's E-Commerce chapter where data obligations can essentially be ignored if a party decides for itself to do so.

Finally, through the agreement Asian supply chains will be strengthened. According to analysis by UNCTAD, RCEP's tariff concessions would increase intra-regional exports by nearly two percent or approximately US$42 billion with many of the gains coming from trade diverted away from non-members, such as the United States. China is expected to realize over a quarter of these gains, with its exports projected to rise by about US$11.2 billion.

While joining RCEP is not a realistic nor desirable prospect for the United States, it is an important milestone that should be factored into U.S. thinking as Washington shapes its own economic trade strategy in the region and considers the timing of new initiatives.

CPTPP – U.S. EXIT LEAVES AN OPEN DOOR FOR CHINA

The CPTPP recently marked its third anniversary, with eight of its eleven members having brought this high-standard agreement into force. This year will be critical in determining the future shape and direction of CPTPP as members face a number of important decisions regarding accession requests by the United Kingdom, China, Taiwan, Ecuador and perhaps Korea which has indicated it may seek membership before its next president takes office.

In particular, all eyes will be on the members' decision on whether to formally start accession negotiations with China. There is no doubt that, given its current trade and investment regime, China would have major difficulties in adhering to many existing CPTPP rules, particularly with respect to digital, labor, IPR and state-owned enterprises. However, just looking at the end game misses the larger picture. Through the establishment of an accession working group, China would be able to get its nose under the tent and over time could become a de facto member of CPTPP. And while certain CPTPP members have serious concerns over China's application, their ability and determination to block the establishment of a working group is far from certain.

For its part, China is not missing a beat in trying to convince CPTPP members to support its bid. At the November 2021 International Import Expo, Xi Jinping indicated that China would take an "active and open attitude" in negotiations on digital, environment, industrial subsidies and state-owned enterprises. China's Ministry of Commerce officials have conveyed that Beijing will provide CPTPP members with new market access opportunities never offered previously in other trade agreements. And, most recently in February, Chinese officials indicated Beijing will make efforts to "fully meet the standards of CPTPP rules through reforms."

If China's accession negotiations move forward, it would be a game changer, likely eclipsing all other regional initiatives and becoming the most important trade negotiation in the region, with the United States as a non-member wielding little, if any, influence over the process.

DEPA – THE FUTURE OF INDO-PACIFIC DIGITAL TRADE?

In addition to comprehensive trade deals like RCEP and CPTPP, regional negotiations in the digital space are taking place at an unprecedented pace, including the conclusion of the Digital Economy Partnership Agreement (DEPA) by Singapore, New Zealand and Chile in 2020. DEPA sets forth rules on data, promotes interoperability between different regimes and seeks to address emerging issues brought about by digitalization. It is also envisioned as a platform for a broader regional deal and has been gaining momentum, attracting interest from Canada and formal applications to join from South Korea and most recently China. DEPA membership would provide another opportunity for Beijing to promote its vision for the digital world, including its view on the use, storage, and application of data.

IMPLICATIONS FOR THE UNITED STATES AND TRADE ENGAGEMENT IN THE INDO-PACIFIC

The trajectory of the Indo-Pacific trade landscape is clear. New trade agreements, both comprehensive and sectoral, will be pursued, and existing trade agreements will be expanded to include new members and updated to reflect new developments. The fundamental question for the United States is whether we want to be part of this regional architecture or sit on the sidelines, forfeiting our ability to help shape the future regional rules and to enjoy the market access benefits provided by these agreements. This is not an academic question – it is one of considerable urgency. Each month we are on the sidelines, we are being disadvantaged and frankly, becoming less relevant as others fill the leadership void we once exercised.

The most straightforward path to re-engagement would be for the United States to consider rejoining the CPTPP. There have been calls in Congress, the business community and elsewhere around the country in support of this move, though there is also serious opposition. Some of our closest partners in the region, including Japan, Australia, and Singapore, are strongly advocating our return. In May 2021, speaking to the U.S. Chamber of Commerce, Singapore's Prime Minister Lee Hsien Loong commented, "I hope that the mood will change and you [the United States] will find your way forward to have a positive trade agenda before too long, and possibly one day find a way to work your way back into the CPTPP. After all, America was a major architect of that, and the house is basically what America had a part in designing and crafting."

While the Biden Administration has technically not ruled out the prospect of re-entry, it has made clear that it is not interested in pursuing traditional trade agreements, like CPTPP. And, even if the United States were to consider returning to the CPTPP, we would need to seek certain adjustments to make the agreement more in line with the political, economic and technological realities of the day, with the U.S.-Mexico-Canada Agreement (USMCA) serving as a useful guide. Certain provisions, like rules of origin, would need to be strengthened; other chapters like digital trade would need to be modernized; a few areas, like investor state dispute settlement and government procurement, may need to be scaled back; new provisions would need to be added to bolster labor and environmental commitments and their enforceability; and supply chain considerations and other emerging issues would need to be incorporated.

ADVANCING THE INDO-PACIFIC ECONOMIC FRAMEWORK

While the Biden Administration is not interested in pursuing a traditional market-opening trade agreement, it recognizes the urgency of strengthening its economic engagement in this vital region. As a result, it is now putting the finishing touches on its Indo-Pacific Economic Framework (IPEF) featuring a set of economic topics that are timely and pressing for the United States and its regional partners. While the word "China" will not appear in this initiative, the challenges presented by the world's second largest economy are the backdrop to many of its tenets.

The IPEF is organized into four pillars – fair and resilient trade; supply chain resilience; infrastructure, decarbonization and clean energy; and tax and anticorruption. In each pillar the Administration is considering a combination of binding rules, softer commitments, and cooperation elements, with important input from stakeholders and Congress. Through extensive consultations in the region, U.S. economic agencies are working hard to attract strong participation by regional partners.

My conversations with counterparts in the region have revealed mixed reactions and pointed questions. Some have expressed skepticism, wondering what incentives will be provided due to the noticeable absence of market access. Having seen many U.S. initiatives come and go in the region, some are also questioning whether the Framework will receive sustained attention by

senior Administration officials. Others are concerned that a new Administration would not follow through, still bearing the scars from the U.S. TPP exit. Moreover, I have picked up in my discussions a genuine concern that whatever specific initiatives Washington proposes under the IPEF, they may pale in comparison to China's move to join the CPTPP.

That said, I sense among many a strong desire for the United States to get back into the region with a substantive economic agenda that will help balance the gravitational pull they are feeling from China. And, even if the IPEF agenda may fall short of what they are seeking, they will be supportive.

The Administration has an important opportunity to re-engage economically in the region through the IPEF. But to be successful, it must ensure that the initiative is substantive, inclusive, coherent, impactful and enduring. Importantly, it needs to offer tangible benefits for partners to join, which is easier said than done with market access off the table. Still, incentives can be offered in such areas as infrastructure funding, capacity building expertise, trade facilitation initiatives and public-private partnerships. Moreover, it's critical that the Administration attract participation beyond the "usual suspects" of Australia, Japan, Korea, New Zealand and Singapore. Washington already has extensive economic ties with this group of five and for the most part see eye to eye on values, standards and norms. Securing participation from economies beyond this grouping, particularly from ASEAN member countries, will help extend the reach and boost the credibility of the initiative.

There is an urgency in getting IPEF moving. As each week slips by, our partners are being pulled closer to China and becoming more skeptical of Washington's ability to deliver. It's now been almost six months since the President first raised the contours of the IPEF at the October 2021 meeting of the East Asian Summit. Over this six month period, while Washington has been working out the details of the initiative, China has ratified and implemented RCEP; consulted with CPTPP members on its CPTPP application; applied to join DEPA; put updates to its FTA with New Zealand into effect; and announced negotiations to update its trade agreement with ASEAN.

China is not standing still. The Indo-Pacific region is not standing still. Through the IPEF, the United States has an important opportunity to help shape the economic future of the Indo-Pacific. It's time to roll out the IPEF and make it become front and center in the regional economic conversation.

OPENING STATEMENT OF TIMOTHY MEYER, PROFESSOR OF LAW, VANDERBILT UNIVERSITY

DR. MEYER: Yes, thank you, Commissioners, for the invitation to appear today. I'd like to talk to you about the role of distributional considerations as well as the importance of conditioning U.S. trade policy on adherence to shared values.

So the United States has always conditioned its trade policy on the adherence to U.S. values and U.S. global objectives. During the 20th Century when the United States built the GATT, the conditionality was to a large extent dictated by the geopolitical circumstances. The Cold War basically defined trading blocks and who would be in and who would be out, and so it obviated the need to some extent to address some of these issues explicitly through trade policy because trade policy was in a sense subservient to a larger foreign policy.

To some extent this continued in the post-Cold War era. A lot of U.S. free trade agreements in the early part of the 21st Century were done with allies in the War on Terror and so were in that sense also part and parcel of foreign policy objectives. But to a large extent I think trade policy has become unmoored from these kinds of considerations, both U.S. foreign policy considerations as well as considerations of distributional concerns, environmental considerations, and the like.

So what I want to suggest today is that although the challenges have to some extent changed, the idea that U.S. trade policy in the Indo-Pacific region specifically and globally should incorporate important U.S. values is not something new, but is something that we need to take seriously and rethink.

The global trade architecture, the project of trade liberalization has delivered enormous benefits, both in the United States and globally. I think it has been probably the most successful human rights regime globally, the project of trade liberalization, but at the same time the integrity of the system requires us to take seriously the incorporation of values and to condition market access that we grant on adherence to those values.

And so I just want to briefly highlight three areas in which I think the United States needs to be thoughtful in the Indo-Pacific region, specifically as to how it approaches the incorporation of those values of the U.S. trade policy.

So the first is distributional issues. The United States has historically tended to focus on equity issues in trade policy by focusing on equity issues in our - with our trading partners rather than within our - the United States itself.

So NAFTA of course incorporated trade environment provisions for the first time by side agreements. Over time those provisions have been strengthened in iterative U.S. agreements that have been brought into the core of the agreement. They've become subject to dispute resolution.

Ultimately USMCA has strengthened those provisions. But those provisions have focused on labor and environment standards within our trading partners and have really to - have really not responded to distributional issues that have arisen within the United States. And it's time for U.S. trade policy to more directly - and by that, I mean U.S. trade agreement as well as IPEF and other sort of foreign-facing aspects of trade policy - to take seriously the distributional aspects of trade policy within the United States.

I'll just offer a couple of reasons for this: Perhaps the most significant which - and TPP and the ultimate U.S. withdrawal from TPP is perhaps evidence of this, is that without taking those distributional issues seriously it's not possible for the United States to make credible commitments to our trading partners in any forum, whether that's joining - rejoining CPTPP or

making other kinds of commitments. So it's critical to address those distributional issues at home and to align them properly with our trade liberalization commitments.

So our trade liberalization commitments heretofore have been indefinite. And they're implemented by the Executive Branch. And so once they are concluded, they just sort of proceed more or less on their own and the United States has then proceeded to negotiate the next trade agreement.

Meanwhile, our domestic programs: Trade Adjustment Assistance, have first of all generally been inadequately funded and inadequately designed, but they also equally importantly have not been tied to our trade agreements in a way that has caused them to lapse or suffer from reduced funding when there's not an opportunity to negotiate adjustment policies at the same time as liberalization policies.

So the first point I want to make is that we need to align how we think about our trade, our foreign-facing trade policy with our domestic trade policy.

The second thing I want to highlight is just the need to incorporate in particular some of the major global challenges we face. I'll focus just now - although I'm happy to talk about others, I'll focus just now on the environment. The Biden administration has moved forward with the global arrangement on sustainable steel and aluminum. This is in the first instance an arrangement with the European Union, but the administration contemplates expanding it. And in its deal with Japan to resolve the controversy over the 232 tariffs, the Japanese have sort of agreed to keep an open mind on joining it. Ambassador Tai has indicated that the United States would be looking for other countries to join in this partnership.

And the global arrangement I think on a sectoral basis offers a model in which the United States is going to be able to learn both how to do trade policy that upholds in this case our values of protecting the climate in a way that also facilitates our commitment to market-oriented approaches to trade and in a sense offers essentially a demonstration project for how we can expand to additional sectors of the economy, in particular in the Indo-Pacific region.

The third area I'll just highlight briefly; and I'll leave this for questions, is just supply chains. It is just critically important that the United States adopt a foreign-facing trade policy that monitors and creates transparency as to the risks to supply chains and then actively seeks to encourage the distribution of supply chains in a way that's going to promote supply chain resilience. And I'm happy to talk more about that in a Q & A. Thank you very much.

PREPARED STATEMENT OF TIMOTHY MEYER, PROFESSOR OF LAW, VANDERBILT UNIVERSITY

Testimony Before the U.S.-China Economic and Security Review Commission

Hearing on Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators

April 14, 2021

Timothy Meyer
Professor of Law and Director, International Legal Studies
Vanderbilt University Law School

Members of the Commission, it is a privilege to testify at this hearing on how the United States should respond to China's trade practices. U.S. engagement in the Indo-Pacific region is a critical component of promoting U.S. interests both at home and abroad. I want to organize my remarks around three priorities: 1) better aligning trade agreements with the interests of U.S. workers, farmers, and communities at home; 2) conditioning access to U.S. markets on adherence to shared values, including through sectoral agreements that set out specific standards for trade in key products, as well as targeted non-market economy clauses in trade agreements and similar instruments; and 3) promoting supply chain resilience and integrity.

Aligning trade agreements with the interests of all U.S. workers

The United States has long led the world in incorporating key values, such as labor and environmental protection, into trade agreements. The so-called labor and environment side agreements on which the United States insisted before the original North American Free Trade Agreement (NAFTA) entered into force were the first efforts to tie trade liberalization to protection of labor and the environment. Since 1994, the United States has consistently pushed to expand those protections by making them enforceable and subject to dispute resolution, tying the standards to which our trading partners must adhere to multilateral standards, and innovating in the kinds of response mechanisms that the United States can use to enforce theses standards.

But for all of the United States' innovation and leadership in this area, the resulting trade agreements have focused on improving conditions within U.S. trading partners, not within the United States itself. Domestically, efforts to protect workers, farmers, and communities that are adversely impacted by the trade liberalization commitments in U.S. trade agreements are confined to time-limited statutes. The primary example is the Trade Adjustment Assistance program, which reverted to a much narrow program on July 1, 2021 when Congress allowed its then-current form to lapse.

The result is a misalignment between the United States' trade liberalization commitments and its domestic adjustment assistance programs.[1] U.S. trade liberalization commitments have

[1] Much of this analysis is drawn from Timothy Meyer, *Misaligned Lawmaking*, 73 VANDERBILT LAW REVIEW 151 (2020).

historically been enshrined in international agreements, of indefinite duration, and committed to the executive branch for implementation. Adjustment assistance, by contrast, can be found only in domestic statutes, have limited and defined durations, and require periodic reauthorization in Congress. This misalignment has created a situation in which our domestic adjustment assistance programs typically lapse when new trade agreements are not on the agenda. Table 1 below shows how trade adjustment assistance fortunes are tied to whether new trade agreements are on the table.

TABLE 1: REAUTHORIZING TAA WITH AND WITHOUT TRADE LIBERALIZATION

Year	Bill Title	Length of TAA Extension	Negotiating Authority or Trade Agreement Approved?
1962	Trade Expansion Act, P.L. No. 87-794	Indefinite	Kennedy Round of GATT negotiations
1974	Trade Act of 1974, P.L. No. 93-618	8 years	Tokyo Round of GATT negotiations
1981	Omnibus Budget Reconciliation Act of 1981, P.L. No. 97-35	1 year	No
1983	A bill to Amend the International Coffee Agreement Act, P.L. No. 98-120	2 years	No
1984	Deficit Reduction Act of 1984, P.L. No. 98-369	10 weeks	No
1985	Emergency Extension Act of 1985, P.L. No. 99-107	5 weeks	No
Lapses from December 19, 1985 to March 1986			
1986	Consolidated Omnibus Budget Reconciliation Act of 1985, P.L. No. 99-272	6 years	No
1988	Omnibus Trade & Competitiveness Act, P.L. No. 100-418	2 years	Uruguay Round & NAFTA negotiations
1993	Omnibus Budget Reconciliation Act of 1993, P.L. No. 103-66	5 years	NAFTA approval
1998	District of Columbia Appropriations	9 months	No
1999	Consolidated Appropriations Act of 2000, P.L. No. 106-113	27 months	No
Lapses September 30, 2001 to August 6, 2002			
2002	Trade Act of 2002, P.L. No. 107-210	5 years	11 agreements
2007	TAA Extension Act, P.L. No. 110-89	3 months	No
Lapses December 31 2007 to Feb 17, 2009			
2008	Consolidated Appropriations Act of 2008, P.L. No. 110-161	1 year	No
2009	Consolidated Security, Disaster Assistance, and Continuing Appropriations Act of 2009, P.L. No. 110-329	2 months	No
2009	American Recovery & Reinvestment Act of 2009, P.L. No. 111-5	2 years	No
2010	Omnibus Trade Act of 2010, P.L. No. 111-344	13 months	No
2011	TAA Extension Act of 2011, P.L. No. 112-40	34 months	Done in connection with legislation implementing FTAs with Colombia, Panama, and South Korea

2015	TAA Reauthorization Act of 2015, P.L. No. 114-27	6 years	Trans-Pacific Partnership negotiations, USMCA
2021	Heightened eligibility and benefits lapse		No

If the dislocations that result from new trade agreements were temporary, this misalignment would not be problematic. Unfortunately, we know now that these dislocations are not temporary. Work on the "China shock" has demonstrated clearly that communities adversely impacted by trade liberalization have felt the effects for over a decade after China joined the World Trade Organization (WTO).[2] Moreover, China has continued to create new disruptions in U.S. labor markets through what are now well-understood mechanisms. China did not simply begin exporting products that it produced at the time of its WTO accession in 2001. Rather, with massive state support, China has aggressively entered new sectors, meaning that the disruptions from Chinese market access have roiled sectors of the economy—such as renewable energy technology and manufacturing—that were inconsequential in size at the time China joined the WTO.

The ongoing disruptions to the U.S. labor market, and the difficulty innovative U.S. businesses face in competing with massive state subsidies from China, make it imperative that the United States address the misalignment between our trade liberalization commitments and our adjustment assistance policies. There are a number of ways in which this can be done.

The Trans-Pacific Partnership (TPP) contained (and its successor agreements, the CPTPP, contains) a Development Chapter. That chapter "acknowledge[s] the importance of development in promoting inclusive economic growth, as well as the instrumental role that trade and investment can play in contributing to economic development and prosperity. Inclusive economic growth includes a more broad-based distribution of the benefits of economic growth through the expansion of business and industry, the creation of jobs, and the alleviation of poverty."[3] The United States should expand this Development Chapter in any future trade agreements and/or as a component of the Indo-Pacific Economic Framework (IPEF).

The components of a revised Development Chapter and the associated implementing legislation would be two-fold. First, member states would commit to monitoring the distributional impacts of their trade agreements within their own borders on a regional, community, gender, and (as appropriate) racial and ethnic basis. The U.S. International Trade Commission has already begun a study of the distributional impacts of U.S. trade policy within the United States—a first of its kind.[4] But this sort of monitoring should be regularized, occurring on a periodic basis with its results updated. Second, members states should, at a

[2] David H. Autor, David Dorn, & Gordon H. Hanson, *The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade*, NBER Working Paper 21906 (2016).
[3] TPP art. 23.1.2.
[4] U.S International Trade Commission, Notice of Investigation, *Distributional Effects of Trade and Trade Policy on U.S. Workers*, Inv. No. 332-587, https://www.usitc.gov/secretary/fed_reg_notices/332/332_587_notice_11242021sgl.pdf.

minimum, report and publicize the policies that they implement to address the distributional impacts identified through the monitoring process. Such reporting could be done to a Development Committee, the creation of which TPP already provided, and the results made available publicly within each member state.[5] These obligations should be enforceable in the same manner as the core obligations within the agreement, including through the suspension of concessions.

In implementing these commitments domestically, the United States should focus on developing community-based measures, rather than only measures that assist individuals.[6] The costs of economic dislocation extend beyond the individuals who lose their jobs to their families, children, and communities that lose the multiplying effect of a thriving economic base. Adjustment assistance policies should target the full scope of these harms by, for example, investing in primary, secondary, and post-secondary education in impacted communities and giving impacted communities priority in receiving federal funds for policies such as infrastructure projects.

A Development Chapter and associated implementing legislation would align the United States' trade liberalization commitments with its domestic commitments to help workers, farmers, and communities adversely impacted by trade. Other approaches are, however, possible to achieve the same end. An alternative approach, building on the United States-Mexico-Canada Agreement (USMCA) would be to embed sunset clauses in trade agreements.[7] Such clauses, if used, should be structured similarly to the USMCA clause, which creates an elaborate mechanism that ensures that member states have the opportunity to extend the agreement well in advance of its expiration, thus providing both certainty to the market as well as guaranteeing that the renewal decision can be made without an approaching cliff's edge.

Sunset clauses in trade agreements would provide the opportunity for Congress to renegotiate trade liberalization and adjustment assistance on the same timeline. Designed correctly, the government could use the opportunity to consider whether to renew a trade agreement to also consider whether and how to update adjustment assistance policies. Congress could even tie adjustment assistance more directly to trade agreements by mandating that the decision to renew a trade agreement automatically renews adjustment assistance at the same level enacted at the trade agreement's inception.

Addressing these distributional considerations in trade agreements would give the United States a powerful platform to address other trade-related considerations. Citizens cannot reasonably be expected to continue to support a policy of trade liberalization if that policy consistently works to the detriment of a segment of the population. The policy of trade liberalization has been an incredible driver of economic growth, both in the United States and abroad. The opening of U.S. markets helped rebuild Europe and Japan after World War II, has

[5] TPP art. 23.7.
[6] Timothy Meyer, *Trade Adjustment for a Worker-Centric Trade Policy,* AMERICAN LEADERSHIP INITIATIVE (2021).
[7] *See* USMCA art. 34.7.

lifted millions out of poverty worldwide, and in so doing has been one of the most important human rights policies the United States has ever adopted. But a democratic society cannot ask its citizens to support their own economic demise, or that of their fellows, in the name of the general welfare. Without broad-based domestic political support for trade agreements, the United States loses one of the major tools in its foreign policy tool kit. Yet the reality is that many Americans feel that trade agreements have not served their interests. More tightly aligning trade agreements with the interests of all Americans will allow the U.S. government to both vindicate its commitment to American workers, farmers, and communities while also giving it the policy space to use trade agreements to advance U.S. interests abroad.

Conditioning market access on adhering to shared values

The development of the Indo-Pacific Economic Framework also offers the United States the opportunity to make clear that access to U.S. markets depends on adhering to shared values. The incorporation of labor and environmental provisions in U.S. trade agreements has been a positive first step in this direction but new tools are necessary given the scale of contemporary challenges to responsible, sustainable economic growth, as well as international peace and security.

Responsible, Sustainable Economic Growth

The U.S.-E.U. Global Arrangement on Steel and Aluminum Excess Capacity and Carbon Intensity (Global Arrangement) offers a model for how concerns about state intervention in the market and climate change concerns can be addressed simultaneously through cooperation outside of the traditional, full-blown trade agreements.[8] As relevant here, the Global Arrangement contains two components.[9] First, it calls for the participating states to develop joint rules that restrict market access for non-participants that do not meet market orientation conditions and contribute to non-market excess capacity; restrict market access for non-participants that do not meet standards for low-carbon intensity; and to ensure that the participants take domestic actions to reduce carbon intensity in production.[10] Second, it creates a framework for cooperation among the participants in monitoring and enforcing efforts to address excess capacity.[11]

In effect, the Global Arrangement would operate as a club of like-minded nations working together to address the linked problems of decarbonization and overcapacity.[12] Steel and

[8] Joint US-EU Statement on Trade in Steel and Aluminum (Oct. 31, 2021), https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/october/joint-us-eu-statement-trade-steel-and-aluminum.
[9] Additionally, the Global Arrangement has resulted in the United States removing the 25% and 10% tariffs on steel and aluminum and the EU removing its retaliatory tariffs and suspending its related WTO disputes.
[10] Steel & Aluminum, U.S.-EU Joint Statement (Oct. 31, 2021), https://ustr.gov/sites/default/files/files/Statements/US-EU%20Joint%20Deal%20Statement.pdf.
[11] *Id*.
[12] For more on how this club might work, *see* Todd N. Tucker & Timothy Meyer, *A Green Steel Deal: Toward Pro-Jobs, Pro-Climate Transatlantic Cooperation on Carbon Border Measures* (June 3, 2021),

aluminum are among the most carbon-intensive products to manufacture, with some estimates suggesting that the steel sector alone could consume 50% of the available carbon budget necessary to remain under the 1.5 degree warming target that nations identified in the Paris Agreement.[13] Moreover, overcapacity in the sector is driven principally by coal-fired production in Asia generally and China specifically.[14]

Although at present only an arrangement between the United States and the EU, the Arrangement contemplates the participation of additional nations. Expansion into the Indo-Pacific in particular would be hugely valuable. In addition to China, Japan, India, and South Korea are all among the top ten steel producing nations in the world.[15] Because participants will pursue domestic decarbonization measures, broader participation in the Global Arrangement promises to pay greater dividends in terms of decarbonization and reducing market interventions. Indeed, the United States and Japan have already reached an arrangement similar to that the United States reached with the EU.[16]

At the same time, greater participation among steel and aluminum importing nations is crucial to the Global Arrangement's twin goals of decarbonization and reducing excess capacity. Taking steel as an example again, many of the largest producers are also among the largest importers (e.g., China, South Korea). But a number of countries in the Indo-Pacific—Vietnam, Thailand, Indonesia—are not among the top producers but are among the top importers.[17] Because participants will impose market access restrictions on imports from non-participants that do not adhere to the Global Arrangement's standards, broader participation promises to reduce overseas market access for steel that runs afoul of decarbonization and market-oriented production standards.

The Global Arrangement's structure—liberalized trade among participants and market access restrictions on imports from non-participants that do not adhere to the Global Arrangement's standards—is a familiar and highly successful model in international law. The Montreal Protocol on Substances that Deplete the Ozone Layer is generally regarded as one of the most, if not the single most, successful international environmental treaty ever reached. Because ozone depleting substances are also greenhouse gases, it is also the most effective climate change

https://rooseveltinstitute.org/publications/a-green-steel-deal-towards-pro-jobs-pro-climate-trans-atlantic-cooperation-on-carbon-border-measure/.

[13] Thomas Koch Blank, *The Disruptive Potential of Green Steel* (2019), https://rmi.org/insight/the-disruptive-potential-of-green-steel/.

[14] Mihir Vora & Mahan Wu, *Southeast Asia's steel surge: how will the region manage overcapacity?* WOOD MACKENZIE (MAY 11, 2021), HTTPS://WWW.WOODMAC.COM/NEWS/OPINION/SOUTHEAST-ASIAS-STEEL-SURGE-HOW-WILL-THE-REGION-MANAGE-OVERCAPACITY/.

[15] World Steel Association, Total Production of Crude Steel, 2021, https://worldsteel.org/steel-by-topic/statistics/annual-production-steel-data/P1_crude_steel_total_pub/CHN/IND.

[16] *A Proclamation on Adjusting Imports of Steel into the United States* (March 31, 2022), https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/31/a-proclamation-on-adjusting-imports-of-steel-into-the-united-states-2/.

[17] Statista, World leading steel importers in 2020, by country, https://www.statista.com/statistics/650538/leading-steel-importers-globally-sorted-by-country/.

agreement ever reached. The Montreal Protocol requires to adopt domestic controls on ozone-depleting substances and ban trade of those substances with non-parties.[18] The controls and the trade measures had two effects. Business rapidly innovated, developing replacements for ozone-depleting substances, while nations rushed to join the Protocol in order to avoid the bar on trade, ultimately leading to universal membership. As President Reagan remarked in 1988, "The Montreal Protocol is a model of cooperation. . . . [It] is the result of extraordinary process of scientific study, negotiations among representatives of the business and environmental communities, and international diplomacy."[19]

The Global Arrangement can also serve as a model for the development of future sector-specific agreements. The negotiation and implementation of standards for assessing decarbonization and market-oriented production can transfer to other sectors of the economy. At the same time, the Global Arrangement can also serve as a proving ground for a more nimble approach to trade, in which nations and the business community come together to address considerations that are unique to specific sectors of the economy.

Promoting Adherence to Shared Values

The Russian invasion of Ukraine has highlighted the fact that large economies tightly entwined with the global trading system may feel free to violate the basic norms of international peace and security, trusting that dependence on their exports may insulate them from a strong response. That conflict has also underscored the need for new tools to address the risks to the global economy posed by nations that do not respect the integrity and sovereignty of their neighbors. Although the war in Ukraine has put the need for these tools in stark relief, in fact the war is just accelerating a trend caused by the creation of discrete trading blocs through regional agreements, such as CPTPP and RCEP, and the increased use of economic coercion by countries like China and Russia.

To address these concerns, the United States should consider two new tools: a divestment authority and a targeted non-market economy clause in any new preferential trade agreements the United States might enter into or in similar instruments that the United States might enter into as part of the Indo-Pacific Economic Framework.

Divestment Authority

Currently, the Committee on Foreign Investment in the United States (CFIUS) has the authority to review inbound foreign investment in the United States and either to block or approve with conditions transactions that pose a threat to the national security of the United States or, if a transaction has not been submitted and approved prior to closing, to order divestment.

[18] Montreal Protocol arts. 2-4.
[19] U.S. Department of State, The Montreal Protocol on Substances that Deplete the Ozone Layer, https://www.state.gov/key-topics-office-of-environmental-quality-and-transboundary-issues/the-montreal-protocol-on-substances-that-deplete-the-ozone-layer/.

Congress should consider legislation that would create a similar kind of divestment authority for outbound U.S. investment.

The divestment authority should consist of a review process for 1) investments 2) by investors subject to the jurisdiction of the United States 3) in designated sectors of the economy 4) within designated countries. On its own motion, an "Overseas Investment Committee (OIC)" (composed of similar membership to CFIUS) would be able to review whether covered investments pose a threat to the United States' national security. In the interest of due process, investors would have the right to present relevant evidence and argument. Upon the recommendation of the OIC, the President would be empowered to order covered investors to divest themselves of covered investments.[20] The President would be empowered to put conditions on the divestment itself (such as time limits for the divestment) or to put conditions on the ability of the investor to maintain the investment.

The divestment authority could also include ex ante review of outbound investment, as the CFIUS process does. In the CFIUS context, ex ante approval insulates investors from ex post action. The divestment authority could mirror this approach or, alternatively, could allow for the reservation of the right to order divestment or impose future conditions in extraordinary circumstances. Such a reservation of the right to order divestment could be wise in the event that circumstances change over the life of an investment.

Were Congress to pass legislation creating such a divestment authority, it should specify by statute the countries and sectors of the economy that are subject to OIC's jurisdiction. It should also specify criteria (for example, designation as a non-market economy pursuant to trade remedies rules or a violation of international peace and security) that would allow the President to designate additional countries or sectors of the economy for coverage. Congress should also consider whether to authorize CFIUS to review or block investment in the United States by an investor (or affiliated entity) not subject to the OIC's jurisdiction that has invested in a sector within a designated country that is subject to a divestment order. By allowing the U.S. government to condition access to U.S.-based investments on adherence to U.S. overseas investment policy, such a measure would reduce the possibility that foreign investors would simply fill the vacuum left by a U.S. divestment order.

Such a divestment tool would ensure that U.S. dollars invested overseas do not undermine U.S. national security by increasing U.S. dependence on foreign countries for critical materials and potentially making it more difficult to take decisive action in the event of a crisis (as the European Union has discovered in the context of its dependence on Russia for energy). The mere existence of a divestment authority would serve as an important signal to nations around the world generally and in the Indo-Pacific region specifically that access to U.S. capital depends on adherence to global standards of conduct. The divestment authority, in other words, would

[20] Covered investments would only include investments by an investor subject to the jurisdiction of the United States into a designated sector in a designated country made after the date on which the sector and country are so designated.

operate as a deterrent to nations that might think that economic integration signals an unwillingness to take a strong stance in defense of the interests of the United States and its allies in the region.

Moreover, a divestment authority has ample precedent. The United States has long had a system of export controls for certain products and technologies. A divestment authority would essentially be an export control for capital. Indeed, under existing authorities, Presidents Trump and Biden blocked investment in Chinese companies known to have ties to the military.[21] President Biden has similarly blocked new investment in the Russian energy sector.[22] And U.S. companies have voluntarily divested themselves of assets in Russia in response to the invasion of Ukraine, suggesting that rapid divestment in response to national security threats is in fact feasible.

Non-Market Economy Clause

USMCA contains a non-market economy clause.[23] In addition to certain notification requirements, the clause allows two parties to USMCA to terminate the agreement and replace it with a bilateral agreement should the other party conclude a trade agreement with a non-market economy. In practice, this clause has minimal significance. Trade agreements usually contain provisions that allow for termination at will after notification. The primary benefit of the USCMA non-market economy clause is that it requires that the two parties that agree to terminate USMCA replace it with a bilateral agreement that contains provisions identical to USMCA, thus obviating the need for a new negotiation.[24] Although this reduction in transaction costs is significant, it still requires that both countries be willing to terminate the agreement with the third party in its entirety. Such an approach is even more unwieldy if extended to an agreement, like CPTPP, that contains more than three parties.

A more effective approach that could be used in any new trade agreements would trigger more targeted measures in the event that a party enters into an agreement with a non-market economy. For instance, a non-market economy clause might automatically tighten the rules of origin for particular products to receive preferential treatment under the agreement in the event the clause is triggered. Tightening the rules of origin would ensure that a country that is party to both an agreement with the United States and with a non-market economy does not become a gateway for products in the non-market economy to make their way into the United States. Similarly, the non-market economy clause could trigger the application of detailed anticircumvention rules designed to achieve the same purpose. Finally, the non-market economy clause could establish a specific safeguards measure that other members could

[21] Executive Order 13959 on Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies (Nov. 12, 2020), as amended by Executive Order on Addressing the Threat from Securities Investments that Finance Certain Companies of the People's Republic of China (June 3, 2021).
[22] Executive Order on Prohibiting Certain Imports and New Investments With Respect to Continued Russian Federation Efforts to Undermine the Sovereignty and Territorial Integrity of Ukraine (March 8, 2022).
[23] USMCA art. 32.10
[24] USMCA art. 32.10.6.

implement unilaterally. Such a measure would allow other countries to unilaterally impose trade restrictions on products the trade in which is distorted by preferential trade with a non-market economy.

These kinds of more targeted measures improve upon the USMCA non-market economy clause. Because they are more targeted, countries are more likely to actually use them. They also address the specific harms caused by being in a preferential trade agreement with a country that is itself in a preferential trade agreement with a non-market economy. Moreover, because they would either be automatic or capable of being unilaterally applied, they would not require all other members to agree on a course of action when the agreement with the non-market economy comes into force.

Promoting supply chain resilience and integrity

Finally, the COVID-19 pandemic has highlighted how the United States is vulnerable to supply shocks from supply chains that are concentrated in particular countries. Ensuring the diversification and resilience of supply chains should thus be a key objective of the Indo-Pacific Economic Framework. The risks posed by supply chain concentration are exacerbated by regional trade agreements, such as CPTPP and RCEP, that have weak rules of origin and thus lead to greater incentive to concentrate supply chains for critical products, such as medical supplies, in particular countries.[25] Instead of creating preferential trade among members, regional agreements with weak rules of origin serve as a backdoor for products from non-market economies to enter into the stream of commerce of the United States and its allies and ultimately disrupt and displace domestic production of critical products in those countries.

The IPEF should thus incorporate a comprehensive effort to address supply resilience in the region. Promoting supply chain resilience involves at least three steps. First, the United States should use the IPEF as a platform to develop robust monitoring and transparency mechanisms that apply to supply chains for critical products.[26] COVID-19 exposed the fact that neither U.S. industry nor the U.S. government has a detailed understanding of how critical products and materials are sourced. We cannot make supply chains resilient to the kinds of shocks they have faced in recent years if we do not understand how supply work. Domestically, reorganizing government agencies to facilitate such monitoring should be a priority.[27] A single agency should be in charge of monitoring and addressing, as described below, supply chain risks.

Second, the United States should pay close attention to the rules of origin associated with any new market access commitments it makes, and it should encourage U.S. allies that are party to

[25] Beth Balzan, *What is the Purpose of an FTA*?, AM. PHX. TRADE ADVISORY SERV. (Mar. 31, 2020), http://americanphoenixpllc.com/what-is-the-purpose-of-an-fta.
[26] Matthew P. Goodman & William Alan Reinsch, *Filling in the Indo-Pacific Economic Framework*, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES (JANUARY 2022), HTTPS://WWW.CSIS.ORG/ANALYSIS/FILLING-INDO-PACIFIC-ECONOMIC-FRAMEWORK.
[27] *See* Timothy Meyer & Ganesh Sitaraman, *It's Economic Strategy, Stupid*, III AMERICAN AFFAIRS 1 (SPRING 2019), HTTPS://AMERICANAFFAIRSJOURNAL.ORG/2019/02/ITS-ECONOMIC-STRATEGY-STUPID/.

regional trade agreements such as CPTPP to tighten up the rules of origin in their agreements. Doing so will provide an incentive for supply chain diversification by providing an incentive—via preferential trading terms—for supply chains to develop within regional trade agreements. Absent strong rules of origin for critical products, importers located in regional trading agreements may simply rely on the same concentrated supply chains that lie outside the regional trade agreement, exacerbating, rather than reducing, dependence on a few countries and producers.

Third, the United States should actively invest in not only reshoring, but "third shoring" supply chains for critical products and materials. In some cases, this may involve offering financial incentives for companies to build in redundancies into their supply chains. These redundancies may seem inefficient judged from the perspective of just-in-time supply chains but create substantial welfare gains in times of crisis and disruption by providing backup capacity for critical products. In other cases, developing robust supply chains may involve investing in infrastructure projects designed to ensure a diversified supply of critical materials can reach global markets. Investing in roads, airports, and the like can thus improve supply chain resilience while at the same time countering the influence of countries like China that have invested aggressively in such projects in the developing world.

Conclusion

In the second half of the twentieth century, global trade was one of the most powerful forces for promoting human flourishing, peace, and security. These goals of the trading system are the same today. But the challenges of the twenty-first century have changed. Our trading tools need to change as well. A successful strategy for the Indo-Pacific region, and a successful response to China's non-market economy approach to economic development, is one that builds for support at home for a global trade policy that is sensitive to distributional considerations, and that also seeks to actively manage the threats posed by models of economic development that seek to undermine the values of the liberal international order that the United States has built over the last eighty years.

OPENING STATEMENT OF LORI WALLACH, DIRECTOR OF RETHINK TRADE, AMERICAN ECONOMIC LIBERTIES PROJECT

COMMISSIONER WESSEL: Thank you.

Ms. Wallach?

MS. WALLACH: Okay. That is on.

Co-chairs Wessel and Cleveland, thank you very much and to all the Commissioners for inviting me to testify today.

There certainly has been a dramatic shift in U.S. public policy maker and even press perceptions with respect to U.S.-China trade since I sat in this room during the China PNTR debate in 2000.

Since then workers and communities across the country have suffered the loss of 70,000 U.S. manufacturing facilities and have seen the jobs that once supported middle class lives lost, as well as the tax basis that supported their communities. Other Americans experienced through the stress test of COVID-19 that we no longer can make in this large powerful country essential goods that we need in a crisis, nor get them in a resilient and ready way. Others have focused on the national security implications of this hollowing out of our economy. Under any circumstances this has left us more vulnerable and weaker and overly dependent on hollow, weak, long supply chains, particularly with respect to being very over-reliant on China.

My documentation of these claims of the damage - I urge you to look at my written testimony and particularly a lot of data that we prepared for the ITC's review on supply chains a year ago, which are available also on tradewatch.org, that document the concentration of production starting in 1999 and decade by decade showing the concentration with respect to China, but also the shift towards imports and lack of U.S. capacity.

My written testimony is long and I will summarize four main points: First, agreements like the Trans-Pacific Partnership, which was ever-so-slightly modified to become the CPTPP, are exactly the model that's gotten us into this mess in the first instance. The United States definitely should not consider joining the CPTPP, but rather needs to create a new model. And in fact it's perverse in a way to think about the CPTPP as a way to deal with our China concerns, which are very real because in many of the specific provisions of that agreement there are enormous benefits for China.

For instance, under the CPTPP a car can enter the U.S. duty-free were we a member despite it having 55 percent Chinese content, it having 45 percent Vietnamese content, and China not being a member of said agreement. Chinese state-owned enterprises and foreign direct-invested firms as well as People's Liberation Army firms could get a waiver of Buy American procurement policies and get into the U.S. enormous procurement policy - procurement markets as well as having investor state dispute resolution rights over the U.S. Government and skirt our courts to attack our domestic laws.

In addition, the arguments made with respect to foreign policy about getting into the TPP are identical to those that were made about China PNTR and have been disproved. And I urge the Commissioners to look at the annex in my testimony to look at 12 pages of side-by-side almost word-for-word promises of what would happen with PNTR, why we needed to get in, and then the same words for TPP, but the evidence of what really happened.

No. 2, the premises and provisions of the TPP approach need to be altogether replaced

with rules designed to promote, not to undermine explicit goals. And it is a hopeful moment we've arrived at where U.S. trade policy is increasingly being considered on the basis of goals first, rules second, as compared to just repeating the same rules over and over, as has happened for generations, decades, on a bipartisan basis. The goals that we need to seek are those that include: employment and good wages, resilient supply chains, domestic economic security and infrastructure strength, our climate's challenges, public health, and other goals.

Rebuilding U.S. economic security is going to require new trade rules, but also domestic changes. What clearly cannot be the case is shifting from over-reliance on China to over-reliance on say Vietnam is not going to solve our problem. We need domestic capacity and we need to diversify our import sources.

No. 3, we need to overcome what is a push to try and resell the same old, same old as new. And in my testimony, I describe both the threat of the current digital trade rules, which do not deal with the real problems of mass imports of goods purchased online being delivered in small packages, of which 2 million daily are arriving from China by Air Express under the current De Minimis Program, uninspected, skirting the ban on Uyghur forced labor and numerous other U.S. programs and policies. That's a real e-commerce digital trade problem.

In contrast, these agreements effectively are designed to put handcuffs on domestic policy makers with respect to gig economy workers rules that conflict with the anti-monopoly pro-competition policies of the Biden administration with respect to the big tech monopolists. They undermine privacy. The undermine security of data. These agreements are another stalking horse of special interest agendas being pushed as if it were pro-trade.

Similarly, I would love to have the opportunity to discuss the RCEP, which is much more of a brand than a trade agreement. I actually brought the index of it and went through all of the chapters that are not enforceable and what is in them, but the core changes rule of origin. It's an agreement on trade only, and not mainly agriculture trade, covered at all among countries that already have duty-free amongst themselves.

And then finally, thinking forward with respect to the IPEF, the process should be guided by four key principles: Those principles are: (1) There must be goals then rules focusing on the goals I've enumerated. (2) Our values and our standards must be the basis. This is a new model of trade agreements. We will have to lead on this. (3) We must pick the right partners. The IPEF neighborhood would not necessarily be the most friendly for this agenda, but it is the one for other reasons that we face. And finally, a transparent and inclusive process. Thank you very much.

PREPARED STATEMENT OF LORI WALLACH, DIRECTOR OF RETHINK TRADE, AMERICAN ECONOMIC LIBERTIES PROJECT

Lori Wallach
Director, Rethink Trade
American Economic Liberties Project, Washington D.C.
Testimony before the U.S.-China Economic and Security Review Commission
Hearing on "U.S. trade policy and impact of China's distortions on U.S. jobs, growth, and innovation"
April 14, 2022

Thank you for the opportunity to testify today. The Commission is performing a vital service by elevating public attention to challenges that have a direct impact on the lives of every American. Some experience the problem as consumers facing shortages of key goods and/or price spikes, including the shock of the United States being unable to make or get critical goods needed to keep their families safe and well during the peak of the COVID crisis. Some experience the problem as workers in communities across the country facing the absence of 70,000 manufacturing facilities that once supported middle-class lives for the large portion of working Americans who do not have college degrees as well as supporting the tax base for communities 'schools, public safety services, hospitals and more. Others focus on the hollowing out of U.S. production capacity and the weakening of U.S. economic resilience as a national security threat.

All of these perspectives are based on specific outcomes that are undeniably linked to policies and practices that have left the United States largely dependent on other countries in general and overly reliant on China in particular for access to the most essential goods. Decades of hyperglobalization as implemented by a particular model of trade agreements and trade policies have undermined our independence and resilience, as all Americans were forced to recognize during the peak of the COVID-19 crisis. With our economy organized to serve a production model focused almost exclusively on "efficiency" and reliant on long, brittle global supply chains and production of many goods in too few countries – often by too few firms after decades of global consolidation – today even the world's wealthiest countries find themselves vulnerable to untenable risks.

My testimony focuses on five main points:

1. **We have more than ample evidence that the hyperglobalization implemented by past U.S. "free trade" agreements, the World Trade Organization (WTO) and various U.S. trade and foreign investment policies during the last three decades have not delivered the promised gains but rather hollowed out U.S. manufacturing capacity and the related innovation it fostered, cost millions of well-paying jobs, subjected Americans to the perils of brittle, unreliable supply chains for even the most essential goods and weakened our national security.** The "stress test" of the COVID-19 pandemic has made most Americans, not only those who lost their jobs to the past U.S. trade model, aware of the untenable economic, public health and security vulnerabilities this model poses.

2. **Agreements like the Trans-Pacific Partnership (TPP), which was ever-so-slightly modified via suspension of a few provisions and renamed the Comprehensive Progress TPP (CPTPP), represent the failed model that has gotten us into this mess.** In numerous ways, TPP rules of origin (ROO), investment, procurement and other terms, among others, would greatly benefit

China without China joining. Given that and the improbability China would agree to various CPTPP terms, its request to join seems designed as clever geopolitical trolling rather than sincere accession interest.

3. **The premises and provisions of the TPP approach must be altogether replaced with rules designed to promote, not undermine, employment, resilient supply chain, domestic economic security and infrastructure, climate, public health and other goals**. Rebuilding U.S. economic security and resilient supply chains will require both rebuilding domestic production and diversifying the sourcing of our imports. Simply moving from overreliance on China to overreliance on Vietnam or other distant and low-wage countries is not a solution. And, to meet these goals in a manner that is consistent with the pro-worker, pro-equity, pro-community well-being goals of President Biden's worker-centered trade policy, we must also consider the rules and standards that will elevate workers' rights to organize and their wages, communities' health and the environmental incentives needed to save us all from the ravages of climate chaos. This will require truly creative thinking, with regional supply chains based on common values one part of the solution as well as changes to not only trade and investment, but U.S. procurement, tax, and other policies.

4. **Instead, the special interests that pushed the TPP and continue to flack for the old model are trying to rebrand and rename the old approach of locking in terms in "trade pacts" that further special interest agendas often unrelated to trade while promoting trade under terms that further weaken U.S. production capacity, drive down wages and undermine critical environmental protections.** This includes pushing for "digital trade" initiatives that promote job offshoring, undermine labor rights and consumer protections, and contradict the Biden administration anti-monopoly and pro-civil rights agendas. Another feature of this effort is fear mongering about the completion of the Regional Comprehensive Economic Partnership (RCEP) as if it were a threat to U.S. economic interests led by China versus an Association of Southeast Asian Nations (ASEAN)-led largely symbolic ROO-simplifying project limited largely to trade in goods (although not key agricultural goods) among countries that almost all already had duty-free trade among themselves. And the usual special interests and their allies are recycling the same arguments – from "either we write the rules or China does" to geopolitical claims to trade-flow arguments – that they have been using for decades and have proved to be entirely wrong.

5. **The TPP's lessons of how not to organize international commercial rules, a focus on goals first and rules second and a transparent and inclusive process will be essential if the prospective Indo-Pacific Economic Framework (IPEF) talks are to be successful.**

Critics of the past model of hyperglobalization and its implementing agreements warned in advance of the inherent, structural problems that have caused our current mess. The special interests that reaped windfall profits from the old model and the think tanks and policymakers that they fund promised us the old model would make us safer and richer and do the same for any and all countries involved. And today, as the evidence from several decades disproves those claims, they continue to try to repackage the same-old, same-old policies that benefit the few under new branding and names and the same claims of broad wonders for all. The Commission is doing a public service in exploring what has not worked and how we can replace the failed model with new policies explicitly designed to deliver resilient supply chains, support good jobs and wages, and enhance our economic and national security.

I. We have more than ample evidence that the hyperglobalization implemented by past U.S. "free trade" agreements, the WTO and various U.S. trade and foreign investment policies during the last three decades have not delivered the promised gains but rather hollowed out U.S. manufacturing capacity, cost millions of well-paying jobs, subjected Americans to the perils of brittle, unreliable supply chains for essential goods and weakened our national security.

The current regime of hyperglobalization, fueled by decades of corporate-rigged trade policies, has encouraged corporations to move production overseas in a never-ending race to exploit the cheapest labor and lowest environmental standards and to concentrate production with too few companies producing in too few locations. The mass outsourcing of U.S. industrial capacity and loss of 70,000 U.S. manufacturing facilities since the mid-1990s and the intensive global concentration of production with little redundancy in many sectors now leaves the United States unable to make or reliably acquire critical medicines, medical goods and personal protective equipment that we needed to combat a pandemic; microchips needed to produce a multiplicity of goods on which we all rely daily from autos to communications equipment; particular grades and shapes of steel and other materials needed for our national infrastructure and national security and even replacement parts for weapons systems.

How did this happen? For decades, our economy and the rules of the global economy have been organized to serve a production model focused almost exclusively on "efficiency" and reliant on long, brittle global supply chains and production of many goods in too few countries. Hundreds of corporate representatives who serve as official U.S. trade advisors pushed for trade and tax terms that rewarded relocating production overseas. Corporate-rigged trade rules and investment policies such as foreign investor protections and their investor-state dispute settlement enforcement made it easier and less risky to move production overseas to pay workers less. A lack of disciplines against currency misalignments undermined domestic firms trying to compete with imports. The lack of competition policy enforcement thanks to the misguided "consumer welfare" standard facilitated a merger mania that resulted in the elimination of "redundant" production facilities as a few dominant firms in key sectors sought to maximize "efficiency" by relying on thin, globalized supply chains with final production concentrated in a few locations.

The result is that the United States is extremely reliant on other countries to provide essential goods, a reality underscored by the United States maintaining the world's largest trade deficit year after year. Overreliance on imports, with increasingly some critical goods now mainly made in one or two countries, poses fundamental risks. When workers in a country on which much of the world is relying for critical goods fall ill, governments prioritize their own peoples 'needs before exporting goods away or goods or transportation systems get snarled, a worldwide shortage can quickly develop. Starting in early 2020, the United States experienced this critical supply chain vulnerability with respect to masks, gloves, medicine, and other goods necessary to combat COVID-19 and now the world is focused on shortages in microchips, which is reducing automobile production and more.

In the face of such shortages, the hyperglobalized production model makes it difficult to quickly increase production elsewhere. Long, thin globalized supply chains mean there often are not redundant sources for inputs, parts, and components needed to scale up domestic production during a crisis. And, with respect to pandemic-related goods, such as medicine, ventilators and more, monopoly patent protections in many trade agreements expose countries to trade sanctions if they produce without approval and licensing by and payment to pharmaceutical and other firms.

As production of key parts and assembly of goods in diverse sectors has become both geographically concentrated and concentrated in fewer companies, when production in a key country, region or company is disrupted – whether by illness in the current instance or natural disaster, war or other calamity – world supplies are affected. Experts have warned about the perils of hyperglobalized supply chains for years. As Barry Lynn's 2005 book "End of the Line" warned:

> "In September 1999, an earthquake devastated much of Taiwan, toppling buildings, knocking out electricity, and killing 2,500 people. Within days, factories as far away as California and Texas began to close. Cut off from their supplies of semiconductor chips, companies like Dell and Hewlett-Packard began to shutter assembly lines and send workers home. A disaster that only a decade earlier would have been mainly local in nature almost cascaded into a grave global crisis. The quake, in an instant, illustrated just how closely connected the world had become and just how radically different are the risks we all now face."[1]

The COVID-19 crisis forced people throughout the United States to recognize a problem previously mainly experienced by those in venues hurt by outsourcing and trade-related job loss: The United States no longer can make many basic goods it needs.

Fall 2020 written testimony[2] to the U.S. International Trade Commission on "COVID-19 Related Goods: The U.S. Industry, Market, Trade, and Supply Chain Challenges" that I submitted on behalf of Public Citizen and recommend the Commission staff review provides:

1. Updated data showing that the U.S. has grown even more dependent on imports from China and the rest of the world for key medical goods during the COVID-19 era as the U.S.-China and U.S.-world deficits in key medical goods increased.

2. Historical data showing the export countries of U.S. imports of critical COVID-19 response goods to demonstrate how the sources of critical goods have substantially shrunk over the last decades.

3. New information about the countries from which the United States imports medicines in 2019 that shows deep U.S. reliance on China and India for many categories of medicines.

Public Citizen's analysis of this data shows why the United States must both increase domestic production and diversify import sources for critical goods in order to better manage what will be an ongoing COVID-19 crisis for some time, and also be better prepared for the next crisis, health, climate-related or otherwise. The COVID-19 crisis has awakened people to the reality that under the current hyperglobalization regime, their governments do not have the means to protect the public interest. The mantra of just-in-time global supply chains maximizing efficiency has crashed into the reality that many governments and people now see: Obsession with efficiency has undermined resilience, reliable access, and public health. As most people understand, in addressing these problems, the choice is not between autarky and hyperglobalization. Rather, changes to trade, investment, procurement, tax, and other policies must be made to ensure that we both have more domestic production capacity for goods we deem essential for public health and security and that we diversify import sources so that if domestic production or that in one country or region is knocked offline, people can still be assured of reliable supplies of critical goods.

II. Agreements like the TPP, which was ever-so-slightly modified via suspension of a few provisions and renamed the CPTPP, represent the failed model that has gotten us into this mess. In numerous ways, TPP rules of origin, investment, procurement and other terms, among others, would greatly benefit China without China joining. Given that and the improbability China would agree to various CPTPP terms, its request to join seems designed as clever geopolitical trolling rather than sincere accession interest.

Especially after policymakers and the public have become unavoidably aware of the extreme vulnerabilities created by the trade agreements of the past decades, it is astonishing that any pine for the TPP, which was the apotheosis of the old model. And at least one of the main arguments these interests used to make in favor of the TPP – that it would "contain" or isolate China – has been sidelined by China's 2021 claim of interest in joining the pact even if most observers consider that prospect remote given China has opposed key CPTPP terms in the context of other agreements and negotiations. Indeed, to date neither Malaysia nor Chile have ratified the CPTPP, which contains almost all of the most extreme terms of the TPP.

Perversely, the few U.S. policymakers and advocates who do mourn the U.S. absence from TPP invariably argue the United States would have been better positioned in our economic and geopolitical competition with China as a TPP member. Yet, in many ways, the TPP rules favored China without China having to join and make any reciprocal commitments. Are those who argue otherwise uninformed about the TPP's actual terms, which were carried into the CPTPP? Or are they cynically making such claims knowing the truth?

For instance, the TPP's rules of origin provided products with up to 65% Chinese content duty-free access to the United States. One such category was auto parts. Thus, under TPP rules, an auto part could have had 65% Chinese content and 35% Vietnamese content and qualify for duty-free entry into the United States. The TPP ROO for automobiles would have allowed a vehicle to have 45% of its value made in Vietnam and 55% in China, and the car would qualify for special TPP duty-free entry into the United States. Because of the actual terms that U.S. negotiators agreed, these benefits accrued for China despite China not being a TPP member.

The TPP also would have granted Buy American procurement preferences to all firms operating in TPP countries, which includes numerous Chinese State Owned Enterprises (SOE) and firms controlled by Chinese sovereign wealth funds. Under the TPP, instead of reinvesting our tax dollars at home to build domestic production capacity, spur manufacturing innovation, and create jobs at home, the TPP would have required the United States to provide Chinese government-owned and -controlled firms as well as Chinese "private sector" firms operating in Vietnam, Singapore, Malaysia and other TPP nations equal access to U.S. government contracts as provided to U.S. firms. This would have occurred on a one-way basis, with China owing no reciprocal access to firms from TPP countries.

As well, the TPP's foreign investor rights would have enhanced China's relative economic might *within* the United States. That is because the TPP granted expansive foreign investor protections to subsidiaries of Chinese firms operating in any TPP country with respect to rights to own and control land, companies and an unlimited array of other assets and property in the United States. The TPP's Investor-State Dispute Settlement (ISDS) regime would have granted new rights to these TPP subsidiaries of Chinese SOEs and other Chinese firms with TPP subsidiaries and U.S. investments to sue the U.S. government before a panel of three corporate lawyers. Under TPP rules, the lawyers would have been empowered to award the corporations unlimited sums to be paid by America's

taxpayers, including for the loss of expected future profits. These Chinese corporations need only have convinced the lawyers that a U.S. law or safety regulation violated their TPP rights. These TPP tribunals' decisions were not subject to appeal and the amount that could be awarded had no limit.

Despite the many ways that the actual pact benefitted Chinese firms, investors and the Chinese government, various commercial interests and Obama administration officials consistently made foreign policy claims in favor of the pact. First, trying to paint the TPP as a way for America to write the rules in Asia *so that China does not* is absurd. TPP was never about establishing "American" rules in Asia. It was about imposing rules that would hurt most Americans, but were favored by the 500 official U.S. corporate trade advisors that helped to shape the TPP. And, as the Annex to this testimony shows, with side-by-side charts of claims about TPP that are almost word-for-word identical to claims about granting China Permanent Normal Trade Relations that can be tested against the actual outcomes, the standard arguments have proven false. The same claims were also trotted out to promote a flagging NAFTA and then later Free Trade Agreements.

While U.S. concerns about the implications of China's rising economic power and influence are legitimate, the notion that the establishment – or not – of any specific U.S. trade agreement would control this process is contradicted by the record. For instance, we were warned that unless NAFTA and free trade deals with eight Latin American nations were enacted, China would write the rules and grab our trade in the hemisphere. NAFTA went into effect and in its first 20 years, the U.S. share of goods imported to Mexico dropped from 70% to under 50%, while China's share rose more than 2,600%. After U.S. pacts with eight other Latin American nations were enacted, China's exports to Latin America soared more than 1,280%, from $10.5 billion to more than $145 billion, while the U.S. saw only modest export growth. The U.S. share of Latin America's imported goods fell 36%, while China's share increased 575%.

Moreover, the notion that the TPP would somehow empower Pacific allies to act as a bulwark against Chinese influence was absurd, as are similar claims with respect to the Indo-Pacific Economic Framework enhancing U.S. influence in the region. Many of the TPP nations see China as a critical partner. Indeed, officials from Australia, New Zealand and Malaysia openly stated that if TPP were to become a China-containment project, they would no longer participate in negotiations. For instance, in February 2012, New Zealand Trade Minister Tim Groser stated: "The moment we smelt or sensed that this was an anti-China thing, we'd leave the TPP." Similar sentiments have been expressed about IPEF, even as that project is described for domestic consumption as a counter-China initiative.

Yet the same "national security" arguments are now being forwarded for IPEF that were also made to push the TPP despite being proved false by actual outcomes after they were used to pressure Congress to pass China PNTR. Instead of improving our situation, our national security was significantly weakened by China PNTR, says retired U.S. Brigadier General John Adams. He notes that we are now dependent on countries like China because manufacturing of critical inputs needed for U.S. military weapons systems and vehicles has been offshored there.

The official U.S. ITC study projected that the TPP would further worsen the balance of trade for 36 out of the 55 U.S. agriculture, manufacturing, and services sectors that the ITC selected to feature. This included vehicles, wheat, corn, auto parts, titanium downstream products, chemicals, seafood, textiles and apparel, rice and even financial services. Auto parts would be hard hit with employment losses projected. The ITC estimated that the TPP would have increased the overall U.S. global trade deficit and that even the U.S. services trade balance would have declined as service imports of $7 billion swamped the estimated increase in exports of $4.8 billion and that five of nine U.S. service

sectors would have seen declines. The ITC projected a $24 billion dollar increase in the manufacturing trade deficit and a decline in output for U.S. manufacturing/natural resources/energy of $10.8 billion as exports would increase by $15.2 billion and imports would increase by $39.2 billion by 2032.

Meanwhile, the ITC projected tiny U.S. economic growth gains (42.7 billion or 0.15%) and income gains ($57.3 billion or 0.23%) by 2032. In other words, the ITC projected that the United States would be as wealthy on January 1, 2032 with TPP as it would be on February 15, 2032 without the TPP. The ITC's negative projections were especially notable, as the agency has been wildly optimistic in its past trade-pact projections with actual outcomes contrasting with projections not only in degree but in direction.

III. The premises and provisions of the TPP approach must be altogether replaced with rules designed to promote, not undermine, employment, resilient supply chain, domestic economic security and infrastructure, climate, public health and other goals. Rebuilding U.S. economic security and resilient supply chains will require both rebuilding domestic production and diversifying the sourcing of our imports. Simply moving from overreliance on China to over-reliance on Vietnam or other distant and low-wage countries is not a solution. And, to meet these goals in a manner that is consistent with the pro-worker, pro-equity, pro-community well-being goals of President Biden's Worker-Centered Trade Policy, we must also consider the rules and standards that will elevate workers' rights to organize and their wages, communities' health and the environmental incentives needed to save us all from the ravages of climate chaos. This will require truly creative thinking, with regional supply chains based on common values one part of the solution as well as changes to not only trade and investment, but U.S. procurement, tax, and other policies.

Rebuilding U.S. economic security, manufacturing and resilient supply chains will require the use of all of the tools available, from taxation to government procurement to trade to the "industrial policy" mechanisms employed by Germany and other nations relating to government investment in research, training, and incentivizing development of local supply chains. Two existing, underutilized domestic policy tools can be – and could have previously been - improved and harnessed quickly to promote greater domestic demand. First is tightening Buy American and other domestic procurement criteria for all U.S. government agencies. Second, and related, is the use of the Defense Production Act for the federal government to issue multi-year contracts to produce significant volumes of essential goods with contracts made with multiple firms per good so as to incentivize investment in equipment and hiring, in a way that invests in creating domestic competitors in sector now dominated by imports.

With respect to domestic procurement preferences, today, "Buy American" really means that goods and firms from 60 countries[3] obtain the same access to U.S. federal government contracts as U.S. goods and firms. That massive loophole is opened via domestic regulations that implement terms in U.S. trade agreements that undermine domestic procurement preferences.[4] The relevant statute does not require a president to waive domestic preferences for trade-pact partners, but authorizes discretion to do so and also explicitly authorizes presidents to alter the waiver list.[5] The Trade Agreements Act (TAA) Buy American Act (BAA) waivers should be reversed, which can be achieved by executive action, and the underlying terms in trade pacts renegotiated. In such renegotiation, the U.S. states[6] that are also forbidden to apply preferences for domestic firms must also be freed from obligations that result in the outsourcing of tax revenues, rather than their reinvestment in building domestic capacity.

Even without taking those steps, massive leakage in the Buy American preference program can be remedied. The U.S. government has discretion with respect to how it implements the trade-agreement waiver. Today, all procurements above a set threshold, which is now $182,000 for goods under WTO rules, evade domestic content rules! This is not required in the WTO agreements or the U.S. implementing legislation for the pact. It is agency discretion that now results in a "substantial transformation" rule of origin being applied, instead of requiring a set percentage of domestic content. Today the domestic content requirement is a meagre 55%, but the Biden administration just issued a new, more stringent standard to be phased in over the next few years. Yet, that improvement will be meaningless unless this practice is changed. Otherwise, as long as some assembly or other processing occurs in a TAA-waiver country that transforms a good, it qualifies for Buy American privileges regardless of it not in any way meeting the improved U.S. domestic content standard. The current way the policy is enforced, goods valued above the threshold price can source inputs from anywhere, including China and other countries not on the TAA waiver list, assemble in U.S. territory or in another of the 60 nations and compete on equal terms with high U.S.-content goods. *Stunningly, U.S. end products also are excluded from meeting the 55% domestic content component test*. That means for procurements above the $182,000 for goods for the WTO's GPA, a product assembled in the United States of 100% foreign content is considered a U.S. end product. Given many, many contracts are above $182,000, zero domestic content rules will apply unless this practice is ended.

Another eviscerating loophole is the commercially available off-the-shelf (COTS) waiver of domestic content rules. This allows firms to import tens of billions in components and parts, perform basic assembly operations and sell goods to the federal government as "domestic end products" with BAA preferences. What is considered COTS now includes military systems and aircraft, not the copier paper and paperclips one might imagine. Additionally, we support the setting of an across-the-board standard and stringent reviews by the new Buy American office with respect to "public interest" waivers, which are another exception to the Buy American requirement that boils down to a price differential standard. Currently, some agencies only apply a 6% price preference for domestic goods.

Perhaps if our only goal is cost efficiency, these exceptions-that-gut-the-rule practices made sense. But in the context of the COVID-19 experience, and the growing national interest in rebuilding our own supply chains, clearly there is a greater value in reliable supply. Finally, even if the notion of offshoring our tax dollars in exchange for opportunities for individual U.S. firms to have better access to contracts from other nations was a good one, the way it is done in trade pacts is a losing proposition for the United States. A recent GAO report found that the United States opened twice as much procurement to foreign firms as the next five largest AGP signatories *combined* (European Union, Japan, South Korea, Norway and Canada).[7]

With respect to creating and maintaining more diverse import sources, the trade flow data following the termination of the General Agreement on Tariffs and Trade Multi Fibre Arrangement in the 1990s has made clear simply offering lower tariffs will not maintain geographically diverse supply chains. Even as textiles and apparel from China, Vietnam and other nations faced tariffs in accessing the U.S. and other markets, as the quota regime that managed worldwide market distribution phased out, an enormous share of production concentrated in those nations. Caribbean, Central American, African and Andean nations having duty-free access into the United States for such goods under various preference programs and trade pacts did not counteract the rapid loss of production capacity in those nations and the concentration of production in China and a few other nations. Given this was the case in the context of a sector with relatively high Most Favored Nation tariffs, there is little prospect that,

absent some sort of managed trade regime guaranteeing market access for more countries or creating regional mechanisms, production of essential goods will become more geographically dispersed.

Finally, with respect to creating a more reliable supply of pharmaceuticals and Active Pharmaceutical Ingredients (API), a significant problem is the lack of merger and competition policy and a lack of mandatory reporting by producers on the sources of API and how many facilities they have making finished medicines and APIs. The lack of information about API sources or the sources of finished medicine production is stunning. The closest proximation is information on the geographic location of production facilities that the FDA has inspected, yet that data provides no insight into the volume or types of medicines or API being produced. And, with so many finished medicines being produced overseas, it is unclear that all API or finished medicines are even coming from FDA approved facilities. This is a longstanding problem on which the pandemic has shone a spotlight.

A decade before the COVID-19 crisis, the National Institutes of Health was already reporting growing shortages of commonly used medicines.[8] The Food and Drug Administration was reporting shortages in more than 100 essential drugs at the end of 2019, well before COVID-19 hit.[8] When workers in China, India and Italy became ill with COVID-19 and factories shut down, worldwide shortages escalated quickly as China produces both a large amount of finished drugs and API, India produces many generic medicines sold worldwide and Italy produces a significant share of antibiotics – even as the exact amounts remain highly contested with the best informed sources suggesting most API and finished drugs are coming from China and India and others contesting this conclusion. As reported in the New York Times:" Out of 21 antibiotics that would be critical for treating secondary infections in COVID-19 patients, 18 antibiotics have greater than 80% of their supply coming out of either China, India or Italy — all places that have had production disruptions," said University of Minnesota's College of Pharmacy professor Stephen Schondelmeyer, whose work with the Resilient Drug Supply Project involves trying to map supply chains for key medicines used in the United States.[9]

Part of the issue is that pharmaceutical firms have engaged in a merger mania,[10] which has now also hit the generic sector,[10] such that relatively few large firms dominate many categories of medicines. In the course of rolling up the competition, they shut down the production capacity of the firms they acquired. Also in the name of efficiency, many do not produce more than previous years' sales show will be used. Thus, when health crises emerge, there are no stockpiles in drugmakers' warehouses nor capacity to quickly gear up larger volumes of medicines. This problem extends beyond trade pact rules, such as their patent terms, that could limit countries' abilities to quickly produce key medicines.

IV. The special interests that pushed the TPP and continue to flack for the old model are trying to rebrand and rename the old approach of locking in terms in "trade pacts" that further special interest agenda often unrelated to trade while promoting trade under terms that further weaken U.S. production capacity drive down wages and undermine critical environmental protections. This includes pushing for "digital trade" initiatives that promote job offshoring, undermine labor rights and consumer protections, and contradict the Biden administration anti-monopoly and pro-civil rights agendas. Another feature of this effort is fear mongering about the completion of the Regional Comprehensive Economic Partnership as if it were a threat to U.S. economic interests led by China versus an ASEAN-led largely symbolic ROO-simplifying project limited largely to trade in goods (although not key agricultural goods) among countries that almost all already had duty-free trade among themselves. And the usual special interests and their allies are recycling the same arguments – from "either we write the

rules or China does" to geopolitical claims to trade-flow arguments – that they have been using for decades and have proved to be entirely wrong.

The January 2022 entry into force of the RCEP brought another round of commentary about how China was moving on "its" regional pact, the biggest trade deal ever. The implication was that the United States was being left on the sidelines. Yet, the RCEP is mainly a brand, rather than a meaningful trade agreement and it certainly is not an economic threat. And RCEP is not "China writing the rules." RCEP is not a Chinese initiative, but rather came from the Association of Southeast Asian Nations (ASEAN) bloc, which includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam. The RCEP final text, which connects the ten ASEAN nations with Australia, China, Japan, New Zealand, and South Korea, is based on ASEAN terms.

Amidst all the hype about the pact covering 30% of the global economy and 30% of the global population and being the biggest trade pact ever, there has been little attention to the pact's limited terms or impact.

To start with, all of the countries involved already had free trade agreements among themselves except for China-Korea-Japan. India started RCEP negotiations, but withdrew. India's exit is one reason the pact is projected to have little effect on the global or U.S. economy. Optimistic projections are for 2/100s of a percent in growth gains over the twenty years during which the pact's Japan-China-Korea tariff cuts go into effect.

And, unlike the TPP, a deal that had 30 chapters with only six actually focused on trade, the RCEP is about trade, although with limits. RCEP's actual trade terms are limited in that it does not cover all goods or zero out tariffs on the goods it covers. It also excludes key agricultural goods.

RCEP does not include the controversial Investor-State Dispute Settlement (ISDS) regime. RCEP does not set uniform product standards. RCEP does not have a procurement chapter. RCEP does not address state-owned enterprises. Its terms on intellectual property restate existing WTO terms while its rules on "digital trade" provide broad exceptions to allow countries to set their own domestic policies. RCEP's coverage of the service sector is not comprehensive.

Meanwhile, Indo-Pacific Economic Framework negotiations are being discussed with Biden administration officials seeking participation from various countries. The same interests that pushed the TPP hope the IPEF process might lead to the establishment of what they call "digital trade" rules as the tip of the spear to continue the old model of limiting domestic policy space via trade pact.

As the public and policymakers have become increasingly aware of the threats posed by the mega-platforms to the principle and practice of democracy and a fair and sustainable economy and livelihoods worldwide, governments worldwide have begun to develop digital governance policies. As a counter strategy, Big Tech lobbyists are simultaneously operating in numerous "trade" fora to try to quietly lock in enforceable constraints on nations' efforts to establish digital policy rules that ensure labor rights for gig economy workers, protect privacy and other rights online, break up Big Tech firms or otherwise counter the mega-platforms' expansive power over our societies and economies.

Effectively, by misbranding an attack against the very notion of digital governance as "e-commerce" or "digital trade" policy, Big Tech interests seek to quietly excavate the digital governance policy space out from under Congress and various U.S. agencies and the governments of countries

worldwide. Initiatives labeled as "digital trade" form a stealthy new front in the *ongoing power struggle* between a relatively few major digital mega-platforms and the rest of us. The IPEF must not become a platform to contradict the Biden administration's July 2019 Executive Order on Competition nor its worker-centered trade policy. At issue is whether Big Tech interests can hijack the IPEF process to gut existing and stop future domestic policies that constrain digital entities' monopolistic size or anti-competitive market power, that protect privacy and individual rights over personal data, that fight algorithm discrimination, that hold platforms liable for dangerous products and violent incitement, and that protect gig workers' labor rights and safety. The "digital trade" rules now being pushed by Big Tech threaten many of these goals.

While Biden administration officials have said that the IPEF will not include market access, they have not been explicit in confirming whether that means no service sector market access terms. It is critical that is also excluded from the negotiations. Terms in the WTO-proximate Joint Statement Initiative on E-Commerce exploit service sector market access to promote further consolidation of corporate power and protect Big Tech monopolies by banning domestic policies that limit size or services offered by one entity or that require break-ups. As corporations exert increasing control over important social functions, governments must be able to combat anti-competitive practices, place limits upon corporate mergers and break up monopolies where warranted. But terms being pushed by tech firms include provisions that Wall Street firms inserted into past trade pacts that forbid countries from establishing or maintaining policies that limit an entity's size, limit the range of services offered by an entity, limit the legal structures under which they may be required to operate, or otherwise restrict the regulation of or break-up of monopolies. These terms have nothing to do with trade: While being labeled as "market access guarantees" in past trade pact texts, these terms really are anti anti-trust measures.

IPEF must also exclude the sorts of "digital trade" rules found in several past pacts that hurt working people by designating gig workers 'labor rights and other public interest safeguards to be illegal trade barriers that must be eliminated. The "digital trade" framework that was included in the TPP reinforces the Original Sin of the "digital economy." That is the notion that leading players in transportation, hospitality, retail, education, healthcare, logistics and other industries that provide services online are something altogether different than their brick-and-mortar counterparts and are excluded from domestic policies that generally apply to protect the rights of workers and consumers. Thus, the "digital trade" rules that Big Tech seeks characterize as illegal "trade barriers" requirements that large ride-sharing companies meet driver hours-of-service-rules or contribute to drivers social security, or requirements that buildings of short stay guest units booked online must meet worker and consumer safety rules. One trick is to use trade terminology and concepts, such as "non-discrimination." A common provision forbids domestic digital policies that may have a "discriminatory impact." That captures neutral policies that have a bigger impact on firms with dominant market positions. An example is the Korean law to end anti-competitive App Store practices, which is similar to U.S. House and Senate proposals with bipartisan support. Apple and Google pushed USTR to attack the law as "discriminatory" because it will affect them more based on their past monopoly practices. (Thankfully USTR did not do so.) Similarly, labor and other policies are characterized as forbidden limits on "market access" if the right to operate is conditioned on meeting such laws. This is not a hypothetical problem. Already, Uber has used trade-pact rules to try to escape registration as a transportation company in Colombia and compliance with applicable rules.

IPEF cannot include rules Big Tech interests seek to hide the discriminatory effect of source code and algorithms through "trade secrets" protections and thwart investigations of intrusive surveillance practices and violent incitement online. Governments increasingly are turning to private corporations

for aid with "predictive policing" and other surveillance, law enforcement and security functions. And, every-day decisions made by artificial intelligence components of online platforms affect which individuals and communities access public and private services ranging from home loans to job postings to medical treatments – a sort of high-tech redlining. Making governments guarantee trade secrets-plus protection for code and algorithms would limit governments to accessing such information only to instances of *known* violations of law. Investigators, congressional committees and scholars would be barred from reviewing code or related data to identify racist, sexist and other discriminatory practices deserving of scrutiny, criticism and correction. And some of the few pacts with "digital trade" rules have required governments to enact liability shields for online entities that allow them to evade responsibility for discriminatory conduct, online racial incitement, and other civil rights violations.

IPEF must not undermine consumer privacy and data security by prohibiting limits on data flows or location of computing facilities. Peoples 'every move on the internet and via cell phone is increasingly tracked, stored, bought and sold — as are interactions with the growing "internet of things." Many people may not even be aware nor may they have a feasible way to opt out. Trade pacts should not restrict governments from acting on the public's behalf in establishing rules regarding under what conditions individuals 'personal data may be collected, where it can be processed or transmitted, and how or where it is stored. Yet provisions that guarantee the platforms "free flow" of data without constraint with respect to where data is processed, stored or transmitted are a core aspect of the Big Tech "digital trade" platform. In contrast, the RECP includes broad exceptions that allow signatory countries to condition how data is handled to meet privacy and other interests.

IPEF must not shield Big Tech firms from corporate accountability via imposing content liability waivers. How to address the ways in which certain online business practices, algorithms and moderation stoke racial and ethnic violence and contribute to other anti-social behavior is a hotly debated topic. While solutions may not yet be widely agreed upon, what is absolutely true is that this rapidly evolving area of public policy must not be restrained via trade agreements. Further, policies such as Section 230 of the Communications Decency Act, which was created to protect free speech online, have been stretched to allow massive corporations to evade liability for dangerous and deadly goods sold online. Using trade pacts to require countries to enact policies that insulate online sale platforms from product liability is unacceptable. Yet even as the U.S. Congress grapples with whether Section 230 should be altered and how, U.S. trade negotiators have worked to export the policy by obliging other countries to provide liability shields to online entities.

Annex:
Foreign Policy Arguments Made for China PNTR Recycled for TPP and Now Being Raised With Respect to the IPEF Versus Outcomes

The demise of the TPP was decried as a *foreign policy* disaster by its backers both at the time and to this day. This is especially notable because for years the agreement was sold as an *economic* panacea. But by the summer of 2016, it became increasingly apparent that the economic case for the final TPP deal had proved unconvincing. Months of intensive White House and corporate lobbying had failed to build majority support in Congress. So, the TPP's proponents shifted to foreign policy arguments to try to scare up the votes, a tactic that has been systematically employed in past contentious trade fights. They argued then, when Donald Trump's declaration that he would not proceed with U.S. approval of the TPP[11] formally buried the moldering deal, and today the thinned ranks of TPP defenders still argue that failure to implement the TPP:

- allows China to write the rules for commerce in Asia instead of spreading U.S. values across the Pacific;
- hurts U.S. national security, and
- undermines U.S. global leadership and strengthens China.

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If many of these arguments sound familiar, it's because they are. For two decades of U.S. trade debates, the same zombie foreign policy and national security justifications have been repeatedly resurrected, in nearly identical verbiage. The tables below compare quotes by prominent supporters of past trade deals with more recent quotes about the TPP and review the outcomes of old claims. The prospect that an agreement may not be implemented has been routinely characterized as benefitting our adversaries – such as China. Passing an agreement is declared to be essential to maintaining U.S. leadership in the world, to exporting "American values" to other countries, and to improving human rights everywhere.

These arguments helped to pass some trade agreements. So we can study whether those previous pacts 'enactment did, in fact, deliver these promised benefits. When Congress debated granting Permanent Normal Trade Relations to China to facilitate its admission to the World Trade Organization, proponents claimed doing so would be a foreign policy cure-all. It would moderate China's authoritarian government, improve human and labor rights, and enhance China's cooperation on an array of national security challenges while also ensuring new access to Chinese markets that would create U.S. jobs. The actual result was just the opposite, and the argument became known as "The China Fantasy."[12] Various U.S. trade pacts with Latin American were also sold as necessary to keep China (or Japan) from dominating the region politically and economically, and as vital to improving democracy and human rights in trade partner countries. Yet the very foreign policy (and economic) threats that the deals 'passage was promised to forestall occurred regardless, while the touted improvements in human rights failed to materialize.

Managing the U.S. relationship with a rising China is a real challenge, but the TPP and similar trade deals have never been the right tool for securing America's future.

NATIONAL SECURITY CLAIM: ***Approval of China PNTR/the TPP goes beyond economics. It is essential for national security and promoting strategic interests beyond trade.***

China PNTR	TPP
…I am strongly in favor of granting permanent normal trade relations to China... doing so would be very much in the U.S. national interest. This, in my judgment, goes far beyond American business and economic interests, as important as these are, to key U.S. political and security interests. –National Security Advisor Brent Scowcroft, April 2000	TPP would also lower barriers to American goods and services in the Asia-Pacific's fastest growing markets. But TPP also makes strong strategic sense... in terms of our rebalance in the broadest sense, passing TPP is as important to me as another aircraft carrier. –Defense Secretary Ash Carter, April 2015
China has the capacity to hinder or help us to advance our interests on a broad range of issues, including: nonproliferation, open markets and free trade, environmental protection, the promotion of human rights and democratic freedoms, counter-terrorism, counter-narcotics, Asian economic recovery, peace on the Korean peninsula and ultimately peace and stability in the Asia-Pacific region. It is only by engaging with China on all of these issues that we will make positive progress on any and thereby advance those interests and our security. –Senator John Kerry, Sept. 2000	[T]he strategic case for TPP is not just crystal clear. It could not be more vital to the national security interests and the long-term strategic goals of the United States of America... counterterrorism, nonproliferation, climate change, cyber security, protection of the ocean environment, sustainable fishery practices, maritime security, human trafficking, just to mention some of the most prominent... Simply put, TPP is a key way to gauge American engagement in the Asia Pacific... with TPP, we will be far better positioned to enhance our national security and to protect our interests... –Secretary of State John Kerry, Sept. 2016
[M]y support for permanent normal trade relations with China is based not just on an assessment of the economic benefits to the U.S., not just on the prospects for political reform in China, but also on the impact on our national security….We need to cooperate with China to rein in North Korea's nuclear missile ambitions, to prevent a destabilizing nuclear arms race in South Asia, and to combat the threats of international terrorism and narcotics trafficking. We cannot work effectively with China in these areas if we are treating them as an enemy in our trade relations. –Senator Joe Biden, Sept. 2000	T.P.P. would strengthen stability and security by deepening our relationships throughout the region and raising the bar to entry to protect the things that matter. This includes enhanced cybersecurity, privacy and intellectual property protections. T.P.P.'s provisions to combat the theft of trade secrets, including by cyber theft, and protects our defense industrial base. And obviously, our partners who've signed up for T.P.P. see it as a vital demonstration of America's enduring commitment to the region. –Admiral Harry B Harris, commander of U.S. Pacific Command, Sept. 2016

Fifteen years later, when the TPP claims were made in 2016, the national security arguments used to push China PNTR passage did not hold up to scrutiny. China's aggression toward its East Asian neighbors has increased: China has escalated territorial disputes with the Philippines in the South China Sea and with Japan in the East China Sea. Beijing is pressing claims to ownership of 90 percent

of the South China Sea.[13] Through environmentally harmful dredging and filling operations, China has turned rocks and coral outcroppings into artificial islands with landing strips capable of handling military aircraft. The Permanent Court of Arbitration at The Hague ruled in July that there is no basis for China's land claims. China has refused to comply with the finding.[14] The disputed territory is included in all Chinese maps and since 2012 is embossed on passports issued to the country's citizens.[15]

Regardless of U.S. entreaties, China remained focused on its own interest in avoiding a flood of North Korean refugees into China rather than in pressuring the regime to shut down the North's nuclear weapons industry. Then-U.S. Defense Secretary Ashton Carter argued that, "It's China's responsibility ... China has and shares an important responsibility for this development and has an important responsibility to reverse it. And so it's important that it (China) use its location, its history and its influence to further the denuclearization of the Korean peninsula."[16] But Gary Samore, then-President Obama's former White House coordinator for arms control and weapons of mass destruction, noted that, "What's remarkable is how consistent U.S. policy has been over last three presidents, and how consistently it has failed ... We are really limited in what we can do as long as China has fundamentally different national interests."[17]

Indeed, U.S. national security has been weakened by China PNTR, according to U.S. Brigadier General (ret.) John Adams. He notes that many components needed for U.S. military weapons systems and vehicles are now manufactured in foreign nations, including China, after trade deals altered production patterns. The U.S. military is "shockingly vulnerable to major disruptions in the supply chain, including from substandard manufacturing practices, natural disasters, and price gouging by foreign nations. Poor manufacturing practices in offshore factories lead to problem-plagued products, and foreign producers – acting on the basis of their own military or economic interests – can sharply raise prices or reduce or stop sales to the United States."[18] After PNTR took effect in 2000, China quickly became a major supplier of U.S. arms and ammunition. Chinese exports of weaponry to the United States increased from $15 million to $183 million from 2000 to 2015, making China the sixth largest U.S. supplier.[19]

Moreover, the notion that a refusal to implement the TPP indicates that the United States is neglecting the Asia-Pacific region is deemed absurd by many China hands. Clyde Prestowitz, President Reagan's Asia trade negotiator, notes that the United States has never neglected or left the Asia Pacific region, nor will it. "The Seventh Fleet has been patrolling the waters of East and Southeast Asia since World War II, and America has had at least 100,000 troops based in Asia for just as long," says Prestowitz. "And, trade deals or not, America had enormous, chronic trade deficits with most countries in the region, guaranteeing economic and political engagement for decades to come. If the combination of the American military presence and their trade surpluses with the United States weren't enough to mollify Asian leaders, no free trade deal would significantly change the situation."[20] And the priority focus on defense matters by Japanese Prime Minister Shinzo Abe in his post-election meeting with Trump – the Seventh Fleet and U.S. troops in Asia providing defense for U.S. allies – reinforces that key countries in the TPP rely upon U.S. leadership in the region regardless of the TPP's demise.

AMERICA'S RULES CLAIM: ***By implementing China PNTR/the TPP, America will write the rules. Failure to do so will allow China to write the rules.***

China PNTR	TPP
This agreement forces China to adhere to our rules-based trading system. –U.S. Representative Rodney Frelinghuysen, May 2000	America should write the rules. America should call the shots. Other countries should play by the rules that America and our partners set, and not the other way around. That's what the TPP gives us the power to do. – President Barack Obama, May 2016
... at the end of the day the way in which to move China toward Western norms and Western values is not to repudiate China, it is to bring it into a rules-based system. –U.S. Trade Representative (USTR) Charlene Barshefsky, May 2000	U.S. leadership in writing the rules of the road for trade in the Asia-Pacific region is critical. After all, this isn't everyone's approach to trade. Other countries, such as China, are already moving forward with deals that don't reflect our interests and our values. –USTR Michael Froman, Nov. 2015
Over the last half-century, the United States has been the driving force behind successive rounds of multilateral trade negotiations... The United States must continue to lead the open trading system... –Committee for Economic Development, July 2000	If we don't establish strong rules, norms for how trade and commerce are conducted in the Asia Pacific region, then China will. –President Barack Obama, Aug. 2016

The Obama administration's inability to win a congressional majority in support of the TPP and then the Trump administration's formal announcement that it would not try to do so was greeted with a chorus of woe about the lost opportunity for the United States to write the rules for trade in the Pacific Rim and how China would call the shots to the detriment of the United States. "TPP is obviously a challenge at this stage. Trade is not going to stop, it will continue. We'll be part of it but we won't be as able to shape the framework to serve our values and our interests. That leaves a vacuum for countries like China and others to fill that is not in our interest," said Obama's National Security Advisor Susan Rice in November.[21] Abandoning the TPP would be "a catastrophic mistake," Charlene Barshefsky, President Bill Clinton's top trade negotiator, told a group of business leaders in early December. "China will fill the vacuum."[22] "There are signs that China will take full advantage of the American shift to press its own trade vision," argued the *New York Times* editorial board.[23]

Similarly, a central argument in support of China PNTR in 2000 was that Congress' approval would ensure that China would adopt the WTO rules that the United States had a prominent role in writing rather than forging its own policies. On the other hand, rejection of PNTR would, as President Clinton claimed, be "a gift to the hard-liners in China's government," who would be empowered to enact policies that would undermine U.S. interests.[24] This argument helped to pass China PNTR. But did China actually conform to "our" rules? If enacted, would the TPP have altered the commercial rules in Asia, especially given that China is the largest trading partner of most of the TPP nations? The post-PNTR reality is that China gamed the WTO rules to benefit its own pre-set interests.

TPP critics similarly predicted that China would have exploited the lax rules of origin in the TPP to circumvent anti-dumping penalty tariffs by shipping components to low-wage Vietnam and Malaysia for final assembly – thus gaining duty-free access to the U.S. market. The TPP also would have allowed access for the many Chinese state-owned enterprises on equal terms to U.S. firms for all U.S. procurement contracts without any reciprocal obligations on China.

Said Robert Cassidy, the principal negotiator on the U.S. side for China's WTO entry: "I have reflected on whether the agreements we negotiated really lived up to our expectations; a sober reflection has led me to conclude that those trade agreements did not."[25] In fact, 15 years after China's entry into the WTO, the U.S. government still considers China a non-market economy, as do the European Union and Japan.[26] Many of the same experts who theorized that PNTR would allow us to set the rules are now saying otherwise: Economist Derek Scissors of the American Enterprise Institute, for example, testified to the House Committee on Foreign Affairs in July 2015 that over the last decade, the Chinese government has made no real progress towards increasing the role of the market in the Chinese economy. Scissors singled out the state's domination of the Chinese financial system – its ability to "without legal or political delay, order the strongest institutions to save the weakest" – as an especially egregious characteristic.[27]

"[T]he only possible conclusion is that China is not a market economy," said Alan Price, chair of Wiley Rein LLP's International Trade Practice. He testified in the winter of 2016 to the U.S.-China Economic and Security Review Commission.[28] A recent report by the Congressional-Executive Commission on China recommended that the U.S. government "should continue to designate China as a non-market economy until the Chinese government makes concrete improvements to policies detailed in this report that violate China's existing international trade obligations."[29]

Those now complaining about China's failure to conform to "our" rules include the very organizations that once so strongly favored China PNTR. Jeremie Waterman, Executive Director for Greater China and Senior Policy Advisor for Asia at the U.S. Chamber of Commerce said in September 2016: "China has the most restrictive investment environment of all G20 economies, according to the OECD [Organization for Economic Cooperation and Development] ... U.S. and other foreign companies have become more concerned about their future in China, perceiving greater challenges to their operations, the business climate, and the fundamental questions about the direction of China's economic reforms."[30]

This view is not a recent development. The National Association of Manufacturers, like the Chamber an ardent PNTR supporter, in a 2010 submission to USTR's Special 301 Committee noted widespread counterfeiting and patent violations: "…member companies report that the problems of IPR [intellectual property rights] theft and enforcement remain rife in China. In spite of continued attention to this issue, most companies report that there has been little change in conditions over the past several years. Authorities at the provincial and municipal levels still are reluctant to take aggressive action to enforce IPR when it involves foreign companies."[31]

Specific commercial sectors that had argued China PNTR would get China to play by our rules have expressed similar criticism. "We, like the USTR, are concerned that China exceeded its [allowable subsidies] for corn, wheat and rice from 2012 to 2015," said Zippy Duvall, President of the American Farm Bureau Federation. "The World Trade Organization's Agreement on Agriculture applies to all members. Each country must follow agreed upon levels of domestic support. Violation of domestic

support levels can lead to overproduction and price-depressing surpluses that affect farmers worldwide."[32]

America's manufacturing sector has also not seen the promised transformation: "China maintains state control over many critical aspects of its economy, including key strategic industries like steel. It is clear that China has not met criteria to be designated a market economy," said Thomas J. Gibson, President and CEO of the American Iron and Steel Institute and co-chairman of the Manufacturers for Trade Enforcement last July.[33]

Like China PNTR, the TPP was increasingly sold as a choice between "our rules" and "their rules" with the TPP standing in as America's rules versus "letting" China set rules that the United States may one day have to obey. President Obama stated this choice explicitly saying, "The TPP means that America will write the rules of the road in the 21st Century."[34]

But the TPP's rules are not "America's rules." The TPP represents the demands and the guidance of 500 official U.S. trade advisors primarily representing corporate interests involved in years of closed-door negotiations while the public, the press and Congress were locked out.[35] Many TPP rules would have undermined U.S. national interests by increasing income inequality here, raising medicine and energy prices, jeopardizing financial stability, and further gutting the U.S. manufacturing base that is essential for our national security and domestic infrastructure.

Two Nobel Prize-winning economists – and supporters of China PNTR, best make the point:

> *I am in general a free trader, but I'll be undismayed and even a bit relieved if the TPP just fades away ... What the TPP would do ... is increase the ability of certain corporations to assert control over intellectual property. Again, think drug patents and movie rights. Is this a good thing from a global point of view? Doubtful. The kind of property rights we're talking about here can alternatively be described as legal monopolies ... Now, the corporations benefiting from enhanced control over intellectual property would often be American. But this doesn't mean that the TPP is in our national interest. What's good for Big Pharma is by no means always good for America.*
>
> –Paul Krugman, February 27, 2014[36]

> *When agreements like the TPP govern international trade – when every country has agreed to similarly minimal regulations – multinational corporations can return to the practices that were common before the Clean Air and Clean Water Acts became law (in 1970 and 1972, respectively) and before the latest financial crisis hit. Corporations everywhere may well agree that getting rid of regulations would be good for corporate profits. Trade negotiators might be persuaded that these trade agreements would be good for trade and corporate profits. But there would be some big losers – namely, the rest of us.*
>
> –Joseph Stiglitz, March 15, 2014[37]

AMERICAN VALUES CLAIM: ***By implementing China PNTR/TPP, American values such as democracy would be exported to other nations and their human and labor rights and environmental protections will be improved.***

China PNTR	TPP
I believe the choice between economic rights and human rights, between economic security and national security, is a false one… I believe [China PNTR] will move China faster and further in the right direction, and certainly will do that more than rejection would. –President Bill Clinton, March 2000	[W]e can't let countries like China write the rules of the global economy. We should write those rules, opening new markets to American products while setting high standards for protecting workers and preserving our environment. –President Barack Obama, Oct. 2015
Bringing China into the WTO and normalizing trade will strengthen those who fight for the environment, for labor standards, for human rights, for the rule of law. –President Bill Clinton, March 2000	In short, these elevated standards can give to people across the Pacific Rim a window into a future of reform and human rights, a smoother and more equitable path to prosperity, an ample reason to build up businesses and communities, and never turn to tearing down their societies and resorting to conflict. –Secretary of State John Kerry, Sept. 2016
By learning to "play by the rules," both internationally and domestically, China will strengthen the rule of law, which will enable it to become a more reliable partner and a fairer society. It can even lay the groundwork for protection of core values in China, such as human rights, religious freedom, workers' rights and environmental protection. –Treasury Secretary Lawrence Summers, May 2000	...when we deepen our trade ties to countries along the Pacific Rim, we become better able to promote essential reforms – reforms that strengthen the rule of law, encourage partners to secure property rights, enforce contracts, fight corruption, and respect the basic dignity of their workers and citizens. –Secretary of State John Kerry, April 2016
Passage of PNTR and China's WTO accession will further open China to American values. –White House press release, May 2000	If, however, we fail to move forward with TPP, Asian economies will almost certainly develop along a China-centric model… Trade is how you export American values in the developing world. –Senate Majority Leader Orrin Hatch, June 2015

Trying to paint the TPP as a way for America to write the rules in Asia *so that China does not* was absurd. The TPP was never about establishing "American" rules in Asia, a fact reinforced by opposition to the deal by the environmental, human rights and labor organizations that promote protections for working people and the planet. Critics of China PNTR raised the same points about the WTO's lack of enforceable rules requiring human rights and other improvements when similar claims were made with respect to China's entry into the WTO.

Since Congress approved China PNTR, human rights violations in China have not declined nor have political freedoms increased. Freedom House still judges China as "Not Free." The Polity IV Project, a widely-used measure of democratic values and achievement, labels China as an autocracy, the same rating given to China in 2000. Human Rights Watch's 2016 World Report found China passed and proposed many new government laws that "conflate peaceful criticism of the state with threats to national security."[38]

The Cingranelli-Richards Human Rights Dataset provides scores for 15 internationally recognized human rights for 202 countries from 1981 to 2011. China has not improved its score among any of the human rights indicators from 2000 to 2011. For example, the Physical Integrity Rights Index ranks countries based on torture, extrajudicial killing, political imprisonment and disappearance indicators. A zero indicates "no government respect for these four rights" and an eight indicates "full government respect for these four rights." China was given a three in 2000, but a zero in 2011.[39]

The Empowerment Rights Index derives from the foreign movement, domestic movement, freedom of speech, freedom of assembly and association, workers 'rights, electoral self- determination, and freedom of religion indicators. A zero indicates "no government respect for these seven rights" and a 14 indicates "full government respect for these seven rights." China was already at a one in 2000, and this has since been lowered to a zero. These diverse human rights indicators show that the situation in China has not improved since China PNTR took effect.[40]

In his book, "The China Fantasy," former *Los Angeles Times* Beijing bureau chief James Mann laments the self-delusion of America's political leaders – who insist that the Chinese government will embrace democracy to please its trading partners:

> Since 1989, virtually every change in U.S. policy toward China has been justified to the American public on the basis that it would help to open up China's political system ... When (the Bush and Clinton) Administrations extended [PNTR] benefits to China, they asserted that the trade would help to open up China. When the Congress voted to support China's entry into the WTO, once again congressional leaders justified their votes as a way of helping to bring political liberalization to China ... Without the claim that trade would open up the Chinese political system, trade legislation would not have been enacted. One can look in vain for American presidents or congressional leaders who said, "It seems as if China's going to remain a deeply repressive country, but let's pass this trade bill anyway."[41]

With respect to the TPP, the words "human rights" do not appear on any of the more than 5,000 pages of the final text. Further, if it had been enacted, the TPP would have eliminated the important policy tools, such as the economic sanctions and selective procurement policies which were used successfully to pressure the apartheid-era government in South Africa to stop human rights abuses.

Among the TPP's signatories are the three notorious human rights abusers: Malaysia, Vietnam, and Brunei. Their inclusion drew Democratic and Republican members of Congress,[42] leading human rights, labor, LGBT, women's and religious organizations[43] into the fight against the TPP. The TPP would have granted Malaysia, one of the world's worst human trafficking offenders, privileged access to the U.S. market. The Obama administration not only allowed Malaysia to stay in the TPP, but removed Malaysia from the State Department's list of worst trafficking violators – even after mass graves for human trafficking victims were discovered.[44]

The TPP also includes Vietnam, despite the government's jailing of political dissidents, systematic anti-union repression and the widespread use of child labor. A group of NGOs including Human Rights Watch and Freedom House co-authored a letter to President Obama in April 2016 condemning Vietnam's inclusion: "Unfortunately, even in light of the agreements it has made as part of the TPP, Vietnam's crackdown on independent voices shows no signs of ceasing. We are particularly disturbed that in the final week of March, Vietnam sentenced seven bloggers and human rights activists to prison terms ranging from seven months to five years."[45] In October, Vietnamese officials arrested blogger Nguyen Ngoc Nhu Quynh on charges of "spreading propaganda against the state," which carries a sentence of up to 12 years in prison. Her "crime"? She wrote a blog post criticizing the Vietnamese government's handling of a foreign investor's toxic chemical spill.[46]

The deal would also forge closer ties between the United States and Brunei, which has enacted a Sharia-based penal code that criminalizes LGBT people and allows punishment for gay people and single mothers by stoning to death.[47] This has provoked LBGT activists to join in the fight against the TPP, as well as evoking consternation from many members of Congress.[48]

AMERICAN LEADERSHIP CLAIM: ***Implementation of China PNTR/TPP is a test of U.S. leadership in the world. Failure to act would cede the U.S. leadership role in the Pacific region to China.***

China PNTR	TPP
All of our Asian friends and allies would view rejection of PNTR as an unnecessary rejection of stable and constructive relations with their largest neighbor; and a turn away from the open, confident vision we have held for the Pacific over the years. –USTR Charlene Barshefsky, April 2000	TPP is seen as a litmus test for U.S. leadership…It's also seen as a demonstration of America's commitment to be a Pacific power. –White House Deputy National Security Advisor Ben Rhodes, Aug. 2016
Voting against PNTR…. Our friends and allies would wonder why, after 30 years of pushing China in the right direction, we turned our backs, now that they finally appear to be willing to take us up on it. –President Bill Clinton, March 2000	If the U.S. abandons TPP, our Asian allies and partners will perceive America as yielding to China, and they will accommodate accordingly. –Robert Zoellick, former USTR, May 2016
The bottom line is that turning down PNTR... hurts our reputation worldwide. We should not be reverting to isolationism at a time when it is more important than ever to show leadership to the world. –CEO of Honeywell International Michael R. Bonsignore, Feb. 2000	Our leadership demands our constant commitment to initiatives that advance our interests and promote our values, including high-standard, innovative proposals like the Trans-Pacific Partnership, or TPP – an agreement that is about boosting our economy at home and deepening our commercial ties in key markets, as well as strengthening our national security and strategic leadership in Asia and across the globe. –Secretary of State John Kerry, Sept. 2016

As you leave West Point, the attitude of China towards our country and our role in the Pacific will be of central importance to our country and to you personally ... [if PNTR fails] we make a very dark statement about the future possibility of a stable, mutually beneficial relationship with the world's largest country. –USTR Charlene Barshefsky, April 2000	I think not moving forward would undermine our position across the region and our ability to shape the rules of global trade in a way that reflects our values and our interests. –President Barack Obama, Nov. 2016

Beyond the damage done by the Obama administration proclaiming endlessly that failure to implement the TPP would undermine U.S. leadership in the region, how precisely might the TPP have enhanced the U.S. role and the TPP's demise undermined it? The examples of China PNTR failing to boost U.S. leadership in Asia are many. When the Obama administration opposed China's proposal to create an Asia Infrastructure Investment Bank to compete with established international development banks, its closest Pacific Rim allies refused to support the United States position. The bank was created in 2015 with Korea, Australia, Britain and Germany joining in over U.S. protests.[49]" We're contemplating a major institution in which the United States has no role, that the United States made substantial efforts to stop – and failed," said former Treasury Secretary Larry Summers.[50] Eswar Prasad, former head of the China desk at the International Monetary Fund (IMF), describes the new bank as "an instrument for China to lend legitimacy to its international forays and to extend its sphere of economic and political influence even while changing the rules of the game."[51] Similarly, U.S. allies in Asia broke with U.S. efforts[52] to stop the IMF from including the China's currency, the yuan, in the IMF's official reserve currency basket in alongside the U.S. dollar, the euro, the Japanese yen and British pound.[53]

While U.S. concerns about the implications of China's rising economic power and influence are legitimate, the notion that the establishment of any specific U.S. trade agreement would control this process is contradicted by the record. "The ever-closer linking of the U.S. economy to those of the TPP countries over the last 35 years has not prevented the rise of Chinese power, nor has it deterred U.S. trade partners and allies from developing ever closer ties with China," Prestowitz, who had served a senior Asia policy staffer in the Reagan administration, noted.[54] Nor do U.S. allies accept that excluding China from the TPP is a way of diminishing Beijing's influence. During TPP negotiations, New Zealand Trade Minister Tim Groser said that, "The moment we smelt or sensed that this was an anti-China thing, we'd leave the TPP."[55]

Indeed, rather than PNTR's passage enhancing American leadership in Asia, Beijing is forcing U.S. companies operating in China to adhere to Chinese rules and practices. "Cyber-governance with Chinese characteristics ... is the choice of history, and the choice of the people, and we walk the path ever more firmly and full of confidence," said Lu Wei, China's Internet czar.[56] U.S. companies operating in China are conforming to these rules, even as limits on free speech increase. In 2015, the Chinese government sent a letter to several American technology companies operating in China asking them to promise that they would not threaten Chinese national security. Some companies believe this means that the Chinese government will eventually require U.S. companies to add "back doors" to allow the government easy access to private information stored on phones, computers and servers.[57]

NOTES

[1] Barry Lynn, *End of the Line: The Rise and Coming Fall of the Global Corporation*, Doubleday, 2005.

[2] Testimony of Lori Wallach Director, Public Citizen's Global Trade Watch before the International Trade Commission, "COVID-19 Related Goods: The U.S. Industry, Market, Trade, and Supply Chain Challenges" Sept. 21, 2020. Available at https://www.citizen.org/wp-content/uploads/Public-Citizen-Written-Testimony-Covid-and-trade-with-Add-Submission.pdf

[3] Products from and firms in the following 60 countries are treated as if they were American. Countries in formal font have obtained waivers from the Buy American Act, and similar domestic preference programs by being a signatory of the WTO's Agreement on Government Procurement. Countries in italics are waived because they have a free trade agreement with the United States. Underlined countries have both. Armenia, Aruba, Australia, Austria, *Bahrain*, Belgium, Bulgaria, Canada, *Chile*, *Colombia*, *Costa Rica*, Croatia, Cyprus, Czech Republic, Denmark, *Dominican Republic*, *El Salvador*, Estonia, Finland, France, Germany, Greece, *Guatemala*, *Honduras*, Hong Kong, Hungary, Iceland, Ireland, Israel, Italy, Japan, Latvia, Liechtenstein, Lithuania, Luxemburg, *Mexico*, Moldova, Malta, Montenegro, *Morocco*, Netherlands, New Zealand, *Nicaragua*, Norway, *Oman*, *Panama*, *Peru*, Poland, Portugal, Romania, Singapore, Slovak Republic, Slovenia, South Korea, Spain, Sweden, Switzerland, Taiwan, Ukraine, and UK.

[4] For information on the trade pact provisions, see Public Citizen, "How Overreaching "Trade" Pact Rules Can Undermine Buy American and Other Domestic Preference Procurement Policies," 2019 Available at: https://www.citizen.org/wpcontent/uploads/Procurement-from-FTAs.pdf

[5] See 19 USC Section 2511(c): "*The President may modify or withdraw any waiver granted pursuant to subsection (a) or designation made pursuant to subsection (b)."*

[6] For a list of U.S. states and a chart showing what procurement policy limits are imposed for each state in U.S. trade pacts, please see https://www.citizen.org/wp-content/uploads/statesboundtointernationaltradeagreements.pdf

[7] Government Procurement: United States Reported Opening More Opportunities to Foreign Firms Than Other Countries, but Better Data Are Needed; GAO-17-168: Published: Feb 9, 2017. Publicly Released: Mar 13, 2017. Available at https://www.gao.gov/products/GAO-17-168

[8] C. Lee Ventola, "The Drug Shortage Crisis in the United States: Causes, Impact, and Management Strategies", P T. 2011 Nov; 36(11): 740-742, 749-757. Available at: https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3278171/ [8] U.S. Food & Drug Administration, "FDA Drug Shortages", last visited September 21 2020. Available at: https://www.accessdata.fda.gov/scripts/drugshortages/default.cfm

[9] Knvul Sheikh, "Essential Drug Supplies for Virus Patients Are Running Low", *The New York Times*, April 2 2020. Available at: https://www.nytimes.com/2020/04/02/health/coronavirus-drug-shortages.html [10] Robert Teitelman, "Big Pharma Can't Resist Big Mergers. Here's Why", *Barron's*, February 18 2019. Available at: https://www.barrons.com/articles/pharmaceutical-companies-mergers-51550430327

[10] Marc-André Gagnon & Karena D. Volesky, "Merger mania: mergers and acquisitions in the generic drug sector from 1995 to 2016", Global Health 13, 62 (2017). Available at: https://doi.org/10.1186/s12992-017-0285-x

[11] Nicky Wolf, Justin Curry, and Benjamin Hass, *The Guardian, "Trump to Withdraw from Trans-Pacific Partnership on First Day in Office," November 22, 2016. Available at:* https://www.theguardian.com/us-news/2016/nov/21/donald-trump-100-days-plans-video-trans-pacific-partnership-withdraw.

[12] James Mann, *The China Fantasy: How Our Leaders Explain Away Chinese Repression*," (New York: Viking Penguin, 2007).

[13] U.S,-China Economic and Security Review Commission, 2016 Report to Congress, Chapter 2, Section 1, p. 193.

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PANEL III QUESTION AND ANSWER

COMMISSIONER WESSEL: Thank you all for your testimony. And this clearly an issue that is front and center here in Washington and in the region.

Because we are virtual, we will go alphabetically, after I take the prerogative of the chair, to ask a question.

It really amazes me that we are once again talking about new trade rules in the region with the expectation that if China enters any of these agreements, any of the structures, that they're actually going to keep their commitments. It reminds of Lucy and Charlie Brown with the football. She continually says she'll hold it, don't worry, run fast, and Charlie Brown lands on his rear end. And that's I think were the American worker feels that they're landing time after time after time.

Ms. Elms, you talked about that these rules can enhance U.S. opportunities. And again I don't understand why we think that China is going to actually going to adhere to them.

Separately, Lori, you talk about goals, all of which agree with. Last week I was asked whether I'm for or against IPEF and I said there's nothing yet to be for or against.

So I commend the administration in terms of taking the time to identify the architecture of this, working with allies. I don't think any of us question that the U.S. shouldn't be in the region. We already are with over $1 trillion of FDI. We got a bilateral trade deficit with Vietnam of $90 billion.

What I'm having trouble understanding - and I think, Ms. Elms, you talked about this has to be meaningful for the countries in the region. Of course. Why would they do it otherwise? I want to understand what's meaningful for U.S. workers that - and, Dr. Meyer, your comment about domestic equity beyond Trade Adjustment Assistance, which has usually been the grease to get an agreement through.

If we're going to do trade differently, how do we do it differently that we can expand U.S. involvement in the region, enhance alliances and friendships, change the rules, but also have confidence that the American worker is going to look to their political leaders and say this is in my interest?

So, Lori, do you want to start with that?

MS. WALLACH: To start with I think we have to be very careful not to have a trade agenda in the Pacific that's based - I jokingly call it the FOMO trade agenda, fear of missing out, which is other countries are running around signing things, but what are the merits of what we're trying to achieve, which, Commissioner Wessel, is your core point.

So it's a little bit of a tough neighborhood if you're thinking about the goals. It's not the place you would necessarily start if you're thinking about climate and labor standards and other democratic values, but I think exactly the IPEF being an opportunity to at least explore what would be meaningful to workers?

And so this is going to sound heretical after all these years, but seems to be the broad consensus in a trans-partisan basis now. Access to the U.S. is not a corporate right. It's a privilege. It's not to be dealt with discriminatorily vis-á-vis this country, that country, but it is granted on the basis of certain rules. And as we're rethinking what the goals are, that's where our tool is, that's where our leverage is in sending what are the rules applicable to all with respect to gaining the access to this very lucrative market?

That is the only upside to having the enormous trade deficit we have. Many countries - so what would be meaningful for a country to join IPEF? If you have to follow these rules to

continue, Vietnam, with a $90 billion access, or whatever - pick your country, maybe Vietnam isn't the right partner for this initially - but if there are standards with respect to not what we're imposing, but rather prioritizing the commitments countries of sovereign nations have already committed to, the standards of the International Labor Conventions, the multilateral environmental agreements, the United Nations' agreements with respect to health, with respect to human rights - if those were a floor that undergirded our market access and were a condition of market access as compared to how the previous three generations of agreements have been written, which is those are trumped by the market access obligations regardless of when they were in time, flipping that would start to try to have something that benefits workers, because we're actually creating a platform of trying to have trade that benefits workers based on rules intended to shape behaviors.

COMMISSIONER WESSEL: Thank you. I'm going to again take the prerogative quickly.

Wendy; and look forward to our other witnesses probably responding to my questions on the record, we're a U.S.-China Commission. So to my initial question of how can we have any confidence that China will actually adhere to the rules if they join a working party, et cetera, what's your response to that?

MS. CUTLER: Well, my response is that we're not part of this, so it's up to the other countries to decide, and that's one of the issues. Some of the countries have already expressed some concern, particularly Australia and Japan. And in fact in some of the CPTPP documents that have come out over the past year with respect to accession agreements, certain CPTPP partners are insisting that CPTPP members look at the track record of implementation of agreements as a criteria for joining the CPTPP, or at least as a consideration.

So again, we're not part of this. So we're not letting China in. And so it's up to the other countries and hopefully - and I agree with you that they should look at this very carefully. Australia has a free trade agreement with China, but if they can turn around and just impose import restrictions on barley and corn and coal and other products without batting an eye, what's that agreement worth to Australia and why would they consider letting China into the CPTPP?

COMMISSIONER WESSEL: If there's time we'll come back - I'll come back to it.

Commissioner Bartholomew?

COMMISSIONER BARTHOLOMEW: Thanks very much. And apologies if the cat commandeering through the screen while I'm talking.

Mike, I really - I echo what you said about sort of - I'll tie it to credible commitments, which is we have seen and heard repeatedly over the course of the past 30 years that Chinese government make commitments to abide by things on trade and seen them repeatedly not comply with what it is they had agreed to.

Wendy, I understand that you're saying we're not there and so it's not ours to make enforceable, but I sincerely hope that the countries that are negotiating these things are paying attention to enforcement.

That said, Lori, I've known you for a long time and I think that this idea is really interesting of sort of a new global trade model, but meanwhile things are moving on in the Indo-Pacific. There are processes underway. And I guess I'm just really curious what you think the leverage is that the U.S. government has try to create a whole new model in the region and have people participate in it.

MS. WALLACH: The leverage is access to our market. It is the enormous reliance by many of the countries in the region on selling goods here that is the leverage we have as we had

with the USMCA, which is to say that was not - that also was not cutting new tariffs. So the straw man is if we don't market access, we can't get anything. That was the same scenario of the NAFTA renegotiation. The tariffs were already gone. The question is what were going to be the rules of access to the markets? And so it is that market access that is what we have to offer.

The problem is in the structure of the IPEF, the notion that it's á la carte, you can pick your pillar, makes that a harder argument. Because if the rules are going to be if you want to continue your access here, you have to now negotiate with us about these new standards for how we're going to relate to each other economically. You're going to have an incentive to have countries not participate as compared to if countries have to, if you're taking part, take all.

With respect to China not following the rules, I just want to - given Commissioner Bartholomew has also raised it, and Commissioner Wessel - there is a joke amongst our partners from the International Civil Society campaigning on TPP. Our partners in Chile and Malaysia to countries that still have not ratified the CPTPP jokingly say that the one upside of China joining is China will do to CPTPP what China did to the WTO, which is by joining it will sink it. So I think that the prospects that the rules are followed is highly remote. The problem is that many of the other parties will follow the rules and have the downside without any of the putative up sides.

COMMISSIONER BARTHOLOMEW: Yield back the balance of my time.

COMMISSIONER WESSEL: Okay. Commissioner Borochoff?

COMMISSIONER BOROCHOFF: Tremendous ideas today. I think I would like to pass and wait until the end.

COMMISSIONER WESSEL: Commissioner Cleveland?

COMMISSIONER CLEVELAND: Goals are great and I commend you for sort of thinking in terms of - thinking in strategic terms. I really want to focus on rules of origin. And we heard this morning some interesting testimony on how to manage or model rules of origin. Each of you have spoken in your testimony on rules of origin. So I'd like to understand from your perspectives what an ideal model on rules of origin would look like.

And then the second part, given testimony this morning on China's current pattern of moving assembly production facilities, buying companies in other countries in order to create access to the U.S. market with shifts in rules of origin, how would you address that? So two more specific questions than our broader goals on human and labor and other rights.

Let's just do it in order of - start with - doesn't matter to me. How about that? Dr. Elms?

MS. ELMS: Thank you very much. That's a great question that I actually haven't really thought through so much. We do a lot of work on rules of origin and we particularly do a lot of work with companies on how to use different rules of origin in different agreements. So we have companies that will come to us and say we want to make this microphone or this bottle of water and we do - we are located here and we're going to go to there. And then here is our supplies and here is what we're trying to accomplish and which agreement gives us the best benefits?

Remember that in Asia we have like a zillion of these agreements. So there are six of them now between ASEAN and its dialog partners, plus RCEP, plus CPTPP, plus a proliferation of bilateral arrangements. All of them have different kinds of benefits and all of them have different kinds of rules. And it's one of those things that has given rise to this complaint about a spaghetti bowl, which is true.

And then you say well, what is the ideal rule of origin? I mean I think it depends on your perspective clearly, because for many companies the ideal rule of origin is the one that works for me and the one that allows me to take advantage of the benefits, especially lower tariffs and/or -

we're not talking about rules of origin for services, but nonetheless use an agreement that allows me to do what I would like to do between the two markets that matter to me.

What are better rules of origin? There's a lot of - if you're talking about current models, there's a lot of ways to get at rules of origin. And again one of the reasons why I think RCEP is significant and needs to be taken seriously is the rules of origin make it easier for you to move products; goods in this case, around Asia.

So once I manufacture this microphone, this bottle of water to meet the RCEP rules of origin, I can ship it between any of the RCEP countries without changing my suppliers, without having to worry about whether the parts and components in here are Japanese or Korean or Indonesian or whatever. I make it; it's done; I can ship it and get the lower tariffs in all of those markets. That's why rules of origin matter.

Now how do we get ideal rules of origin? And there's a bit of a debate about this, but I think in general it's easier for firms if we have multiple ways to accomplish the rules of origin. So if you have regional value content plus or in addition to - not at the same time - not dual rules, but two different ways you could do it.

Value content. How much of this has to be from RCEP? Let's say 45 percent from RCEP countries. Or alternatively change in tariff heading because it was a something and now it's become something else. Much easier for firms, and particularly much easier for smaller firms. Very beneficial. So the more ways that you give a firm to qualify for rules of origin, the better it is, and particularly the better it is for small businesses who struggle with ROOs.

So again, ideal is in the eye of the beholder, right? So I'm talking about it from the perspective of firms who are going to be using these agreements. You may have a different definition of what is ideal. And if you want to say ideal means that you cannot have foreign content, then you're going to have a very different view on rules of origin.

But I would say that across Asia in general rules of origin that are flexible, that accommodate different kinds of ways of manufacturing that are simple for small businesses to understand, those are more interesting to certainly Asian governments who are signing all of these different agreements than the alternatives.

COMMISSIONER CLEVELAND: Well, I started out in our camp, Dr. Elms. I want to give everybody else a chance to respond. What I'm hearing is it's - beauty is in the eye of beholder, therefore having any kind of agreement that is relevant to small business versus labor, versus multinational enterprises, would be very difficult to develop with enforceable - with some enforceable - and universal is not the right word, but an approach to rules of origin that made sense for everybody. MS. ELMS: It's challenging. Trade agreements in general is - it's a balance and it's a challenge. So you have to think about what are the objectives that you're trying to accomplish and then what are the ways that you get there? And again it's not just your ideas that matter.

COMMISSIONER CLEVELAND: Right.

MS. ELMS: It's also whoever else is in the agreement. And so there's compromise along the way. And I would say for rules of origin - and just in general in trade, to go back to an earlier question about how do we design better trade policies, I think if you thought about trade agreements from the perspective of smaller businesses first and you said let me make this MSME-friendly, I think you could ultimately create a better agreement because it would be easier, it would be clearer, it would be less complicated, with all due respect to my lawyers, it would be less legalese.

And anyone who's ever looked at the rules of origin chapter for any trade agreement -

COMMISSIONER CLEVELAND: Right.

MS. ELMS: - and in particular, heaven help us, on textiles, it is an eye-watering nightmare. And so having those be simpler is much better. And in this respect, I would say RCEP, so much easier. It was cloth; it's now a piece of clothing. Done. That's an MSME-friendly rule.

And so I think for me that would be great if we could have those kinds of MSME-friendly rules. But clearly it's a balance because then you have to think about what does that do for labor, what does it do for the environment? I mean all those other competing interests is what makes trade policy challenging.

COMMISSIONER CLEVELAND: So I think I'd be interested - Mr. Meyer, since you talk about non-market economy clauses in USMCA and how rules of origin might be introduced to new agreements, I'd be interested. But we have a very short amount of time and I am confident Ms. Wallach wants to speak to this issue.

So, Mr. Meyer, if you would speak briefly in terms of your ideas on how an agreement might include ROO and then we will wrap with -

MR. MEYER: Sure. I'll actually take a slightly different tact, which is to say that I think that this is an issue of understanding supply chains. And so what we really need is investment - government-level investment in understanding supply chains so that we understand what we're doing when we draft ROOs.

So it's one thing to concentrate on a sector like autos, which has high salience, but our ability to do that is driven by the high salience of the sector. And so we're not able to make the kinds of sort of informed decisions and the informed trade-offs between small, medium-sized enterprises, national security considerations that may be implicated because we don't we have the information.

And so what we really need is a government-led investment I think in supply chain transparency that we can then use to draft ROOs in a way that is thoughtful given the different kind of products and sectors we might be talking about. I don't think there's likely to be sort of an overarching answer that is going to sort of say for an agreement that is an economy-wide agreement here's what we want to do. What we need is the information that helps us make more fine-grained distinctions, which unfortunately would probably involve lawyers and being slightly more complicated.

COMMISSIONER CLEVELAND: Ms. Wallach?

MS. WALLACH: It's a long and complicated question for sure, but I would say looking at it from the policy maker perspective as compared to the industry perspective if you think about the goals you would set, the rule of origin model is then part of the enforcement of the goals.

So if you want to make sure that the benefits go to the countries that are actually conforming to the rules, whatever those goals are, then you want a strong rule of origin. You definitely don't want single transformation because it's too easy to launder the good.

But specifically sort of boiling in your question about how do you avoid nationality shopping with respect to -

COMMISSIONER CLEVELAND: Yes.

MS. WALLACH: - rules of origin like China does now, something I think that is worth taking into consideration, also just because it's politically part of how will we politically get new rules enacted, is to think of other sort of external realities that are coming up next to the same outcomes, such as the climate crisis.

So policy makers on a trans-partisan basis after COVID want more resilience. No more

sole supply chains on critical goods. Redundance is no longer a bad word in certain ways. And at the same time with the climate crisis I think we have to take into consideration once carbon starts - prices are internalized, the long-distance shopping that is now inherent in these supply chains is going to become too expensive to continue.

So if you're thinking of rules of origin within systems how do you use a rule of origin to create almost a parallel system of supply chain that also represents those values and goals? You'd want high ones, high rules of origin. And you would in that way effectively either have to make the Chinese firms meet the standards that they would abhor, or they're out.

COMMISSIONER CLEVELAND: Well, then enforcement becomes the issue, but go ahead.

COMMISSIONER WESSEL: Commissioner Fiedler, if you're there.

(No audible response.)

COMMISSIONER WESSEL: All right.

COMMISSIONER FIEDLER: I am here.

You don't need me to tell you again and again like Michael and Lori have that trade agreements haven't necessarily benefitted ordinary people in the United States for years.

I want to take a completely different tact. Since we're all fairly preoccupied with what's going on in the Ukraine, I think it's reasonable to assume, since the Chinese make it clear, that we might have a conflict on our hands involving Taiwan and China. And what's happened in Europe on the Ukraine is certainly not likely to happen in Asia in the Indo-Pacific region in terms of solidarity. And what do you think happens in the event of a conflict over Taiwan to the trade architecture in Asia?

And by the way, are we not like the Germans in the following way? Germans are dependent on Russian gas. We are dependent on Chinese medicine. So let's assume for the moment the Chinese invade Taiwan. Are we still going to get their medicine? What are we going to do? Are we going to say oh, we'll have sanctions on them on everything but medicine? What's going to happen to the trade world when there's a conflict? And I think that people - I'm not talking about an ephemeral possibility here. I think we're talking about a real possibility.

Anybody want to touch it? Doctor, please?

MR. MEYER: So I think this is a great question and a really, really important one, and so I'll just say a couple of things about it.

So first of all, I think it's important now to be proactively - and we sort of touched on this a little bit, but proactively trying to manage the supply chain risks in order to reduce them. Supply chain diversification is incredibly important, but this requires again I think a massive investment by the government to understand where are we exposed? We tend to only know where we're exposed after the fact.

And so it's going to be just important for us to develop a much greater I think emphasis on proactively investigating and determining what kind of risks we have and then offering appropriate incentives for supply chain diversification which could include re-shoring, but could also include third-shoring or something along those lines. And that's something that I think actually could fit quite comfortably within something like an IPEF framework that could be done at a more sectoral level.

The second thing is that we need to be thinking I think proactively about tools that we can use to deter that sort of conduct that you're describing. And so Congress is obviously thinking about legislation now that would authorize essentially an outbound CFIUS or something like a reverse CFIUS.

But I would suggest that we might even go further than that and think about something that is more in the form of an affirmative divestment authority. So the legislation Congress is looking at contemplates divestment as a means of enforcing the provision, the screening provisions.

But the idea - we've seen in the Russia context that the possibility that Western companies would simply divest themselves of their assets and their investments and their operations in Russia has been meaningful. China is obviously not Russia. But there's also an opportunity I think to put that on the table at some scale in a way that might serve to more meaningfully deter the kind of conduct you've alluded to.

And finally, I think it's important to develop an arsenal of tools because you want some tools that could be used in a targeted fashion in order to deter in advance and then you want some more aggressive tools in the event that you actually have something like an outright military intervention in the Indo-Pacific region.

And so it's important I think not to only think about what do we do in the event of the worst case scenario? It's important to be thinking about what do we do along the road that puts us off of that path and puts us on a path towards a more constructive outcome? And I think that involves developing a much broader set of tools than we currently have.

MS. CUTLER: Yes, if I could add, I've taken a few notes.

My first point was supply chains as well, that I think what the Biden administration is doing now by really focusing on certain products, and looking at how we can rebuild resiliency at home.

But also launching work programs and dialogues with our allies and partners, not just in the Indo-Pacific, but in Europe as well, as elsewhere in the quad, to, you know, to work on these issues; have a better understanding of where our vulnerabilities are.

And, hopefully to work with those that we trust, to, you know, basically have each other's back in times when there are vulnerabilities, and there are conflicts.

So, that would be number one.

Second, I think that the speed and, the speed and the depth of the sanctions that the West imposed against Russia, has caught notice in Beijing.

And, I would also say it's not just Europe and the U.S. Japan, Korea, Taiwan, Singapore also imposed sanctions.

And, these sanctions if they were to be imposed against China, particularly on the financial side, I would argue would really hurt China.

And, so I think we have time now but we need to use this time wisely, to really up our game with our allies and partners, develop trusted supply chains; do what we need to at home to rebuild, you know, to re-shore what we need to; to build some stockpiles, and to understand our vulnerabilities; and to act.

And, also to once again, to, you know, to look for other tools and other deterrences, that we can put into place to make China pause before it moves more aggressively in a quest, in the cross-straits area.

COMMISSIONER FIEDLER: Thank you.

COMMISSIONER WESSEL: Commissioner Friedberg?

COMMISSIONER FRIEDBERG: Thank you very much. I'd like to continue this question about potential deterrents to Chinese aggression.

Because after all, what we learned in the Ukraine case was that the threat of sanctions in itself, was not sufficient to deter aggression.

So, Dr. Meyer, am I correct in understanding that the divestment authority would be something that would give the power to the U.S. government, to compel American companies to withdraw from China under some circumstances?

Is that what that means?

MR. MEYER: Yes. Yes, I think what you would want, so the way the CFIUS model works, would be essentially an outbound screening, where you would have essentially an ex-ante review in which the President could block, you know, outbound investments in areas that are deemed critical.

And, the legislation that currently Congress is looking at, would contemplate divestment as essentially a sanction for failing to comply with those rules.

But the legislation is not terribly specific about how divestment would work.

So, I think it would benefit substantially, from sort of clarifying the scope of that divestment authority. First of all just as a point about drafting legislation.

And, then secondly, substantively, I think it would be sensible for Congress to actually specify the conditions under which a, the President could order divestment in the event of something like a national security crisis, as we've seen in Eastern Europe.

COMMISSIONER FRIEDBERG: So, I wanted to ask you about that. Is there a precedent, legal precedent for doing something like this in circumstances other than wartime?

MR. MEYER: Other than wartime. So, I am not, I'm not off the top of my head, aware of a precedent that would involve a government ordered divestment outside of, outside of wartime.

MS. WALLACH: Iran.

But I, well I'm right that I'm not aware of it, but I may be wrong that there's not one.

(Simultaneous speaking.)

MR. MEYER: Oh, Iran, Iran.

MS. WALLACH: I didn't say you're wrong, I said Iran.

MR. MEYER: Yes, Iran.

COMMISSIONER FRIEDBERG: Yes, so was that a situation in which the U.S. government required American companies to withdraw from Iran?

When did that happen?

MS. WALLACH: There we go.

I don't recall the exact dates, but I recall actually reading not that long ago, a law review article on this very question that described how after the hostage taking, even though there wasn't like an invasion territorially, but that kind of act of aggression.

Within a certain period of time, Congress passed a law requiring companies to divest, and to basically exit.

MR. MEYER: And, just as a matter of legal authority, you know, the idea has been floated that this would be feasible currently under IEEPA.

So, P is a very broad grant, you know, conditional on the declaration of an emergency, to regulate foreign transactions of various kinds.

So, there is the thought that actually there is already legal authority, to do this. The Trump and Biden administrations have relied on that authority to control IEEPA investment to certain critical sectors.

But what I'm proposing is essentially a regularizing of that kind of authority, and a clarification that it exists.

Because I think both the legislation on sort of an outbound CFIUS that's pending, as well as the existing language in IEEPA, are sufficiently broad both that they would be susceptible to

abuse if this were opened.

I think it would be wise to sort of cabin that kind of authority. And, also, are subject to challenge just because the language is so broad.

So, I think clarifying that authority works in both directions. It both makes the threat of use more credible, and also is more likely to, to cabin the abuse.

President Trump raised this idea that it could be done under IEEPA, but, you know, I think it would benefit from certainly consideration by Congress.

COMMISSIONER FRIEDBERG: So, would you imagine this as some law that would give the president the authority to do this across the board?

In other words, to say every American company operating in China has to divest, or would it be targeted in some specific way?

If you targeted it, narrowed it, would it be susceptible to legal challenges?

MR. MEYER: So, I think with respect to legal challenges, there's a lot of legal challenges that you could imagine.

So, we could have a long discussion about how you would insulate it from legal challenges.

I think what you would want, is you would want a, you know, a set of circumstances that are going to authorize the president to pursue this.

So, the way the existing, you know, the pending legislation works, is its key to critical sectors.

And, so I would suggest that if what we're trying to do is build a deterrent, essentially an economic deterrent to conflict, that a focus on critical sectors is actually probably not enough.

In part, because the critical sectors are sectors that are critical to us, and so those are likely to be the very sectors that we're unwilling to act in the event of a crisis.

So, I do think that it needs to be sufficiently broad, that it could conceivably encompass any kind of investment that a U.S. company might make in China.

Having said that though, I do think you want to have conditions that would limit the president's ability to simply wake up one day, and order the divestment, you know, a wholesale divestment of China.

You would want a series of conditions that had to be satisfied. You would want an invest -- and again, CFIUS operates like this already.

So, Congress should be, I don't mean to be suggesting this would be a presidential power that would not have administrative apparatus attached to it, nor that it wouldn't have conditions. I think the conditions would need to be spelled out.

But I think for it to be an effective deterrent, it does have to encompass a broader swath of the economy than simply those sectors that are critical to the U.S., and thus, are ones where we are unlikely to want to take action in a crisis.

COMMISSIONER FRIEDBERG: Okay, thank you. That seems to me an idea well worth exploring.

Thank you.

COMMISSIONER WESSEL: Commissioner Glas?

VICE CHAIR GLAS: Many thanks to our panelists, and the diversity of opinion here around some of these key topics. I've really appreciated the discussion and want to echo the comments made by several of our Commissioners, including Commissioner Wessel, and the questions about rules of origin by Commissioner Cleveland.

It's nice to see Wendy Cutler again. I actually worked in the administration during the TPP negotiations, and I recall that President Obama was on the stump quite a bit talking about the need to pivot to Asia to be a counterweight to China.

And, that was the goal of the TPP agreement.

Lori Wallach and Tim Meyer, I was hoping that you could comment a bit, and you did this in your written testimony, about how China would have benefitted had the U.S. maintained us remaining in the TPP agreement.

And, given that Congress has just developed with the administration a new trade model, i.e., USMCA that had strong bipartisan support, do you think that new model could be applied to CPTPP, and would that have us sleep at night?

So, your response to that would be appreciated.

And, then the last point. Since Congress is currently reconciling the China bills out of the House and Senate, there are several key trade provisions.

Ms. Wallach touched on one related to market access, that provides unfettered market access to the U.S. market for China, and everyone else through the de minimis tariff loophole.

So, I'm wondering if there are any comments that you have related to that, as Congress is nearing the conclusion. Hopefully nearing the conclusion of this, this piece of legislation.

MR. MEYER: So, I don't think that USMCA would go far enough to address the concerns we would have with TPP.

And, I don't think it would go far enough either, as a matter of just addressing the political concerns that were raised with TPP, nor you know, at a technical level.

So, I think for all the advancement that USMCA made, and I alluded to this in my opening comments as well as my written testimony, I think it doesn't go far enough in actually trying to address the equity issues at home, that arise.

Now, you know, there were some modifications particularly in rule of origin, in certain sectors that tried to address that.

But I think we need to fundamentally rethink how we deal with distributional issues at home, and integrate those into, into trade agreements.

And, so I alluded to this in my written testimony I think. The TPP has something called a development chapter in it. This is not what the development chapter was written for.

But I think we could imagine using something like a development chapter as a template to essentially require investigation, transparency, and the adoption of adjustment assistance policies, on kind of an ongoing basis.

So, the ITC right now is conducting an investigation that looks at distributional considerations. That should be something we're doing on a regular basis at home.

And, it's hard for me to imagine that we could effectively think about doing economy-wide trade agreements on a regional basis, in the Indo-Pacific if we're not doing that kind of basic monitoring, and investigation at home.

And, so for me, that's what I'd like to see is, you know, if we were to pivot back towards something like the TPP.

VICE CHAIR GLAS: Thank you. Ms. Wallach?

MS. WALLACH: I concur with respect to the USMCA not cutting it for the CPTPP. The USMCA standard was basically what could be supported by a broad set of political and outside interests, with respect to an existing agreement, and trying to limit its ongoing damage.

But for a TABULA RASA kind of project, which would be I think, what the U.S. would have to think about with TPP, which is we're not in it. We're not being damaged by it. It's not

how to limit the damage.

It's do we get into, and how do we make sure if we were thinking about it, it would be good.

It is not anyplace sufficient. However, there are some tools that were created in the USMCA context, that certainly are of value with respect to whatever platform is that negotiating context for future rulemaking.

So, for instance, the labor content value. Super interesting tool of thinking about rules of origin, to take into consideration on some of those distributional issues.

And, there are other things that were done that were very creative, that I think are pieces that certainly should be tools, that go into whatever is the future agreement.

But with respect to trying to make CPTPP something agreeable, no, that would not do it.

On the question of USICA and COMPETES, this may be seen as somewhat crass, but I would suspect when USICA passed, it was celebrated in Beijing.

I would imagine there was a cable from the embassy here that said, unbelievable in the midst of this discussion of supply chain reviews, and resilience, and et cetera, they passed that out of the U.S. Senate.

So, there are rules in it that directly are anti-U.S. resilience, contradict the supply chain review, are pro-Chinese trade interests with respect to: number one, getting rid of some of the Section 301 penalties, and the review process.

Number two, unilateral duty-free access for China on a whole set of different goods. Number three, the miscellaneous tariff bill approach that has numerous finished goods, of the 1,400 goods, about half of them are finished goods with the unilateral tariff cuts, or duty-free access.

And, I ran a bunch of the SIC codes. A lot of it is when you put it to HTS, a lot of it is coming from China.

In addition, you've got de minimis. So you have a flood of undocumented goods. Some people guesstimate that between 14 to 16 billion dollars of that from China, unbooked, uninspected, weaker, forced labor stuff coming in.

And, then finally there's a special 301 not for labor standards, not for human rights, but for big tech that would undermine U.S. values with respect to privacy, to labor rights, and attack the best of those kind of policies around the world, as compared to putting pressure on raising wages and human rights.

COMMISSIONER WESSEL: Senator Goodwin?

COMMISSIONER GOODWIN: Thank you, Mr. Chair.

Professor Meyer, I wanted to return back to your discussion of supply chains, during your response to Commissioner Fiedler's question.

In your written testimony, you cite the need to develop a robust supply chain monitoring system. But I suspect it's probably not as simple as simply centralizing an office, and giving them some legal authority.

So, how lacking is our understanding and expertise, of how critical goods are sourced? And, how much work awaits us to stand up such a mechanism?

MR. MEYER: So I think a significant amount of work. So, I've written elsewhere, including with a colleague initially around and about the need for essentially a cabinet-level agency.

A department of economic growth and security, that would be tasked with among other things, essentially conducting this kind of information gathering process, as well as providing the

various kinds of incentives that might be necessary to act on, and to sort of induce the private sector to act on the results of that supply chain mapping.

I think, you know, we have become aware of these supply chain issues sort of as they become problems, or after they have become problems.

So, that certainly is true of medical supplies with respect to China, coming out of COVID. It is to some extent, true of critical minerals as we're trying to scale up on the production of batteries.

And, so I think we can identify those because they have become choke points. And, so we were really talking about I think, a significant investment in government capacity, to engage with the private sector and identify those kinds of supply chain efforts.

And, I think it requires a significant amount of new capacity. So, it's not just a matter of standing up an agency and saying, you know, you have the authority to send out questionnaires.

I mean, I think it requires both resourcing that agency right, and this doesn't necessarily require a new agency. It could be done at the Commerce Department, it could be elsewhere.

But I do think we are not talking about a small task. We are talking about a significant task that's going to require a mix of financial resources and legal authority, to compel the production of information.

COMMISSIONER GOODWIN: What do you think will be the more difficult challenge, identifying those sectors or particular supply chains that we need to be concerned about, or actually grasping the full complexity of how those supply chains work, and bearing from sector to sector, good to good, product to product?

MR. MEYER: Oh, I think it's a very complicated task. And, I think when you're talking about, you know, one of the things we know from scaling up any kind of intelligence gathering operation, and no matter where we are, is that the more information you introduce, the more noise you get.

And, so I think it's going to be important as we start thinking about in whatever context we do it, as we start thinking about scaling up our study of supply chains, and our ability to get ahead of these bottlenecks, choke points, critical supply chain risks, it's going to be important to develop mechanisms that allow us to sort signal from noise.

And, so I think that's the answer I would give, is that I think that as you, collecting the information if you properly resource it, is not going to probably be the bigger challenge.

The bigger challenge is going to be, analyzing that information in a way that allows you to identify what the risks are going to be in advance of them happening, right.

And, that's going to really require I think, a lot of effort. It will not be done perfectly. Those kinds of things are not, you're not going to bat 1,000.

But I think that is both the challenge, and where we need to really focus our effort. The gathering I think, is likely to be the easier of the task, as opposed to the analysis.

MS. ELMS: Can I intervene on this one?

COMMISSIONER GOODWIN: Sure.

MS. ELMS: I think if you want to know how hard it will be, look to the Asian Development Bank.

So, the ADB early on in the pandemic said, we have supply chain challenges. Let's map the supply chain for four critical goods: masks, ventilators, surgical gowns, and something else.

It took them months and months, to come up with a database that tracked the supply chains for those four types of products.

The investment of time and effort was spectacular. And, at the end of it, no one used it

because actually by the time it was done, everybody had changed their sourcing.

And, so I mean I understand the impetus and the desire, to map out supply chains and to understand what they look like, and how they might adjust.

But I recommend that you look at that ADB database, to get sense of what is the actual level of work that you would have to do, in order to know what is a supply chain in any product, and recognize that by the time you've sorted it out, it will have changed, most likely.

I mean there will be some products for which it may not have changed, but in general supply chains move. And, they're not as, you know, they're sticky, but they're not like immutable.

And, I suspect that if you were to have said ahead of time surgical masks are going to be the key thing, you would not have had that in your database.

You would have found some other product that you thought was going to be critical. It would not have been, it would not have been surgical masks, and you would not have had the information that you needed, at the time in which you needed it.

So again, I understand the political imperative to do so, but the practicalities of doing it is intense.

MS. WALLACH: Senator Goodwin? Just to add I think one thing to think about, is not so much supply chain per se, but capacity. And, the building block capacities.

So, one of the reasons we're having this mess with the medicine, is we've lost largely the chemical industry in the U.S.

The reason China has the market cornered there, and frankly supplies the chemicals to India, which does a lot of the generic meds, is because India has, sorry, China has strategically sort of cornered the market on chemical production.

And, so they're building block components. We started to think about how to do a study. If you looked at mergers and a list of mergers in the infrastructure, so production infrastructure.

So, there's certain grades of steel we can't make here that we need for infrastructure. There's certain chemicals that go into numerous different things.

If you look at the capacity of manufacturing, and then the question is the scale. So, by region, by trade agreement, by unclear.

But the capacity as compared to the supply chain I think, is a broader way to consider how you would build up more resilience.

COMMISSIONER GOODWIN: Thank you.

COMMISSIONER WESSEL: Before we go on to Commissioner Mann, Senator Goodwin, we may want to have staff contact the administration, which just issued five critical supply chain reports, to understand from them the collection activities, et cetera, which is very deep, very broad, but is also incomplete and needs to be advanced.

Commissioner Mann?

COMMISSIONER MANN: Thank you.

I wanted to ask both Deborah Elms, and Wendy Cutler, to respond to Lori Wallach's views on our opposition to joining the seat to the new CT, where am I? CPTPP.

You've said you were in favor. I just wanted, she made a critique of it and I'd like to hear your response, and also Wendy Cutler's.

MS. ELMS: Sure. So, this is hard to do very briefly.

First of all, I think it's critically important for the United States to remain economically engaged in Asia.

And of course, there's lot of U.S. investment, and of course, U.S. business is very active,

and of course, it's not like the State Department forgot that Asia exists.

So, let me put all that on the table. Of course that's the case.

But I do think that it's important in a region that cares so much about trade and economics, that is very focused, hyper-focused really on trade arrangements, for the United States to have more clear trade arrangements in the region.

Because we have very few FTAs that exist in the region. And, I do think that you're at a competitive disadvantage.

And, it's particularly starting to harm American companies, American farmers, American small businesses, in trying to work with what is ultimately the fastest growing part of the global economy, with the most amount of consumers and businesses.

I think that's a problem.

So, with that, what is the fastest way and the, frankly in my view, the easiest way to re-engage would be to pick up CPTPP. That's the fastest and easiest way.

The alternative is to say let's make a new model, and I again, I understand the impulse for why we should make a new model. But I think it's very challenging to make a new model.

It's very challenging to figure out how that new model will interact with, and be interoperable with, existing models that exist, especially in Asia.

And, the critical problem for me, remains why would I, if I were a potential counter-party in Asia, sign up to this new U.S. model that is unclear, that has very little benefits for me, frankly, and has a whole lot of downsides? Especially in areas that I am not wildly enthusiastic about.

So, I think, again, I understand the impulse for let's make a new model. And, if you had a completely open playing field and 20 years in which to do this, I think you could maybe create something interesting.

That's not the world we live in. The world we live in has a lot of trade agreements. Has a lot of trade arrangements. Has a lot of activities that are structured a certain way.

If you want to say I want to move the boundaries around the edges, I think that's fine. If you want to say there should be some domestic distributional effects attached to this, which I think is a great idea.

That doesn't need to be in a trade agreement. That's a U.S. domestic issue. That is U.S., you guys solve that.

But that is not a trade agreement problem. That's a domestic issue, how do we deal with the consequences of trade.

And, then in that complicated environment, it just strikes me that the fastest, easiest thing to do is CPTPP.

And, I realize that people say no, but I would like at the minimum, I would like people to say are we in the same context in 2022 in saying no, that we were in in 2015, 2016, 2017?

And, I'm going to suggest to you that the context is quite different, and at the minimum, we should re-look with seriousness at CPTPP entry in 2022 and 2023.

COMMISSIONER MANN: Thank you. Wendy?

MS. CUTLER: So, yes, my view is TPP in that CPTPP is an old agreement. It's outdated with respect to technologies; it's outdated with respect to concerns in the country and what we would want to achieve. I don't think the word supply chain is even mentioned in TPP.

So, as I stated in my opening remarks, I think that if we were to think, even think about rejoining, we would need to think about what revisions we would need. And, here, I think USMCA would be useful guide.

But I want to just emphasize one point that hasn't been made, and that's the question of leverage in trade negotiations. Or in economic negotiations.

I mean, during, in USMCA, Canada and Mexico exported 75 percent of their total exports to the United States. We had enormous leverage.

When you look in the Indo-Pacific, guess what? The U.S., we're not even the largest trading partner for most, almost all countries in the region, including our closest allies, Japan and Korea.

They're very, you know, they're linked economically very closely with China. And, our share of regional trade has declined as China's share of regional trade has increased. So, I think we need to be realistic about that.

My view now is let's give IPEF a chance. My understanding that this is kind of getting close to this new type of economic/trade agreement that folks are talking about, let's see when we put it forward who signs up.

What their concerns are, what the domestic reaction is, when everyone sees the details of this.

And, then let's have a discussion afterwards if we need to recalibrate. And, maybe we need to start thinking about maybe providing some limited market access, if that could get us more with respect to the goals that Ms. Wallach has elaborated.

COMMISSIONER MANN: Commissioner Schriver?

COMMISSIONER SCHRIVER: Thank you, and thanks to all our witnesses.

Bearing in mind the great American philosopher Yogi Berra's advice, predictions are very hard to make, especially about the future.

I do feel like I can predict the future pretty well over the next couple of years. We're not going to rejoin any of these major multilateral agreements.

IPEF is going to be weak, and not terribly specific and ambitious on its ambitions. And, the opportunities to remake, reimagine, remodel trade, are going to be limited in this political environment.

So given that, and this really goes to Wendy's last comment, IPEF maybe being our best chance.

If I put the two of you on the right in the category of "we want to do things differently, better, faster, reimagined," do you see an opportunity in IPEF to do something meaningful, consequential that's even a baby step in terms redefining the playing field in a positive way?

MS. CUTLER: Well, I do, but like you, none of us have seen the details yet. So, it's hard to have this conversation.

We know the topics, and the topics seem to be relevant and pressing in the region, including infrastructure, decarbonization, supply chain resiliency, fair and resilient trade, tax and anti-corruption.

And, based on my conversations in the region, with the administration, and with stakeholders, I think this initiative is going to be a lot more substantive, Randy, than I think you're expecting.

Again, we don't know. You can bring me back, and we can have the debate once we see the details.

But I think let the administration spent six months trying to put, you know, put meat on the bones. They went out with a Federal Register notice, they've received a lot of comments. They were consulting widely before that.

And, they are making an effort to consult in the region, and to, you know, seek input

from our partners as well.

And, you know, again, certain aspects will be lifted from our trade agreements, that's my understanding.

Other aspects will partially be lifted, and then they'll, you know, there will be additions to reflect interest to help workers and the middle class.

There will be kind of soft commitments. There will be cooperation, dialogues. But there will also be some binding commitments as well.

So, I'm trying to keep an open mind and be positive, because I think it's extremely important that we engage economically in the region.

And, as you mentioned Randy, if TPP is not going to happen, then, you know, let's go forward with this. Let's see if it works. But let's keep an open mind.

And, I think what would really help this initiative going forward, would be strong bipartisan support in Congress, for this initiative.

Because many of the same countries that will be asking to join IPEF, are still feeling the scars of our exit from TPP.

And, they'll want some certainty that if they make concessions, and if they kind of respond positively to some of our requests, that these commitments will continue into the next administration.

COMMISSIONER SCHRIVER: So Wendy, I'll take you up on that conversation after it's released. But Ms. Wallach or Dr. Meyer, any quick thoughts on that?

MS. WALLACH: Yes. I think part of what will determine the prospects, at least in part, is the partners. Which countries. And, I think there is a lot of uncertainty.

So, I think even Yogi Berra would have a difficulty here, because depending on the partners and what parts of the agreement they're getting, they're going to join.

But I think there are three things that could be interesting possibilities. And, I guess the first one would be trying to figure out, in a way modeling an agreement that doesn't have market access is like the external reality we face of a low tariff environment.

So, already with some peaks and exceptions amongst countries, we're just in a very, we're in a different environment where there's not a lot of tariff to trade off.

So, some of the questions about how you enforce, or how you entice countries to want to be part of the party under those circumstances. They're not entirely dissimilar with just external reality, if we hadn't chosen to not be talking about goods market access.

So, I think trying to figure out enforcement mechanisms, how do you do rules that are enforceable in that context are, is an important question.

And, related to that, how you also do the kind of enforcement of say labor standards, with respect to services.

Because so much of global trade relates now to services, but obviously much harder to figure out how would you do a facility specific incentive structure, to get the outcomes you wanted.

And, the second thing is perhaps a possibility of having an alternative model on digital.

So, the Singapore-Australia digital agreement is sort of the, you know, the high priestess of the big tech version of how to do it.

And, could we come up with one that is more pro-workers and pro-consumers, and start having a battle of ideas? That's an interesting question, but again depending on the partners.

And, then the third thing is what is some kind of a system like readiness criteria. To think about what are the partners who are auspicious, potential like-minded fellows for supply

chain resilience. For any of these rules setting projects.

MR. MEYER: If I could just a couple things really quickly.

Just first would be there's a lot of issues that are basically technical issues. As we try to sort of expand what we do with trade policy, we're going to have to develop technical capacity to do things like map complicated supply chains.

And, we're not going to know how to do that until we try to do it.

And, so I think IPEF offers a potential framework to try to do those things. Whether it's mapping critical supply chains and figuring out how to do that more efficiently, or whether it's figuring out standards for decarbonized trade, in for instance, steel and aluminum.

All of those things are going to involve the development of these technical standards. And, I think that that is something that might actually be done very effectively at a sectoral level, or on a piece-by-piece basis, where we're not trying to do everything all at once.

Instead, we try, we pick a project and figure out how to do it before we expand.

COMMISSIONER MANN: Commissioner Scissors?

COMMISSIONER SCISSORS: I have leading questions, my favorite kind for Dr. Elms, and for Wendy.

Dr. Elms, I actually don't know this. I tried to look it up and there's so much horrible legal text, and I blame Professor Meyer for this. I couldn't find it quickly.

What's the accession protocol in CPTPP? Is it by unanimous vote? Is it by majority vote, it's two-thirds? What is it? Do you know?

MS. ELMS: It's not specified.

COMMISSIONER SCISSORS: Oh.

MS. ELMS: So, the original accession, the original accession provisions have been updated three times by the CPTPP Commission, and remain still a little vague.

I mean, maybe we need more lawyers, I don't know. It follows the model that we had during TPP, which is you are meant to go and do informal consultations to start.

COMMISSIONER SCISSORS: Uh huh.

MS. ELMS: Having done those informal consultations, the members, and here we have a little bit of ambiguity over whether it's active members or signatories, then they have to vote, or they have to decide by consensus, on whether they form a working party.

And, then how that working party forms is something that we're exploring now at the, with the U.K. in the accession process.

COMMISSIONER SCISSORS: Okay, so the follow up to that is can the, could the U.S. join CPTPP with a veto over any other country joining it? Could that be part of our negotiation? Is that on the table?

MS. ELMS: I would argue that it's, it is part of the process for any member, which is to say if you're moving ahead by consensus -

(Simultaneous speaking.)

COMMISSIONER SCISSORS: Okay.

MS. ELMS: -- if the members say no, then, if any member says no, then you're stuck.

COMMISSIONER SCISSORS: So do the CPTPP countries understand that if the U.S. joined, China would never be able to join?

They understand that they're making a choice because the U.S. would never allow China to join this trade group.

And, they prefer, I'm asking you, and they prefer the U.S. Is that right? Would you say that in your opinion?

MS. ELMS: I think it's quite clear to the members that if you had the U.S. in, you would not have China in.

COMMISSIONER SCISSORS: Okay.

MS. ELMS: The alternative is probably also true, although little less discussed. If you had China in, then you would never get the Americans.

So, yes, it's a choice.

COMMISSIONER SCISSORS: Okay.

MS. ELMS: I think for current CPTPP members, they would say we have to go with who are the potential candidates on the horizon.

And, if the U.S. is not a candidate, then we have to talk to candidates who have applied.

COMMISSIONER SCISSORS: Well, then we really should support the British, because then they can block the Chinese on our behalf.

I told you it was a leading question.

Wendy, I have a leading question for you.

When is the Biden administration going to submit trade promotion authority to Congress?

MS. CUTLER: Ask them.

COMMISSIONER SCISSORS: Okay.

(Laughter.)

COMMISSIONER SCISSORS: Okay, so --

(Laughter.)

COMMISSIONER SCISSORS: -- excellent answer, excellent answer.

Without trade promotion authority, what is the point of talking about IPEF? What, who cares?

You're going to take the entire time of the first term, there may not be a second term. This is just no consequence whatsoever.

All the discussion you guys have had about it, it will be good this way, it'll be good that way. It's a total waste of time.

It's an executive order that will never get implemented during the first term because there isn't enough time. And, then it will probably be gone, right?

So, you know, that's a comment.

Let me ask you a question that I think is more, more relevant.

MS. CUTLER: You don't want me to respond to that?

COMMISSIONER SCISSORS: Yes, you can respond to that. Go ahead.

MS. CUTLER: No, no, go ahead.

COMMISSIONER SCISSORS: Okay.

Is there in your view, anything and this is an honest question and I'll take anything that you have, anything likely to come out of the TTC, so I've given up on Asia for reasons I've just lend, asked leading questions about.

Anything to come out of the TCC, TTC that's relevant to U.S.-China economic competition?

So, you know, meetings about purely transatlantic issues not really relevant.

Is there anything there, and I'm asking from a position of ignorance, that you see like, I'm not, you're not guaranteeing it's going to happen, that's not what I'm asking for.

This potentially will matter to U.S.-China economic competition.

MS. CUTLER: Yes, and I will admit I'm not as close to European matters as I am to Asian matters, being at the Asia Society.

But my understanding is there are detailed discussions going on between U.S. and Europe, on coordinating defensive tools that can be used against Chinese practices.

Not, you know, not agreeing necessarily to the same tools, but, you know, the EU now has been really expanding the tools in its toolbox, to respond to subsidization, and to other, other unfair competition. So, that's number one.

I think there are discussions that are going on on economic coercion, a practice that China is more brazenly following in recent years.

And, this discussion may be even broader than what's, broader than between the U.S. and the EU.

So, yes, I think there are these discussions going on both on the defensive side, but also on the offensive side.

The EU, Japan, and the U.S. during the Trump administration, were working on a set of rules on industrial subsidy state on the enterprises, technology transfer, and other non-market economy practices.

And, Katherine Tai has met with her counterparts from the EU and Japan, over the past few months, and they've revived that work.

So, I think we're going to see tangible stuff coming out of the TTC, and out of bilateral discussions, and trilateral discussions.

And, who knows, maybe other countries like Korea with their new president, may be more willing to join these discussions as well.

All designed to address the China challenge both from a defensive, but also from an offensive perspective.

COMMISSIONER SCISSORS: Just like a two second comment. The TTC solves some of the problems we have in Asia. Democracies, labor standards, environmental standards.

I think, I'm not saying it's likely to be productive, but since I think the Asian discussions are not going to be productive, I would just say that's something for us, our Commission and for the Congress to consider.

Sorry for the extra time.

COMMISSIONER WESSEL: Let me just quickly comment.

The TTC includes export controlled coordination investment issues, and the recent U.S.-UK 232 Agreement for the first time, includes audit provisions regarding Chinese owned entities operating in a country's territory that are bilaterally available.

So, staff should get some of that material to us.

Commissioner Wong?

CHAIRMAN WONG: Mr. Meyer, in your written discussion on TAA, or Trade Adjustment Assistance, you know, I think I'm in agreement with you that there should in general, be a tighter fit between trade agreement passage or negotiation, and the structuring and passage, and reauthorization of TAA.

I guess economists would say that trade agreements are inherently Kaldor-Hicks efficient, so there needs to be a discussion on how to redistribute that unequal distribution of benefits, at least in a transitional basis, until the dynamism of our economy can restructure the economy.

My question though, given that where the China Commission is, how relevant any policy on TAA is toward China.

You mentioned in your discussion that there are ongoing distortions from Chinese subsidies, and its effect on our, on workers, and on businesses here, and certain sectors here.

But to me, that's not a Kaldor-Hicks issue. That’s not an efficiency issue. Because there

is no efficiency.

We're actually highly inefficient if we're letting a partner abuse trade rules, not abide by the agreement.

So, we're not redistributing. There it's not so much a question then of TAA, or a distribution problem.

It's a good faith problem on the part of the Chinese. It's a wisdom problem on agreeing to these agreements in the first place.

And, then also an enforcement problem to get them in line, or in compliance.

Am I wrong about that?

MR. MEYER: I guess I don't think it's an either-or. And, so I think I agree with the characterization, everything you said at the end, which is that we have an enforcement problem with China. That they have not acted in good faith with respect to many of their trade obligations.

And, that that is the source of some of the ongoing disruptions that, you know, Chinese membership in the WTO has caused.

The question is what do we do about that? And, so part of the strategy, and this is where there's no either-or, I think.

So, part of the strategy to respond to that seems to me to be, to directly address the kinds of concerns you just raised.

So, we do that through, you know, it's been done through the 301. I think some of the divestment authority that I talked about, I think could be responsive.

That the European's anti-coercion instrument is aimed at addressing a different facet of these kinds of problems.

So, I think building the toolkit to address those problems, is absolutely part of the answer. I just don't think it goes all the way.

And, so the idea that, you know, the economy sorts itself out, is at a national level in some sense that might be true.

But I think we've just got the data now to know that there are communities that just haven't bounced back. And, the question is what do we do with those communities?

So, and some of the work I've done on TAA is that, TAA more generally, is that this is a program that probably needs to be community-focused to a much greater extent than it is, in order to address these kinds of ongoing, ongoing disruptions.

And, there's a sense in which I think that if we want to be able to both as a matter of equity within the U.S., and also as a matter of being able to say to our trading partners, we have the political will in the United States to follow through on the commitments we're making to you, be those market access commitments, or other kinds of commitments.

Whatever those commitments are, we have to be able to say that these communities which have been so critical politically, that they're going to support the U.S.'s outward facing trade policy.

And, so that's a slightly more political way, I think, of thinking about it as opposed to the economic frame, the, you know, the sort of Kaldor-Hicks kind of efficiency model.

The issue is we have communities that have suffered, and that are not likely to support a U.S. trade policy that doesn't build in some mechanism to, to aid those kinds of communities.

And, with all due respect to Ms. Elms, I think that is squarely a trade agreement issue, right.

I absolutely agree that it's something that could be done domestically. The problem is it

just hasn't really been done domestically, at a scale that would allow us to basically represent credibly that we can honor whatever trade commitments we make to our counter-parties.

CHAIRMAN WONG: Yes, just a comment on your last piece. I'm in agreement. I phrased it a little bit differently.

I run in kind of strategic security circles, and I tend to think that the folks I talk with, when they talk about trade agreements, whether it's CPTPP or others, they look at the strategic value of being in these agreements.

And, I think we all agree there is strategic value, political value, diplomatic value to it.

But we can't ignore the economic piece of it, simply because if it's not a sustainable situation for our workers and our businesses, and our economy, in the end we will not reap the strategic benefits.

Because in fact, we'll create more strategic space between us and our partners, because those ties continue to fray. Because it doesn't work for us economically.

So, it's a different way of kind of phrasing it, but I see where you're going with that.

Thank you.

COMMISSIONER WESSEL: Commissioner Glas?

VICE CHAIR GLAS: It was touched on in some of the earlier testimony from Mr. Meyer, but the Trade Adjustment Assistance has expired.

And, many of these workers and these communities, have been impacted by the implications of our trade policies, as well as imports coming from China.

Ms. Wallach, I know you talked about some of the provisions and the existing China bill, but can you just talk about the sense of urgency related to TAA?

MS. WALLACH: Thank you, I actually was, if the timer hadn't run out, I was going to ask to be recognized.

Because it is the case that already at the beginning of this year, the full TAA program that covers most of the workers who have lost jobs to China, expired.

And, at the end of this year, the entire program that's been in effect since the Kennedy administration, runs out of authorization.

So, shockingly, USICA, the Senate version of the China competition bill, does not include a TAA reauthorization. COMPETES, the House version does.

And, moreover, it has some importance and I think useful and in part, community oriented additions to the core program.

The core program provides retraining but it's very narrowly defined. And, as a result, unless there's literally a free trade agreement, it's harder to qualify.

The extended program that expired at the beginning of this year, has a different measurement mechanism.

Covers services, has the community program, and has some coverage for people who need help with the COBRA of their healthcare.

And, that's already gone.

So, this is literally in the matter of seven months, the tens of thousands of workers who just now again, every month are getting certified by the Department of Labor as having lost their jobs explicitly under the criteria of the program, will have nothing.

COMMISSIONER WESSEL: Commissioner Borochoff?

COMMISSIONER BOROCHOFF: Thank you for letting me do this at the end.

The reason that I passed was because I was thinking about Dr. Meyer, the divestment authority section of your report. And, I was hoping that someone else would bring it up.

And, in fact, by my count, Commissioners Friedberg, Goodwin, Mann, Schriver in his own way talking about limited trade, and then Commissioner Wong all brought it up.

And, I just wanted to make this statement that I come at all these things usually just based on my own experience. And, so it's limited to what I know.

But when you take a framework and change it, the unintended consequences have to be thought through.

And, I agree with what you said earlier that it's a super complicated proposition.

I have been thinking for some time now, that when you have a business partner that you find out is actually an adversary, and you've opened your heart to him and all they do is hook up a line and drain all your blood, you have to decide maybe the carrot's not going to ever work. So I have to use the stick.

Well, I have seen this done in a variety of political and economic arenas, and it's so complicated. I live in a city where proudly in Texas, had no zoning. We're the fourth biggest city in America.

So, it has become obvious zoning is necessary. All the public wants zoning in some way.

But the problem with over, with creating a new rule and dropping it on top of your entire real estate base, is that you create winners and loser.

And, the same can be said in politics with term limits. In trying to correct corruption in a variety of publicly traded companies, when you try to fix it without really exploring what the result is going to be, it's sometimes catastrophic.

And, I'm in favor, I know I'm in favor, of as a patriot, if we have to divest and use export controls to say hey, maybe you shouldn't be paying for something that's going to destroy the planet.

We have to understand that it's the American way, the capitalist way that people make investments, and they get to lose money, and they get to do whatever they want to do.

But at some point, you have to say well, that's not okay for the greater good.

So, I have really that comment to make that this is so complicated and so important, and probably it's the light coming at us from the tunnel.

We're going to have to at some point, answer this challenge with decisions that are going to create some winners and losers.

So I have a question. I think I know where you stand on it, I read it, and I heard your explanation and I actually think you're right, that there's probably a way to do it.

I think it's so complicated it's you can't just discuss it in passing. It's going to take a real effort.

I'm curious about the other panelists. You've listened to this and you probably read the report. Do you agree that divestment authority is something that probably has to be done, or do you not think that?

And, we can start with you, Ms. Wallach, and just go around.

MS. WALLACH: I think it is necessary. And, I think outward bound investment screening is also important.

COMMISSIONER BOROCHOFF: Uh huh.

MS. WALLACH: And, while we're on the endless theme of the USICA versus the COMPETES, the House version COMPETES includes ironically, a bill that started here in the Senate, that has bipartisan sponsorship.

That starts the process of having investment screening, with respect to the prospect of outsourcing important supply chains to China.

COMMISSIONER BOROCHOFF: But --

(Simultaneous speaking.)

MS. WALLACH: Another reason the trade provisions of the House bill are the way to go.

COMMISSIONER BOROCHOFF: I will confess that I have not read either of the two versions.

But I'm assuming because I haven't heard about it, it doesn't address the issue of an individual president deciding you company, can't have that investment anymore, does it?

MS. WALLACH: No.

COMMISSIONER BOROCHOFF: What about you, Ms. Elms?

MS. ELMS: I think you're right that the risk of unintended consequences, is significant. And, it needs some very careful thought.

And, I would say as a sort of broader point, something that has come up all day that I don't think has been noted, is that when you say that you want to shift up supply chains and you want them to be more resilient, and you want them reshored or whatever, just be aware that that involves a lot more cost.

Or is likely to involve a lot more cost. And, so you are driving up costs in the economy, and driving up costs for firms.

Now, you may decide in the end that that's worthwhile to do so, but there are definitely going to be economic consequences to decisions around new rules on whether or not you can be ordered to divest.

Or rules about whether or not you have to, you know, have a transparent supply chain, or how you could create a supply chain, et cetera.

There are consequences to that, and the cost of surviving is going to go up.

So, I think it's worth noting.

COMMISSIONER BOROCHOFF: And, I would say that's a wise comment. And, in the business world, we make them all the time.

If a competitor does something, you have to decide am I going to answer it with, by spending money, or am I going to take the risk they're going to put me out of business by not answering it.

So, also may I have our last panelist please tell me how you feel about that?

MS. CUTLER: So, just to add to what the other panelists said, I think the scope needs to be carefully considered.

Which sectors, which products, which types of investments? And, careful thought needs to be given before some broad authority is granted, or a new program is established.

In one of the pieces of legislation, I can't remember if it's the Senate or the House side, they give USTR the authority to administer this new outbound investment program.

Having worked at USTR for 28 years, I can say that's probably not the right choice. They're not equipped to do that. They don't have the personnel, nor the expertise.

So, that's just another example I think, where more thought needs to be given that if we're going to go down this route, who should be implementing this in terms of which government agency, and what new resources will be needed?

COMMISSIONER BOROCHOFF: Thank you very much.

COMMISSIONER WESSEL: Commissioner Cleveland?

COMMISSIONER CLEVELAND: I just want to clarify, Dr. Meyer. When you talk about divestment authority and what that might look like in terms of a legislative provision, that

is distinctly different from what we're talking about in terms of outbound investment screening, correct?

MR. MEYER: Correct, yes, correct.

So the legislation that Ms. Wallach referenced includes divestment as a potential penalty for failing to comply with the ex-ante screening provisions.

But we don't have a comprehensive scheme that would authorize just the, that order of a divestment.

COMMISSIONER CLEVELAND: Right, thank you. I was just thinking about what Professor Friedberg had talked about.

Thank you.

COMMISSIONER WESSEL: And, I urge our audience and witnesses to look at last year's Commission report, which had a recommendation in this area.

Not referring to the specific bills and no mention of divestment, et cetera.

We will take a break till 3:40.

Thank you all to your, for your preparation and appearance, and we'll stand adjourned for 10 minutes.

(Whereupon, the above-entitled matter went off the record at 3:29 p.m. and resumed at 3:39 p.m.)

PANEL IV INTRODUCTION BY COMMISSIONER ROBIN CLEVELAND

COMMISSIONER CLEVELAND: This Panel will examine the adequacy of the WTO to address Chinese nonmarket practices. Looking specifically at the structure of WTO rules and jurisprudence to tackle Chinese state capitalism.

We welcome Dr. Robert Staiger, professor of economics at Dartmouth College for his first time before the Commission. Dr. Staiger's testimony will cover ways to change China's relationship to the WTO as, well, as a nonmarket economy.

We will then welcome back Terry Stewart, former managing partner at Stewart & Stewart, who is familiar to this Commission from his testimony as most recently in 2016. And he'll speak on the limits of WTO to address China's distorted behavior and how Congress could expand its role in guiding U.S. trade policy.

We thank you both for your time and attention and testimony. So, Dr. Staiger, if you'll begin. And as noted previously, please keep your remarks to seven minutes because we ask a lot of questions. So, Dr. Staiger, please.

OPENING STATEMENT OF ROBERT STAIGER, PROFESSOR OF ECONOMICS, DARTMOUTH COLLEGE

MR. STAIGER: Okay, many thanks to Commissioners Cleveland and Wessel for inviting me to testify before this Commission from the WTO's role and a workable U.S. strategy to challenge China's trade practices and integrate China more fully into the rules based multilateral trading system.

My research suggests that the architecture of the WTO and of the General Agreement on Tariffs and Trade, or GATT, on which the WTO is built, is based on sound economic principles and is well designed to meet the challenges faced by the world trading system in the 21st century.

These challenges include the important task of integrating China more fully in the rules based system, the focus of today's hearing. But to accomplish this task it is critical that the underlying China specific challenge by the WTO is identified and that it is distinguished from other non-China specific challenges in which the WTO must also contend.

In particular, I believe that the rise in economic importance for the large emerging and developing economies with China playing a leading role has created three interrelated challenges for the World Trading system. And I believe it is only when these challenges are identified and distinguished from one another that the appropriate WTO legal instruments can be deployed to address each challenges.

What are these three challenges? First, there appears to have emerged a substantial departure from reciprocity between China and its major industrialized trading partners. A departure that is directly attributable to the nonmarket features of China's economic system.

But I believe that these features are not, by themselves, incompatible with China's obligations in the most lateral trading system. And that the applied need for re-balancing market access commitments between China and the other WTO members can be addressed with GATT/WTO non-violation claims. This challenge is clearly China specific, and I would call it the essence of the WTO's China challenge.

Second, once reciprocity between China and its trading partners is established, there is a possibility that the Uruguay Round MFN tariff commitments made by the United States, and other industrialized countries, now imply the grant of a greater level of market access than some of these countries are comfortable with.

I believe that the implied need for reconsideration of the level of reciprocal market access commitments were necessary can be addressed with GATT Article XXVIII renegotiations.

Going to the sheer size in the World Trade, China undoubtedly plays a leading role in the second challenge as well. But this challenge is not specifically about China.

The third challenge arises from the historical lack of participation by non-industrialized countries and 50 years of GATT reciprocal tariff negotiations and the asymmetric levels of market access commitments between the developing, emerging economies and the industrialized countries that exist as a result.

This has led to a latecomers problem for the WTO that may be hindering the ability of many developing and emerging economies to gain from the GATT/WTO membership. Because China made significant market access concessions as part of its 2001 protocol for accession to the WTO, this third challenge is less about China and more about other emerging and developing

economies.

In my remaining few minutes I will elaborate on the first of these challenges and refer the Commission to my written statement for a treatment of the second and third challenges.

My research suggests that the fundamental purpose of a trade agreement, such as the WTO, remains the same whether member countries adopt market oriented or nonmarket economic systems. This is because the choice between these two economic systems will not impact the nature of the problem for a trade agreement to solve.

Either way, it is still the international spillovers associated with unilateral government decisions, which are driven by the quantities of goods and services that countries offer for exchange across national borders, not by what happens inside those national borders to generate those quantities that creates the problem that a successful trade agreement must address.

This observation is clarifying because it indicates that succinctly put, the challenge for the WTO posed by China Inc is this. The WTO must find a way for China to make additional policy commitments tailored to compensate for the nonmarket features of economy.

They conserve the role of preserving the market access applied by tariff bindings, much as the role that GATT articles play for market oriented economies.

Evidentially, there is no need to think that China's entry into the world trading system raises issues that are fundamentally inconsistent with the WTO's underlying mandate. To the contrary, the market access orientation of the GATT/WTO provides a useful guardrail for what China should be willing to contemplate and what the United States and other WTO members have a right to expect in the context of China's WTO commitments.

The essence of the WTO's China challenge can therefore be characterized as follows. Upon China's 2001 accession to the WTO, and in combination with existing WTO disciplines and together with the expectation that China would involve strongly toward a more market-oriented economy, its trading partners believe that the tariff bindings and additional specific market access commitments that China agreed to were sufficient to ensure that China would adhere to an appropriate balance between rights and obligations. A balance that is embodied in the GATT/WTO norm of reciprocity.

But the set of specific commitments that China has agreed to has turned out to be unsatisfactory for this purpose, primarily because China has not evolved toward a market economy as quickly or as fully as its trading partners expected. If this characteristic is, if that characterization is accurate, then the non-violation clause provides a promising path for the United States and other WTO members to address the current impasse.

This provision, which was an important focus of the drafter of GATT in 1947, and whose relevance was reaffirmed with the creation of the WTO in 1995 allows one GATT/WTO member government to seek compensation from another for adverse trade effects of the others policies. Even though those polices do not violate specific obligations under the GATT/WTO agreement.

Under a successful non-violation claim the, the defendant government is under no obligation to remove the measures at issue. But it does, if it does not remove them, then the claimant government is owed compensation. The level of which is subject to arbitration by the WTO dispute settlement body.

The successful non-violation claim would provide China with the freedom to decide whether, and if so, how best to offer new and secure market access commitments that would reestablish reciprocity with its trading partners. With the knowledge that if this offer is not sufficient for this purpose, then its trading partners have a right to restore reciprocity by withdrawing market access concessions of their own.

Crucially, any disagreements between China and its trading partners over the magnitude of the policy adjustments required to restore reciprocity would be referred to the relevant WTO dispute settlement bodies for ruling thereby keeping the resolution of these issues with a rules-based multilateral system. Of course this presumes that the current vacancies in the appellant body are filled so that it is able, once again, to review appeals.

In short, I believe that China is unlikely to agree to a one-way do over of its accession negotiations in order that industrialized countries can impose new commitments on it. But as a WTO member, China did agree to be the subject of a logic of the non-violation claim.

And China did negotiate its accession under the explicit expectations that it would achieve reciprocity between its rights and its obligations. It is for these reasons that utilization of the WTO's non-violation clause provides the appropriate U.S. strategy for address the nonmarket features of China's economy and integrating China more fully into the rule space multilateral trading system.

Thank you. And I look forward to questions.

COMMISSIONER CLEVELAND: I'm not sure you'll look forward to questions, but Mr. Stewart, if you would proceed.

PREPARED STATEMENT OF ROBERT STAIGER, PROFESSOR OF ECONOMICS, DARTMOUTH COLLEGE

TESTIMONY
OF
ROBERT W. STAIGER

ROTH FAMILY DISTINGUISHED PROFESSOR IN THE ARTS AND SCIENCES AND PROFESSOR OF ECONOMICS, DARTMOUTH COLLEGE; AND RESEARCH ASSOCIATE, NATIONAL BUREAU OF ECONOMIC RESEARCH

BEFORE THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

HEARING ON
CHALLENGING CHINA'S TRADE PRACTICES: PROMOTING INTERESTS OF U.S. WORKERS, FARMERS, PRODUCERS AND INNOVATORS

THURSDAY, APRIL 14, 2022
DIRKSEN SENATE OFFICE BUILDING, ROOM 419
WASHINGTON, DC 20002

THE UNITED STATES COULD USE WTO PROCEDURES TO ADDRESS THE TRADE DISTORTIONS RESULTING FROM CHINA'S POLICIES AND PRACTICES

TESTIMONY OF ROBERT W. STAIGER[1]

1 Introduction

Since its 2001 accession to the World Trade Organization (WTO), China has become a dominant economy in world trade but also a major source of trade friction for the United States and other WTO members. These trade frictions stem from the non-market elements of China's economic system, and they have interfered with the full integration of China into the rules-based multilateral trading system. Given China's sheer economic size, if left unaddressed these frictions have the potential to threaten the very existence of the multilateral trading system itself.

How should the United States address its trade frictions with China? I argue here that existing WTO procedures, possibly augmented and employed in novel ways, may provide the best path forward. I begin by describing more broadly why the WTO should remain the constitution of the world trading system of the twenty-first century. I then turn to the specific question of how the WTO's existing provisions could be utilized by the United States to address its trade frictions with China and thereby more fully integrate China into the rules-based multilateral trading system.[2]

The case for the GATT/WTO The multilateral trading system is in trouble. Governed by the WTO, which came into existence in 1995 and builds on and extends the principles of its twentieth century predecessor agreement, the General Agreement on Tariffs and Trade (GATT), this system of global trade rules is facing a growing list of twenty-first century challenges that include the rise of large emerging markets led by China, efforts to address climate change, the growing importance of digital trade, the rise of offshoring and global value chains, and the push for regulatory harmonization as an end in itself. These challenges reflect changes in the global economy that have occurred in recent decades, and they raise questions about the legitimacy of the GATT/WTO as the arbiter of global trade rules.

Is the WTO, an institution that has traditionally been about "shallow integration" with a focus on trade impediments imposed at the border rather than on "deep integration" that results from direct negotiations over behind-the-border measures, capable of meeting these challenges? Or do we need a new global trade order for the twenty-first century?

[1] Robert W. Staiger is the Roth Family Distinguished Professor in the Arts and Sciences, and Professor of Economics, at Dartmouth College, and a Research Associate of the National Bureau of Economic Research. I thank Kyle Bagwell, Emily Blanchard, Chad Bown and Robert Koopman for helpful input. Disclosure of Relevant Financial Interests: In 2011 I wrote a background paper on the treatment of non-tariff measures for the WTO's 2012 World Trade Report; and since 2009, I have served on the selection panel for the Annual WTO Paper Prize for Young Economists.

[2] The remainder of this section, as well as sections 2-5 of this written testimony, represent a repackaging of the material in the Preface to and Chapter 7 of Staiger (2022).

In Staiger (2022) I address these questions, and I argue that the best hope for creating an effective world trading system for the twenty-first century is to build on the foundations of the world trading system of the twentieth century. I construct this argument in two steps: first, by developing an understanding of why GATT worked and the economic environment it is best suited for, and second, by evaluating from the perspective of this understanding whether the changes in the global economy that have occurred in recent decades imply the need for changes in the design of the GATT/WTO. Throughout I adopt the view that design should reflect purpose, and that identifying the fundamental purpose of a trade agreement in a given economic environment - that is, what problem the agreement should solve for the member governments - is essential to understanding its appropriate design in that environment.

Building on these steps, I argue that the "terms-of-trade theory" of trade agreements - which holds that the problem for a trade agreement to solve stems from the international price effects of a country's trade policy on that country's trading partners (the international spillovers or "terms-of-trade externalities") that are not accounted for when governments make their trade policy decisions unilaterally, and holds that solving this problem amounts to helping governments internalize these spillovers in their policy choices - provides a compelling framework for understanding the purpose of a trade agreement in the twentieth century and the success of GATT.[3] And I argue that, according to this understanding, the logic of GATT's design features transcend many, though not all, of the current challenges faced by the WTO.

Two overarching themes emerge from the research that I describe in Staiger (2022). A first theme is this: Trade agreements that lack deep-integration provisions are not necessarily "weak" agreements; by the same token, those trade agreements that contain the most developed deep-integration provisions should not necessarily be seen as the "gold standard." Indeed, where the terms-of-trade theory is applicable the opposite may be closer to the truth, as shallow-integration agreements then hold out the possibility that countries could reach the international effi ciency frontier without sacrificing national sovereignty.

A second theme is more subtle. When it comes to trade agreements it could be said that the primary task of national governments during the GATT era was to dismantle the excessively high trade barriers of the large industrialized countries, and to move the world from a starting point far away from the international effi ciency frontier to a position on the frontier - or in the language of the terms-of-trade theory, to escape from a terms-of-trade driven prisoner's dilemma; and by the end of the twentieth century much, though not all, of this task had been completed. For the twenty-first century, by contrast, it could be

[3] More specifically, a terms-of-trade externality arises whenever one country's restrictive import policies reduce the price that foreign exporters can receive for exports of their product to that country. When countries negotiate over their trade policies, foreign exporters gain a forum to voice, through their governments, their concerns over the injury caused by the reduced exporter prices that can be charged when serving the first country's markets; by negotiating trade policies that take account of these concerns, a mutually beneficial liberalization of the first country's import restrictions is possible.

said that while in many ways the fundamental problem for trade agreements to solve has not changed, the primary task for the WTO has shifted, away from helping governments traverse to the effi ciency frontier, and toward providing them with the flexibility they need to remain on the frontier in the face of various shocks to the world trading system, including the rise of China and the large emerging economies, the digitalization of trade, and the rising threat of climate change. For this era, how well countries are able to rebalance and renegotiate their commitments within the GATT/WTO framework is likely to become paramount to the WTO's success. I argue that in principle, the GATT/WTO is as well-equipped for this second task as the GATT proved to be for the first task. And while the rise of offshoring and global value chains, and the push for regulatory harmonization as an end in itself, may reflect a change in the purpose of trade agreements and therefore present more fundamental challenges to the GATT/WTO approach, I argue that there is still a strong case for building on the GATT/WTO foundation to address these particular twenty-first century problems where they arise.

In short, the message I offer in Staiger (2022) can be summarized as follows: The best advice for designing a world trading system for the twenty-first century may not be Facebook founder Mark Zuckerberg's famous motto "Move fast and break things," but rather Britain's now-ubiquitous war-time slogan from World War II, Keep Calm and Carry On. With this advice I am not claiming that reforms to the world trading system are not needed, or that all is well at the WTO. But I am claiming that the basic architecture of the GATT/WTO - and of the GATT, in particular - is well-suited to guide the design of the world trading system of the twenty-first century.

Identifying the WTO's China challenge

Is the basic architecture of the GATT/WTO up to the task of integrating China into the rules-based multilateral trading system? I argue below that it is, but only once the underlying China-specific challenge that the WTO must confront is identified and distinguished from a number of other challenges with which the WTO must also contend but which are not China-specific. In particular, below I argue that the rise in economic importance of the large emerging and developing economies, with China playing a leading role, has created three interrelated challenges for the world trading system.

First, there appears to have emerged a substantial departure from reciprocity between China and its major industrialized trading partners. Below I suggest that the implied need for rebalancing market access commitments can be addressed with GATT/WTO non-violation claims. Second, even once reciprocity between China and its major industrialized trading partners is established, there is a possibility that the Uruguay Round tariff commitments made by industrialized countries now imply the grant of a greater level of market access than some of these countries are comfortable with. Below I suggest that the implied need for reconsideration of the level of market access commitments, where necessary, can be addressed with GATT Article XXVIII renegotiations.

The first of these challenges centers on China. And owing to its sheer size in world trade, China undoubtedly plays a leading role in the second challenge. In Appendix A I include a more detailed discussion of how existing WTO flexibilities might be harnessed to address these two challenges. The third challenge arises from an asymmetry in the level of market access commitments between the developing/emerging economies and the industrialized countries. This asymmetry is a result of the historical lack of participation of non-industrialized countries in 50 years of GATT reciprocal tariff negotiations, and it has led to what Bagwell and Staiger (2014) call a "latecomers problem" for the WTO that may be hindering the ability of many developing and emerging economies to gain from GATT/WTO membership. Because China made more significant (though, as it turned out, perhaps still not reciprocal) market access concessions as part of its 2001 protocol for accession to the WTO than have any other emerging and developing economy WTO members to date, this third challenge is less about China than about other emerging and developing economies.[4] I suggest that the latecomers problem can be addressed with GATT Article XXVIII renegotiations between industrialized countries, followed by GATT Article XXVIII bis negotiations between industrialized and developing/emerging countries.

In the following sections I consider in more detail each of these three challenges, and I describe how the WTO, with some possible adjustments, is in principle well-designed to address them. Admittedly, my comments here are focused squarely on market access issues, and do not directly address U.S. concerns over intellectual property rights violations and other related issues associated with digital/new technologies. But by serving as a trust-building exercise for the United States and China on the more WTO-familiar issues that my comments are meant to address directly, it is possible that the way may be paved for addressing these other issues in the future.

2 Rebalancing market access commitments

Industrialized countries have grown increasingly frustrated with the inability of WTO rules to effectively discipline China's economic policies, owing to the non-market features of China's economy. For example, in its 2020 Report to Congress on China's WTO Compliance, the United States Trade Representative stated:

> ...China's non-market approach has imposed, and continues to impose, substantial costs on WTO members. In our prior reports, we identified and explained the numerous policies and practices pursued by China that harm and disadvantage U.S. companies and workers, often severely. It is clear that the costs associated with China's unfair and distortive policies and practices have been substantial. For example, China's non-market economic system and the industrial policies that flow from it have systematically distorted critical sectors of the global economy such as steel,

[4] On the unusually far-reaching market access commitments that China agreed to in its protocol of accession to the WTO relative to other developing and emerging economy GATT/WTO members, see for example, Lardy (2001).

> aluminum, solar and fisheries, devastating markets in the United States and other countries. China also continues to block valuable sectors of its economy from foreign competition, particularly services sectors. At the same time, China's industrial policies are increasingly responsible for displacing companies in new, emerging sectors of the global economy, as the Chinese government and the Chinese Communist Party powerfully intervene on behalf of China's domestic industries. Companies in economies disciplined by the market cannot effectively compete with both Chinese companies and the Chinese state. (USTR 2021, p 2)

Similar frustrations about China's economic policies have been voiced by the EU (see, for example, European Commission, 2016).

Wu (2016, p 284) attributes this frustration not so much to any one specific China policy or even a handful of specific policies, but rather to China's "complex web of overlapping networks and relationships - some formal and others informal - between the state, Party, SOEs [state owned enterprises], private enterprises, financial institutions, investment vehicles, trade associations, and so on." Adding to this frustration is the fact that many of the distinct elements of China's unique economic model were put in place after its 2001 accession to the WTO. But rather than reflecting frustration with a bad-faith effort on the part of China to escape from its WTO commitments, it is more accurate to say that the growing frustration among industrialized countries reflects their unmet expectations that China would have by now evolved further in the direction of a market-oriented economy than it, in fact, has. Summarizing the nexus of non-market forces operating in China with the moniker "China, Inc.," Wu puts the point this way:

> This is not to suggest that the Chinese concealed their true intentions. Throughout the 1990s, Chinese leaders openly and repeatedly stated that they sought to forge their own unique economic system. Moreover, economic developments in China's reform era have proceeded largely through incremental rather than through radical, abrupt policy shifts. Thus, the development of China, Inc. should not be understood as a deliberate ex post act to circumvent WTO rules. (Wu, 2016, p. 292, footnotes omitted)

As Wu (2016) describes it, China, Inc. poses a particularly subtle challenge for the WTO. This is because the pursuit of complaints against China's policies through the WTO dispute settlement system has not been altogether unsuccessful in helping China's trading partners address these concerns. As Wu documents, for certain kinds of issues, such as state-coordinated economic actions, local content requirements and state trading enterprises, the GATT/WTO legal framework has proven to be effective against those countries that have used such policies in the past, and it continues to be effective against China's use of these policies. The real challenge lies in other issues raised by China's policies - the definition of a "public body" in the context of defining the reach of WTO disciplines on subsidies, or whether China's trading partners can treat it as a non-market economy for purposes of administering their antidumping laws -

which involve technical legal and factual questions that the WTO dispute settlement body has little prior experience resolving, with trade stakes that are potentially enormous. Left unaddressed and in light of China's sheer size, these issues have the potential to upset the fundamental balance between market access rights and obligations that lies at the core of the GATT/WTO bargain. They are the kinds of thorny issues posed by China, Inc. on which, Wu argues, the WTO could founder.

What is the nature of the WTO's China challenge? So how should the WTO confront the China, Inc. challenge? To answer this question, it is clarifying to first ask: What is the purpose of a trade agreement?

The literature on the economics of trade agreements has shown that the purpose of a trade agreement in a wide range of settings can be seen as expanding market access to internationally effi cient levels, a purpose that is formally equivalent to providing member countries with an avenue of escape from an international terms-of-trade-driven prisoner's dilemma.[5] But in all of the settings that this literature considers, market forces - subject to the kinds of government policy interventions that typify those found in market economies - are assumed to shape the decisions of firms and consumers everywhere.

Does the purpose of a trade agreement change when one of the countries adopts an economic system like China, Inc.? Reassuringly, it is straightforward to see that the answer to this question is "no," as long as international prices continue to be determined by the international market clearing conditions that equate quantities demanded to quantities supplied on world markets.[6] This is because when one country chooses to organize the economic activity within its borders under a policy regime that features important non-market elements, it does not alter the fundamental international externality - namely, the international-price or terms-of-trade externality - that is generated by the unilateral policy choices of this country and the unilateral policy choices of its trading partners, and that underpins the essential insuffi cient-market-access problem for a trade agreement to solve.

A simple way to see this is to think of noncooperative (unilateral) policies as being determined in two steps: First, facing the constraints imposed by international market clearing conditions, a national "social planner" in each country determines the economic magnitudes (the "allocation") within its national borders and the implied quantities of goods and services that it will offer for exchange across its borders; and second, in each country the national social planner then chooses whether to decentralize the implementation

[5] This point was made by Bagwell and Staiger (1999, 2002). See Bagwell, Bown and Staiger (2016) and Staiger (2022) for recent reviews of this literature.

[6] As Antras and Staiger (2012 a, b) emphasize, a different form of international price determination may be associated with the rise of offshoring, and this can alter the purpose of a trade agreement from that which I have emphasized here. Given China's important role in global value chains, this raises a potential issue with the path for addressing the current impasse with China that I propose below. But that is a potential issue associated with offshoring, not China per se. I discuss the challenges to the WTO associated with the rise of offshoring in chapter 10 of Staiger (2022).

of the desired within-country allocation using a market system and appropriate tax/subsidy/regulatory policies or instead impose this allocation directly on its citizens by fiat. The choice made in this second step could be interpreted as determining whether a country is market-oriented or not. Choosing the first option amounts to the "primal" approach often used by economists to solve the optimal policy problem for a market economy, whereby the fictional planner decides on the allocation and then implements the desired allocation in a market economy with the appropriate policy instruments. Choosing the second option simply omits the use of markets to implement the desired allocation, and instead implements this allocation by fiat. But the choice between these two options will not impact the nature of the problem for a trade agreement to solve, because either way it is still the international terms-of-trade externality associated with unilateral decisions - which is driven by the quantities of goods and services that countries offer for exchange across national borders, not by what happens inside national borders to generate those quantities - that creates the problem for a trade agreement to solve.

Confirming that the purpose of a trade agreement is unchanged when a country adopts an economic system like China, Inc. is clarifying, because it indicates that the challenge for the WTO posed by China's entry into the world trading system is not to find the capacity to evolve beyond its essential market-access focus in order to successfully accommodate China. Rather, the challenge, succinctly put, is this: The WTO must find a way for China to make additional policy commitments, tailored to compensate for the non-market elements of its economy, that can serve the role of preserving the market access implied by its tariff bindings, much as the role that GATT articles play for market-oriented economies.[7] Evidently, there is no reason to think that China's entry into the world trading system raises issues that are fundamentally inconsistent with the WTO's underlying mandate. To the contrary, the market access orientation of the GATT/WTO provides a useful guardrail for what China should be willing to contemplate - and what other WTO members have a right to expect - in the context of its WTO commitments.

In essence, then, the current circumstances that the WTO finds itself in with regard to China's economic policies can be summarized as follows. Upon China's 2001 accession to the WTO, its major industrialized trading partners believed that existing WTO rules, in combination with (a) the very substantial tariff bindings and additional specific market access commitments they had secured from China as part of its accession negotiations and (b) their expectation that China would evolve strongly in the direction of a more market oriented economy, were suffi cient to ensure that China's tariff bindings represented market access

[7] As I describe further in Staiger (2022), as a GATT/WTO legal matter market access is defined by the competitive relationship between imported and domestically produced products, and a negotiated tariff commitment is treated as a commitment to a particular competitive relationship between imported and domestic products and hence as a market access com- mitment. And as Petersmann (1997, p. 136) observes, "...the function of most GATT rules (such as Articles I-III and XI) is to establish conditions of competition and to protect trading opportunities...".

commitments that would deliver the appropriate balance between rights and obligations, a balance that is embodied in the GATT/WTO norm of reciprocity. But the initial set of specific commitments that China agreed to as a condition for accession to the WTO appears to have turned out to be unsatisfactory for this purpose. This is not because China has failed to live up to its specific commitments or to comply with WTO rulings against it when it has not.[8] Rather, it is because China has not evolved toward a market economy as quickly as these trading partners expected, and it does not now appear that China is likely to evolve toward a market-oriented economy as strongly as these trading partners once hoped.

The non-violation clause If this is an accurate summary of the China, Inc. challenge faced by the WTO, then the non-violation clause provides a promising path for WTO members to address the current impasse.[9] This provision, which was an important focus of the drafters of GATT in 1947 (see Hudec, 1990) and whose relevance was reaffi rmed with the creation of the WTO in 1995 (see Petersmann, 1997), allows one GATT/WTO member government to seek compensation from another for adverse trade effects of the other's policies, even though those policies do not violate specific obligation under the GATT/WTO agreement.

The argument for the relevance of the non-violation clause in addressing U.S.-China trade frictions is made forcefully by Hillman (2018) who, in describing the role of a non-violation claim in the context of her testimony before this committee about the best way for the United States to address the challenges created by China's economic policies, observes:[10]

> It is exactly for this type of situation that the non-violation nullification and impairment clause was drafted. The United States and all other WTO members had legitimate expectations that China would increasingly behave as a market economy—that it would achieve a discernible separation between its government and its private sector, that private property rights and an understanding of who controls and makes decisions in major enterprises would be clear, that subsidies would be curtailed, that theft

[8] As Wu (2016) notes, many of the specific commitments agreed to by China as part of its WTO Protocol of Accession (see WTO, 2001) can be litigated successfully in the WTO (and have been, where violation claims against it have been brought), so they are not the source of the challenge posed by China, Inc.. And on China's record of compliance with WTO rulings against it, see Webster (2014) and Zhou (2019).

[9] Of course, this presumes that the impasse among WTO members that is holding up the confirmation of WTO Appellate Body judges is resolved, so that the current vacancies in the Appellate Body that make it unable to review appeals are filled.

[10] The non-violation clause in the original GATT 1947 was incorporated into the WTO Agreements in GATT 1994, in the General Agreement on Trade in Services (GATS), and in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). However, WTO members agreed to an extendable 5-year moratorium on the use of the non-violation clause in TRIPS, and this moratorium is still in place today. Hence, it is not clear that the non-violation clause could be utilized to address concerns about China's intellectual property rights regime.

> of IP [intellectual property] rights would be punished and diminished in amount, that SOEs would make purchases based on commercial considerations, that the Communist Party would not, by fiat, occupy critical seats within major "private" enterprises and that standards and regulations would be published for all to see. It is this collective failure by China, rather than any specific violation of individual provisions, that should form the core of a big, bold WTO case. Because addressing these cross-cutting, systemic problems is the only way to correct for the collective failures of both the rules-based trading system and China. (Hillman, 2018, pp 10-11)

Importantly, by focusing on the departure from reciprocity in market access commitments and the implied imbalance itself, rather than specific policies that may have violated WTO legal obligations and led to this imbalance, the non-violation complaint can side-step the kinds of thorny legal and factual issues noted above and described by Wu (2016). This feature of non-violation complaints is highlighted by Sykes (2005) in the context of disciplines on domestic subsidies:

> A nice feature of the nonviolation doctrine is the fact that it does not require subsidies to be carefully defined or measured. A complaining member need simply demonstrate that an unanticipated government program has improved the competitive position of domestic firms at the expense of their foreign competition. (Sykes, 2005, p 98).

Moreover, under a successful non-violation claim the defendant government is under no obligation to remove the measures at issue, but if it does not remove them then the claimant government is owed compensation, the level of which is subject to arbitration by the WTO Dispute Settlement Body. Hence, a non-violation claim would provide China with the freedom to decide whether and, if so, how best to offer secure market access commitments to its trading partners that can reestablish reciprocity, with the knowledge that if its offer of market access commitments is not suffi cient for this purpose then its trading partners have the right to restore reciprocity by withdrawing market access concessions of their own as part of the resolution of a successful non-violation claim. In this way, the non-violation clause would be serving the role it was designed to serve, namely, as Petersmann (1977, p. 172) observes, to provide a check on the domestic policy autonomy of member-countries,

> ...and to prevent the circumvention of the provisions in GATT Article XXVIII ... if a member, rather than withdrawing a concession de jure in exchange for compensation or equivalent withdrawals of concessions by affected contracting parties, withdraws a concession de facto.

And crucially, any disagreements over the magnitude of the policy adjustments required to restore reciprocity between China and its trading partners would be

referred to the relevant WTO dispute settlement bodies for a ruling, thereby keeping the resolution of these issues within the rules-based multilateral system.

What kinds of commitments might China offer as a way to reestablish reciprocity? It is possible that China might be able to find certain policy commitments that would have clear market access implications without undermining core features of its chosen economic system. And it is also possible that transparency issues would warrant the use of certain quantity targets rather than tariff bindings as a second-best tool for generating market access commitments.[11] Indeed, the use of quantity targets as a means of securing market access commitments from a non-market economy is not without precedent in the GATT/WTO, as such targets were utilized in the GATT accession agreements for Poland and Romania (see, for example, Kostecki, 1974, and Haus, 1991). In Appendix B I provide more detail on the earlier GATT/WTO experience with integrating non-market economies into the trading system. More generally, it is likely that a combination of measures might be needed to secure market access commitments from China, but it is also likely that China is in the best position to know what combination of measures would be most effective while minimizing inconsistencies with its desired economic system.

This perspective also yields an important insight into the nature of the challenge that China, Inc. poses for the world trading system, and the choices that are available to the WTO membership to address this challenge. Recall from above that there were two elements to China's accession negotiations: (a) a list of agreed specific market access commitments, and (b) an expectation that China would evolve strongly toward a market economy. And recall that the imbalance between China's market access rights and obligations has emerged as a result of the failure of (b): China has not evolved toward a market economy to the extent that its trading partners expected. Does this imply that the only solution is for China to now promise to evolve to a market economy at the speed and to the degree that fulfills those expectations? Not at all, because it is clear from the above that there is an alternative solution, and one that is more targeted to the underlying source of the trade tension. The alternative is for China to agree to additional specific market access commitments of its own choosing, and thereby to compensate for the unanticipated non-market features of its economy - and hence for the shortfall in part (b) - by augmenting its specific commitments in part (a). This is what the non-violation clause can facilitate. Looked at in this way, there is no reason to think that, unless China chooses to relinquish China, Inc., "decoupling" China from the world trading system is the inevitable endgame.

On this last point my position diverges somewhat from Hillman (2018, p. 13), who describes the choice facing China as one of reforming its economic system

[11] While China's record of compliance with its commitment to purchase US goods and services in the 2020 "Phase One" Agreement with the United States has not been good (see Bown, 2022), that agreement was negotiated between the parties outside of the rules-based multilateral trading system. Given China's record of compliance with WTO legal findings (see note 8), there is reason to believe any quantity targets that China agreed to in the context of a non-violation claim would be met.

or exiting the WTO. There is still the important question of whether China can, in fact, find ways to make the needed additional market access commitments given the unique features of its economic system. And this would no doubt be a diffi cult task. But as observed above, several of the non-market economies of Eastern Europe found creative ways to do this when they joined the GATT in the 1960's and 70's, suggesting that China might find similarly unorthodox ways to make market access commitments that can respond to those non-market features of its economic system that were not anticipated by WTO members at the time of China's WTO accession but that China wishes to preserve. And while finding effective disciplines on China's subsidies will be particularly important and may ultimately entail reforms of the WTO's Agreement on Subsidies and Countervailing Measures in the wider context of WTO multilateral or plurilateral negotiations (see Bown and Hillman, 2019), Zhou and Fang (2021) argue that these reforms are not necessary to address the China-specific issues that arise in the context of subsidy disciplines and that such reforms would be better approached outside the context of China-specific trade tensions.

Clarifying the challenge for the WTO posed by China, Inc. also has a potential side benefit. As is well known, bringing successful non-violation claims in the GATT/WTO is exceptionally diffi cult, and indeed this is so by design. As one WTO Panel report put it, "... The non-violation nullification or impairment remedy should be approached with caution and treated as an exceptional concept. The reason for this caution is straightforward. Members negotiate the rules that they agree to follow and only exceptionally would expect to be challenged for actions not in contravention of those rules" (WTO, 1998). But once it is understood that the goal of a non-violation claim is to find a way to allow China to make meaningful market access commitments, and not to confront China with a choice between reforming its economy or decoupling from the world trading system, it becomes more likely that China might see it in its own interests to facilitate a successful rebalancing within the context of such a claim. As such, enlisting China's support in bringing such a claim might even be feasible. This is because it is in China's own interests, just as it is in each WTO member's own interests, to be part of a world trading system that is effective in permitting the voluntary exchange of secure, negotiated market access commitments between its members. And this is especially so if the current imbalances in the world trading system attributable to China's accession to the WTO are putting the WTO at serious risk of foundering. So, while enlisting China's support in bringing such claims against it would be unprecedented, it is not unreasonable to attempt to do so, given the unique challenge that China poses for the WTO and the world trading system.

This is not to say that the more traditional WTO violation claims against China, where viable, should not also be brought, just as with viable violation claims against any WTO member. Indeed, in her testimony before this committee Hillman (2018) lists 11 specific issue areas where violation claims against China might be viable (and as Hillman notes, her list is not meant to be exhaustive). But as both Hillman and also Wu (2016) make clear, even if such violation claims were all successful, they are not likely to address the fundamen-

tal sources of the imbalances that have emerged in China's market access rights and obligations and that have led to the growing frustrations of industrialized countries with China, Inc. By channeling these frustrations into non-violation claims, where such claims might perhaps be aided by China itself and where the process of filing and resolving these claims might also serve as a mechanism for resolving among the parties any pending or imminent violation claims, the existing GATT/WTO procedures for dispute settlement can be most effectively put to use.

Finally, an added benefit of addressing this issue with non-violation claims is that it helps to draw a clean distinction between concerns over non-reciprocity with China on the one hand, and the possibility that even with reciprocity established a WTO member might wish to rethink its own level of market access commitments, on the other. With this distinction cleanly drawn, these two separable issues could then be addressed on separate tracks. As I describe next, the second issue is best addressed within the context of Article XXVIII renegotiations. And the separation of these two issues is crucial, because while the maintenance of reciprocity should be a central concern of attempts to address the second issue (and would be under Article XXVIII renegotiations), by design it cannot be a feature of the solution to the first issue (and would not be under a non-violation claim, where the whole point is to address an imbalance and thereby restore reciprocity).

3 Reconsideration of the level of market access commitments

Suppose that the imbalance between China's market access rights and obligations in the WTO can be addressed, and that reciprocity is restored in the world trading system. Does this mean that all of the major challenges to the world trading system presented by the rise of the large emerging markets will have been met? In this and the next section I suggest that the answer to this question is "no," by describing two additional challenges that would still remain. A first challenge relates to the impact on industrialized country income inequality that the rise of large emerging markets has had. Whether this impact would be mitigated or rather exacerbated by the restoration of reciprocity with China depends in part on how reciprocity is restored; and in particular this depends on whether reciprocity with China is restored by an expansion of access to the markets of China, or rather by a reduction in access to the markets of the industrialized world. I discuss this challenge in this section. A second challenge relates to the history of reciprocal tariff negotiations in GATT, the historical lack of participation by nonindustrialized countries in these negotiations, and how that history has positioned the world trading system going forward in the presence of the large emerging markets today. I discuss this challenge in the next section.

Concerns about the possible adverse effects of trade on income inequality

are not new, and indeed such effects are central predictions of the standard neoclassical models of trade. But as of the mid 1990's the general view among economists was that as an empirical matter the distributional impacts of trade were relatively modest. Today that view is markedly less sanguine, thanks in part to changes in the nature and scale of trade over the past three decades - including a dramatic rise in the manufacturing exports of developing and emerging economies - and thanks in part also to changes in the focus of the economics research investigating these effects (a shift in focus from economy-wide impacts to local labor market effects).[12] This observation is especially illuminating for the current discussion, because the WTO tariff commitments in place today are the product of multilateral market access negotiations in the Uruguay Round that were completed in 1994 with the signing of the Marrakesh Agreement that created the WTO on January 1 1995. In this light, there is a possibility that the Uruguay Round tariff commitments made by some industrialized countries now imply the grant of a greater level of market access than these countries are comfortable with given the level of income inequality that they are now grappling with.[13]

In short, it would not be unreasonable if those industrialized countries that have experienced a significant increase in income inequality over the past several decades now wanted to pause and reconsider some of their existing tariff commitments, given that these commitments were made before the rise of the large emerging markets at a time when it was thought that the potential for trade to generate significant income inequality issues within industrialized countries was small. Nevertheless, several important hurdles would have to be cleared before one can convincingly argue that the reimposition of tariffs is an appropriate response to a country's concerns about income inequality.

A first hurdle is to demonstrate that there are not alternative policy responses that are available to the government to address its concerns about income inequality at lower overall cost to the economy. At a general level, the targeting principle (Bhagwati and Ramaswami, 1963) implies that tariffs will almost never be the first-best policy choice for achieving any particular goal (the exception being for purposes of terms-of-trade manipulation, a "beggar-thy-neighbor" consideration that should play no role in clearing this first hurdle). For example, at least for those countries that have the means to finance them, the use of production or wage subsidies would typically dominate tariffs as a policy tool for addressing concerns about income inequality.[14] Of course, in the

[12] See Krugman (2019) for a nice summary of the evolution of economists' thinking on the link between trade and income inequality. The local labor market impacts of trade competition were first considered by Borjas and Ramey (1995); Autor, Dorn and Hanson (2013) were the first to investigate the regional/local labor market impacts of trade with China.

[13] Not all countries experienced rising income inequality over this period. See Bourguignon (2019) on the cross-country diversity of trends in income inequality over the past 30 years.

[14] In this regard, the WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement), which regulates the use of subsidies relating to trade in goods, includes a provision (Article 8.2(b)) that identifies assistance to disadvantaged regions as "non-actionable," granting WTO member governments wide latitude to implement the kinds of subsidies that might be called for in addressing income inequality related to the local labor market effects of

real world such policies may not, in fact, be widely available to all countries. Indeed, this may be true even for rich countries: For example, after describing the labor market policies and programs that are available in the United States, Kletzer (2019, p 171) concludes that "despite the array of US programs, there is considerable evidence that these labor market interventions are inadequate."[15] But the targeting principle at least provides a rebuttable presumption that better policy responses than tariffs can be found to address concerns about income inequality. So this is not an easy hurdle to clear.

A second hurdle is to demonstrate that the proposed tariff increases would actually have the intended effect on income inequality. This demonstration is complicated by the fact that technology as well as the supplies of labor and capital within the industrialized countries have changed dramatically over the period that income inequality has risen, and it is therefore almost certainly true that "turning back the clock" with tariffs to achieve the trade patterns and volumes that a country experienced in an earlier time would not bring back the income distribution that the country had experienced at that time. Notice, though, that the effectiveness of tariffs as a response to rising income inequality in a country does not hinge on whether trade has caused the rise in inequality; rather it is simply a question of whether the use of tariffs - and the price effects that their use would generate in the country - might be part of the optimal response to addressing inequality, whatever its causes, given the technologies and factor supplies that exist today.[16]

Where does this discussion leave us? The reimposition of tariffs surely cannot be the centerpiece of an appropriate response to concerns about income inequality. But in light of the complexity of the issues involved and the plausible lack of first-best policy instruments to address these issues, neither does there appear to be a compelling reason that tariff responses - above all other possible second-best policy responses - should be taken off the table. In the abstract, a sensible position might therefore be that industrialized countries that have experienced rising income inequality and have concerns about this development should be able to reconsider some of their Uruguay Round tariff commitments as part of a broader package of policy interventions to address these concerns.

How would the restoration of reciprocity between China and its industrial-

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trade. However, this provision was temporary, and it was allowed to lapse at the end of 1999. Reforming the SCM Agreement to reinstate Article 8 in some form would help to remove WTO legal barriers that could have the effect of precluding the use of subsidies over tariffs for purposes of addressing income inequality concerns, and on these general grounds would be supported by the targeting-principle logic. See, for example, Charnovitz (2014), who makes similar arguments for the reinstatement of Article 8 in some form as that article relates to environmental subsidies.

[15] That said, it should be noted that Kletzer (2019) advocates for implementing a program of wage insurance in the United States, not the use of tariffs.

[16] I am abstracting from the dynamic effects of tariffs on technologies and factor supplies. There is also the deeper question whether income inequality as typically measured, or rather broader measures of economic inequality such as inequality in job tenure prospects and the prospects for one's children, should be the target of policy interventions, and how trade policy interventions would measure up to other available policy responses with such targets in mind. See Bourguignon (2019) for an illuminating discussion of these issues.

ized trading partners impact these considerations? As I mentioned above, that would depend in part on how reciprocity is restored. If reciprocity with China is restored as a result of a reduction in access to the markets of the industrialized world, then this implies that some industrialized-country tariffs would rise, and these tariff increases might be structured so as to mitigate income inequality concerns in industrialized countries. On the other hand, if reciprocity with China is restored as a result of an expansion of access to the markets of China, then this implies that China would be liberalizing its import regime which, if this does not impact China's overall trade imbalance, implies that China will also be exporting more, a scenario that is likely to exacerbate the existing income inequality concerns of industrialized countries.[17] The upshot is that restoring reciprocity between China and its industrialized trading partners is unlikely to address existing concerns over income inequality, and might even exacerbate these concerns.

Article XXVIII renegotiations This brings me to the possibility of GATT Article XXVIII renegotiations. Specifically, while I argued above that the non-violation clause is well-designed to deal with concerns over non-reciprocity with China, I now argue that Article XXVIII is well-designed to deal with the possibility that, even with reciprocity established, a WTO member might wish to rethink its own level of market access commitments.

In brief, according to Article XXVIII, if a country wants to reverse an earlier GATT/WTO tariff negotiation and raise its MFN tariff binding for any reason, it is free to do so. It only needs to offer compensation to its affected trading partners - or barring that, accept equivalent withdrawals of market access from those trading partners - so that the balance of reciprocal market access rights and obligations from the original negotiation is preserved. Hoda (2001) describes the mechanics of Article XXVIII renegotiations in detail, and provides a comprehensive history of the hundreds of renegotiations that have occurred over the GATT and early WTO years.

As Hoda (2001) explains, the key features of Article XXVIII renegotiations are that a country is allowed to modify or withdraw the tariff commitments that are the subject of its renegotiations, even if it cannot (within defined time limits) reach agreement in those negotiations with its impacted trading partners; and that its impacted trading partners are then allowed to respond - at most - in a reciprocal manner by withdrawing "substantially equivalent" tariff commitments of their own, where any disagreements over what constitutes substantially equivalent tariff commitments are subject to rulings of the relevant

[17] Absent any impact on its overall trade imbalance, and holding its terms-of-trade fixed, China's unilateral import liberalization would lead to equivalent increases in its exports; and if China is large in the import markets where it liberalizes, then its terms of trade should deteriorate, implying an even larger increase in its exports to maintain its existing trade balance. Of course, if China were to make policy changes that altered its overall trade balance, additional considerations would come into play. Krugman (2019) provides a recent discussion of the potentially important impact of trade imbalances on U.S. income inequality in the short run.

GATT/WTO dispute settlement bodies. In this way, with reciprocal actions defining the disagreement or "threat" point for the negotiations, Article XXVIII renegotiations avoid the possibility that a threatened or actual breakdown in those negotiations could hold up the modifications that a country desires to make to its tariff commitments. At the same time these renegotiations imply that the original balance of negotiated reciprocal tariff commitments between the country and its trading partners is preserved; this last feature is important, because as Bagwell and Staiger (1999, 2002) have shown and as I discuss in Staiger (2022), the application of reciprocity that delivers it ensures that inefficient terms-of-trade motives are removed from the country's incentives to initiate the renegotiation.

These features of Article XXVIII are the reason that legal scholars claim that GATT/WTO tariff commitments are designed to operate as "liability rules." For example, Pauwelyn (2008) distinguishes between GATT articles that are designed as liability rules and others that are designed as property rules, and he designates tariff commitments as liability rules on the basis of the renegotiation opportunities provided by Article XXVIII (as well as other similar but temporary escapes such as the GATT Safeguard clause Article XIX). In explaining the logic of this design, Pauwelyn (2008, p 137) writes:

> . . . Trade negotiators cannot foresee all possible situations, nor can they predict future economic and political developments, both at home and internationally. As a result of this uncertainty, they wanted the flexibility of a liability rule.

An important benefit of a liability rule is that it can allow for "efficient breach." Schwartz and Sykes (2002, p S181) put the point this way:

> Economic theory teaches that a key objective of an enforcement system is to induce a party to comply with its obligations whenever compliance will yield greater benefits to the promisee than costs to the promisor, while allowing the promisor to depart from its obligations whenever the costs of compliance to the promisor exceed the benefits to the promisee. In the parlance of contract theory, the objective is to deter inefficient breaches but to encourage efficient ones.

It is exactly in the spirit of efficient breach that limited use of Article XXVIII renegotiations might be made by those industrialized countries that are concerned about rising inequality and wish to reconsider some of their Uruguay Round tariff commitments as part of a broader package of policy interventions to address these concerns. Importantly, under the rules of Article XXVIII, those countries would not be making this choice "for free." Rather, they would be making this choice with the knowledge that any modification or withdrawal of tariff commitments would be met with reciprocal withdrawals of market access by their effected trading partners. If a country still prefers to raise its tariffs under these conditions, then that is how the GATT renegotiation process

approximates effi cient breach.[18]

It is also instructive to consider what can happen in a renegotiation of trade commitments that are not designed to operate as liability rules. Although it is not directly comparable to the Article XXVIII renegotiation of a GATT tariff commitment, the Brexit negotiations for the withdrawal of the United Kingdom from the European Union provide something of a cautionary tale. These negotiations, which had no meaningful equivalent to the reciprocity "buy out" provision of GATT's Article XXVIII that could have acted as a threat point for the outcome of the negotiations, offi cially began on March 29 2017 when the United Kingdom activated its withdrawal notice under Article 50 of the Treaty on European Union, and the negotiations were concluded in October of 2019. As is well known, the initial two-year negotiation period had to be extended in order that an agreement on the terms of withdrawal could be reached, and the negotiations were fraught with seemingly ample room for strategic behavior.[19] The liability-rule structure of GATT Article XXVIII renegotiations acts as an insurance policy against the possibility that such renegotiations would devolve into a Brexit-like situation.

4 The latecomers problem

I have argued that there are three interrelated challenges for the world trading system created by the rise in economic importance of the large emerging and developing economies. In this section I focus on the third of these challenges, which Bagwell and Staiger (2014) have called the "latecomers problem." As I noted in the Introduction, this challenge is less about China than it is about other emerging and developing economies. Following Bagwell and Staiger, I now briefly describe the latecomers problem and how it might be addressed with GATT Article XXVIII renegotiations between industrialized countries followed by Article XXVIII bis negotiations between industrialized and developing/emerging countries.

As I detail in Staiger (2022), according to the terms-of-trade theory, negotiations that abide by MFN and reciprocity can eliminate third-party spillovers from bilateral tariff bargaining. This feature underpins the effi ciency properties of a tariff negotiating forum such as GATT that relies heavily on bilateral tariff bargaining and is built on the pillars of MFN and reciprocity.[20]

But historically GATT has extended to its developing country members an exception to the reciprocity norm, codified under "special and differential treatment" (SDT) clauses. These SDT clauses were intended to provide developing countries with a "free pass" on the MFN tariff cuts that the developed countries negotiated with one another, and in this way allow developing country exporters

[18] Maggi and Staiger (2015) provide a formal rationale for the effi cient-breach role that the reciprocity rule can play in a model where international transfers are costly.

[19] See, for example, Martill and Staiger (2014) on the bargaining strategy pursued by the UK in its Brexit negotiations.

[20] These points are developed in Bagwell and Staiger (1999, 2002, 2005, 2010, 2018), and supporting empirical evidence is provided in Bagwell, Staiger and Yurukoglu (2020).

to then share with exporters from developed countries in the benefits of greater MFN access to developed country markets.

As Bagwell and Staiger (2014) point out, however, in the presence of SDT the fact that third-party spillovers from bilateral tariff bargaining are neutralized when those bargains abide by MFN and reciprocity now carries with it a more negative connotation: It implies that, by design, these SDT clauses cannot succeed at their intended purpose. This is because, as I describe more fully in Staiger (2022), when two (developed) countries engage in a bilateral tariff negotiation that abides by MFN and reciprocity while the third (developing) country sits it out, the third country gets nothing from the negotiation of the other two countries.

Indeed, a wide range of anecdotal and empirical evidence suggests that developing countries have gained little from more than half a century of GATT/WTO-sponsored tariff negotiations. For example, based on interviews with WTO delegates and secretariat staff members, Jawara and Kwa (2003, p. 269) conclude:

> Developed countries are benefitting from the WTO, as are a handful of (mostly upper) middle-income countries. The rest, including the great majority of developing countries, are not. It is as simple as that.

In an implicit acknowledgement of this fact, the WTO's Doha Round was semi-offi cially known as the Doha Development Agenda, because a fundamental objective of the round was to improve the trading prospects of developing countries. But as the declaration from the WTO Ministerial Conference in Doha, Qatar, November 14, 2001, states in part:

> We agree that special and differential treatment for developing countries shall be an integral part of all elements of the negotiations... .

Ironically, as Bagwell and Staiger (2014) observe, according to the terms-of-trade theory it is the GATT/WTO's embrace of SDT that explains the disappointing developing country experience with GATT/WTO membership to begin with; and this suggests that the Doha Round could not succeed in one of its fundamental objectives under the bargaining protocol that it adopted.

Even if one accepts this diagnosis for the lack of developing country gains from GATT/WTO membership, simply abandoning SDT at this point and bringing the developing and emerging market countries to the tariff bargaining table is unlikely to be suffi cient to address the issue, and this is where the latecomers problem becomes relevant for the Doha Round: because they are "latecomers" to the bargaining table relative to the industrialized countries, developing and emerging market countries are unlikely to find industrialized-country bargaining partners that can reciprocate the substantial tariff cuts that they might have to offer.[21] This kind of asymmetry is at the heart of various diagnoses of the central sticking points at Doha, such as this diagnosis from The Economist (April 28, 2011):

[21] If the arrival of the developing and emerging economies had been anticipated by the industrialized countries at the time that the latter were engaged in tariff negotiations, then the findings of Bagwell and Staiger (2010) on bilateral sequential tariff bargaining in a GATT/WTO-

> ...the real bone of contention is the aim of proposed cuts in tariffs on manufactured goods. America sees the Doha talks as its final opportunity to get fast-growing emerging economies like China and India to slash their duties on imports of such goods, which have been reduced in previous rounds but remain much higher than those in the rich world. It wants something approaching parity, at least in some sectors, because it reckons its own low tariffs leave it with few concessions to offer in future talks. But emerging markets insist that the Doha round was never intended to result in such harmonization. These positions are fundamentally at odds.

Article XXVIII renegotiations and Article XXVIII bis negotiations In some sense, then, the industrialized countries find themselves in a position in the Doha Round not unlike the position that the United States tried very hard to avoid in the context of sequential bilateral tariff bargaining under the 1934 Reciprocal Trade Agreements Act (see Staiger, 2022): New potential bargaining partners have arrived, but because of previous MFN tariff bargains with each other, the industrialized countries have not preserved suffi cient bargaining power to engage in a substantial way with these new potential partners.[22] This is the essence of the latecomers problem. Here I argue that existing GATT/WTO flexibilities can be used to address the latecomers problem within the rules-based system.

The essential idea is to find a way to implement the set of tariff commitments that the current WTO membership would choose to negotiate if countries were not constrained in their negotiations by their pre-existing tariff bindings. This means providing countries with the flexibility to first raise their existing GATT/WTO tariff bindings in an orderly way when necessary, so that they can then engage in reciprocal MFN tariff bargaining with all willing WTO-member bargaining partners. As Bagwell and Staiger (2014) emphasize, there are obvious dangers in encouraging such flexibility for this first step, and suffi cient care would need to be taken to prevent uncontrolled unraveling of existing tariff commitments. That said, the flexibility needed for the first step is already provided in GATT by the Article XXVIII renegotiation provisions which I discussed in detail in section 3 (i.e., industrialized countries could renegotiate in an upward direction some of the bindings to which they had previously agreed in negotiations with other industrialized countries), while the flexibility for the second step is provided by the standard bilateral tariff bargaining protocols that have been employed in the various GATT rounds under Article XXVIII bis (i.e., these industrialized countries could then engage in a round of reciprocal tariff bargaining with the "latecomer" emerging and developing countries). So, at

like bargaining forum as an effi cient means of accommodating new countries into the world trading system might apply. But it is the unanticipated arrival of the "latecomers" that makes achieving effi cient tariff bargaining outcomes in the GATT/WTO framework more diffi cult.

[22] Mattoo and Staiger (2020) argue that the latecomers problem and its implications for the preservation of tariff bargaining power in the WTO system may be helpful for interpreting recent United States trade actions as signifying a switch from "rules-based" to "power-based" tariff bargaining. I discuss their paper further in Staiger (2022).

least in principle, the WTO has the design features that would allow its member governments to address the latecomers problem. But a necessary ingredient for success would be to revisit the commitment to SDT.[23]

5 Conclusion

The architecture of the GATT/WTO is based on sound economic principles, and it is well-designed to meet the challenges faced by the world trading system of the twenty-first century. These challenges include the important task of integrating China more fully into the rules-based multilateral trading system. But to accomplish this task, it is critical that the underlying China-specific challenge for the WTO is identified, and that it is distinguished from a number of other challenges with which the WTO must also contend but which are not China-specific. In particular, I have argued that the rise in economic importance of the large emerging and developing economies, with China playing a leading role, has created three interrelated challenges for the world trading system.

First, there appears to have emerged a substantial departure from reciprocity between China and its major industrialized trading partners. I have suggested that the implied need for rebalancing market access commitments can be addressed with GATT/WTO non-violation claims. Second, even once reciprocity between China and its major industrialized trading partners is established, there is a possibility that the Uruguay Round tariff commitments made by industrialized countries now imply the grant of a greater level of market access than some of these countries are comfortable with. I have suggested that the implied need for reconsideration of the level of market access commitments, where necessary, can be addressed with GATT Article XXVIII renegotiations.

The first of these challenges centers on China. And owing to its sheer size in world trade, China undoubtedly plays a leading role in the second challenge. The third challenge arises from an asymmetry in the level of market access commitments between the developing/emerging economies and the industrialized countries, an asymmetry that is the result of the historical lack of participation of non-industrialized countries in 50 years of GATT reciprocal tariff negotiations. This has led to a latecomers problem for the WTO that may be hindering the ability of many developing and emerging economies to gain from GATT/WTO membership. Because China made more significant (though, as it turned out, perhaps still not reciprocal) market access concessions as part of its 2001 protocol for accession to the WTO than have any other emerging and developing economy WTO members to date, this third challenge is less about China than about other emerging and developing economies. I have suggested that the latecomers problem can be addressed with GATT Article XXVIII renegotiations between industrialized countries, followed by GATT Article XXVIII bis negotiations between industrialized and developing/emerging countries.

[23] See Bagwell and Staiger (2014) on the possibility that negotiated reductions in US agricultural subsidies in the context of the Doha Round might serve the same purpose as Article XXVIII renegotiations in the first step of the process described above.

For meeting each of these twenty-first century challenges to the world trading system, and others that I detail in Staiger (2022), the basic design features of the GATT/WTO appear well-suited. From this perspective, I believe that working within the WTO framework holds out the best chance of integrating China fully into the rules-based multilateral trading system.

6 Appendix A: A Way Forward on US-China Trade Relations

In this Appendix I reproduce my Concurring Statement included in the Joint Statement of The US-China Trade Policy Working Group, "US-China Trade Relations: A Way Forward," October 27 2019. That Working Group, of which I was a member, was composed of a group of economists and legal scholars from China and the United States who believe that both the United States and China could benefit from a new framework for trade negotiations. The Joint Statement describes one such framework. My Concurring Statement proposes a way to enlist existing WTO flexibilities in pursuit of the goals of the Joint Statement, and I believe that this proposal and a set of answers to frequently asked question that I composed at the time are still relevant.

6.1 Concurring Statement of Robert W. Staiger for the Joint Statement of The US-China Trade Policy Working Group

In this concurring statement I propose a way to enlist existing WTO flexibilities in pursuit of the goals of the Joint Statement. I begin from a distillation of the five changes described in the Background section of the Joint Statement into two distinct issues that have contributed substantially to the current US-China impasse.

First, US expectations of reciprocal market access expansion into the Chinese market arising from China's 2001 entry into the WTO have not been met. This requires a rebalancing of the existing WTO market access commitments between the US and China to achieve the degree of reciprocity in these commitments that was intended to arise from their 2001 negotiations.

Second, US expectations of the balance between the internal benefits and costs of its own tariff commitments agreed to at the 1994 conclusion of the Uruguay Round have not materialized. This may require a rethinking and possible renegotiation of some of the Uruguay Round tariff commitments made by the US, subject to the preservation of reciprocity (once achieved) with China and with other US trading partners who would be impacted by this renegotiation.

To address these two issues and end the trade war, the following three-step procedure is proposed:

Step 1. The US and China should agree to end their trade war immediately and revert to tariffs consistent with their respective WTO commitments (e.g., their tariff levels prior to March 1 2018).

Step 2. Rebalancing: (i) The US should agree to pursue through the WTO dispute resolution process its concerns about unmet expectations of market access expansion in China, by filing a non-violation claim against China; (ii) In return, China should agree to take the unorthodox step of submitting materials in support of this claim (details of which could be part of the agreement to end the trade war) to the WTO dispute resolution body, thereby augmenting the normal non-violation-claim process and ensuring the success of the US claim in this case; and (iii) The US and China should agree that, once a successful non-violation claim has been adjudicated, both countries will abide by any subsequent WTO rulings on the amount of trade compensation that the US is owed by China (or permissible US retaliation).

Step 3. Renegotiation: The US should agree that, as implied by Step 1, any further permanent upward adjustments to its WTO tariff commitments that would have trade implications for China will be undertaken within the context of Article XXVIII renegotiations in the WTO.

Discussion The proposal acknowledges the legitimacy of US concerns over non-reciprocity with China (first issue), but asks the US to seek redress for these concerns via a non-violation case brought - with China's assistance - in the WTO dispute forum, thereby rerouting the US-China trade dispute on this issue into WTO dispute resolution processes that are designed to address such issues in the context of measured, reciprocal, compensatory tariff responses which are themselves subject to the restraints of international control, rather than in the context of uncontrolled unilateral retaliatory tariff actions. At the same time, by drawing a distinction between US concerns over non-reciprocity with China on the one hand and the possibility that the US might rethink its own level of market access commitments (second issue) on the other, the proposal allows these two issues to be disentangled and addressed on separate tracks, and thereby builds on the distinct WTO provisions which are designed to address these issues and which, once augmented to reflect the exceptional circumstances of the US-China trade conflict, can provide the needed flexibilities. The proposal leaves unaddressed some of the important issues facing the US and China (e.g., those relating to digital/new technologies). But in describing a way for both countries to engage in good-faith efforts to address more familiar issues, the proposal may also serve as a trust-building exercise and help pave the way for solutions to these other issues in the future.

6.2 FAQs

Question on the Balance of the Proposal The two stated motivations for your suggested approach could be read as being unbalanced; they both discuss unrealized expectations on the US side. Is this proposal unbalanced?

Answer. While the proposal might at first look unbalanced in favor of the US, it actually provides a lot for China.

First, it disentangles US trade concerns into one concern that is squarely about China (unmet US expectations of reciprocity) and another concern that is more about US market access commitments with all of its trading partners (though of course China is a big part of this as well), and in so doing takes some of the focus of US trade anger off of China.

Second, it provides China with a way to learn about the intent of the US. Is the US seeking to find solutions to legitimate trade concerns that it has with China, or is the US simply interested in preventing China from overtaking the US in terms of economic strength? By agreeing to a path down which the US could reasonably address its legitimate trade concerns, China can learn something about US intent that is valuable to it.

Questions on the Non-Violation Claim (Proposal Step 2) Use of the non-violation claim has met with little success in the history of the GATT/WTO. In light of the apparent difficulty of bringing successful non-violation claims, why would the US agree to commit to using this path to address its concerns about unmet expectations of market access expansion in China?

Answer. The proposed agreement to end the trade war addresses the difficulty of bringing a successful non-violation claim by, in this instance, enlisting China's assistance in the US non-violation claim against it: with both the US and China committing - as part of their agreement to end the trade war - to submit materials to the WTO Panel in support of the US non-violation claim, the success of this claim in this case should not be in question.

Question. But why would China agree to provide assistance for the US non-violation claim against it?

Answer. The proposed agreement to end the trade war would have China commit to take the unorthodox step of providing assistance for the US non-violation claim against it, in exchange for a commitment from the US that the US will stay within the relevant WTO dispute resolution processes to address its concerns about unmet expectations of market access expansion in China.

In effect, China is agreeing to actions that will make the non-violation claim a more viable tool for the US to use to address these concerns, and the US is agreeing in turn to address these concerns with the non-violation claim.

Question. OK, suppose the US and China go down this path and it results in a successful US non-violation claim against China. Then what?

Answer. In response to the successful US non-violation claim against China, China could then choose to make adjustments to its policies that had the effect of increasing US access to the Chinese market, thereby bringing the US and China WTO commitments into balance and eliminating the basis for the US non-violation claim; or China could choose not to make adjustments to its policies, in which case the US would then be allowed under WTO rules to make adjustments to its policies that had the effect of decreasing Chinese access to the US market, thereby bringing the US and China WTO commitments into

balance and eliminating the basis for the US non-violation claim; or more likely, the required rebalancing might occur through some combination of both China policy adjustments and US policy adjustments.

But crucially, in all cases, any disagreements between the two countries over the magnitude of the policy adjustments required to bring their WTO commitments into balance would be referred to the relevant WTO dispute settlement bodies for a ruling, and as part of their agreement to end the trade war both the US and China would commit to abide by these rulings.

Question on Article XXVIII renegotiations (Proposal Step 3) When countries try to renegotiate their trade commitments, it can lead to a quagmire; just look at the Brexit negotiations. If the US were to decide to back away from some of its Uruguay Round tariff commitments by attempting to renegotiate them in the WTO, wouldn't the implied Article XXVIII renegotiations suffer from the same problems, making this approach impractical?

Answer. According to the provisions of Article XXVIII, a country is allowed to modify or withdraw the tariff commitments that are the subject of its renegotiations, even if it cannot reach agreement in those negotiations with its impacted trading partners; and its impacted trading partners are then allowed to respond - at most - in a reciprocal manner by withdrawing "substantially equivalent" tariff commitments of their own, where any disagreements over what constitutes substantially equivalent tariff commitments are subject to rulings of the relevant WTO dispute settlement bodies (and as part of their agreement to end the trade war both the US and China would commit to abide by these rulings).

In this way, with reciprocal actions defining the disagreement or "threat" point to the negotiations, Article XXVIII renegotiations avoid the possibility that a threatened or actual breakdown in those negotiations could hold up the modifications that a country desires to make to its tariff commitments, while at the same time ensuring that the original balance of negotiated reciprocal tariff commitments between the country and its trading partners is preserved.

Question on Digital/New Technologies What does your suggested approach do for the important issues relating to digital/new technologies, where there are no WTO commitments/rules?

Answer. The proposal does not directly address the digital/ new technologies issues. But related to the answer to the first question posed above, by serving as a trust-building exercise on the more WTO-familiar issues that the proposal is meant to address directly, it may also help pave the way for addressing these other issues in the future.

7 Appendix B: A Brief History of Non-Market Economy Accessions to the GATT/WTO[24]

In this Appendix I provide a brief history of non-market economy (NME) accessions to the GATT/WTO. My purpose here is twofold: First, to establish that NMEs have not traditionally been viewed as incompatible with GATT/WTO obligations; second, to illustrate some of the creative ways that have been utilized to secure reciprocal market access commitments from acceding NMEs in past GATT/WTO accessions.

The first GATT experience with integrating a non-market economy into the trading system came in the 1950's when Czechoslavakia (a founding GATT member) transitioned toward a centrally planned economy. As Thorstensen et al (2013) observe:

> The transition of Czechoslovakia (to a NME) also brought difficulties in the application of Article XV:6. The provision deals with the membership of the contracting parties at the International Monetary Fund, stating that parties that fail to join the Fund shall enter into special exchange arrangements with the CONTRACTING PARTIES. The Article aimed to avoid parties to adopt exchange rate policies incompatible with the rules of the multilateral financial system that could impact on international trade Czechoslovakia claimed that a country with complete monopoly of foreign trade could change the par value of its currency without affecting international commercial transactions and without impairing any concessions made under the GATT. Thus, a waiver from the obligations under GATT Article XV:6 was accorded to the country The case of Czechoslovakia is relevant because it shows that its transition to a centrally planned economy was never regarded, neither by other contracting parties, nor by itself, as incompatible with its obligations in the Multilateral Trading System. The parties considered the need to adjust some of the rules, in order to adapt to the particularities of centrally planned economies, but the core of the system would remain intact. [p 779, footnotes omitted]

Thorstensen et al (2013) go on to describe how the efforts to integrate NMEs into GATT, which in addition to Czechoslavakia included the accessions of Yugoslavia (1966), Poland (1967), Romania (1971) and Hungary (1973) and which reflected a range of adjustments tailored to the specific circumstances of each acceding NME, were nevertheless all based on the "interface principle," a term that Jackson (1990, pp 81-82) used to mean the creation of "mechanisms that would mediate between the different economic structures, providing rules to reduce the incompatibilities among them."

Poland provides a striking illustration of the potential for simplicity in the mechanisms that were adopted to mediate between NMEs and other GATT

[24] Appendix B reproduces material taken from Bown, Chad P., Ralph Ossa, Alan O. Sykes and Robert W. Staiger, "What to do about China and Trade," February 2022, in process.

members in accordance with the interface principle. The heart of Poland's market access commitments in its 1967 protocol of accession to GATT came in the form of a commitment to grow the total value of its imports at a pre-specified annual rate as follows:

> 1. Subject to paragraph 2 below, Poland shall, with effect from the date of this Protocol, undertake to increase the total value of its imports from the territories of contracting parties by not less than 7 per cent per annum.
>
> 2. On 1 January 1971 and thereafter on the date specified in paragraph 1 of Article XXVIII of the General Agreement Poland may, by negotiation and agreement with the CONTRACTING PARTIES, modify its commitments under paragraph 1 above. Should this negotiation not lead to agreement between Poland and the CONTRACTING PARTIES, Poland, shall, nevertheless, be free to modify this commitment. Contracting parties shall then be free to modify equivalent commitments.

The challenges in integrating NMEs with market economies while attempting to minimize deviations from the core GATT principle of reciprocity was made especially diffi cult in light of the second core GATT principle of nondiscrimination (MFN), raising the issue of how to handle MFN. This was a contentious question in the context of GATT accession for earlier NMEs such as Hungary, Poland and Romania (see Douglass, 1972, Kostecki, 1974 and Haus, 1991). The account by Douglass (1972) of Poland's GATT accession negotiations is especially informative on this issue:

> The complexity of devising a method for Poland to reciprocate for most-favored-nation treatment was exacerbated by the diffi culty of quantifying, during the negotiating stage, the advantages of accession. Poland's first serious offer (in 1959) was based on the concept of "global quotas," under which Poland proposed to commit herself to purchasing specified quantities or values of specific goods from those contracting parties who offered tariff concessions. ...
>
> Because the proposal for global quotas was unacceptable to the contracting parties, Poland modified it in 1963, and promised: (i) to draft future plans in such a way as to ensure that a "reasonable" share of the growth of the Polish market would be awarded to GATT countries, (2) to offer assurances that any foreign exchange earnings obtained as the result of tariff reductions (or reductions of other barriers to trade) would be used to increase imports from those countries which undertook such reductions, "on conditions and in proportions to be agreed upon during negotiations," and (3) to commit herself to negotiate for "the inclusion in her import plans of certain categories of goods with guarantees that [the] percentage growth in Polish imports [from countries which have undertaken tariff reductions] would be higher than average."
>
> Thus we can see that Poland and the contracting parties were moving away from the idea of specific global quota commitments toward a general

> obligation to increase imports from the contracting parties as a group, but it is clear that Poland still sought a means to enforce non-discriminatory treatment by contracting parties by awarding shares of her imports to those nations which did not discriminate against her. ...
>
> After eight years of negotiations, the contents of the Protocol for Accession were agreed upon in 1967 in return for most-favored-nation treatment, Poland agreed to increase her imports from the contracting parties by seven percent per annum for three years, commencing in 1968. Since the Protocol left no hint of global quotas, Polish planners deciding how to meet this quantitative import commitment had considerably more latitude to determine from whom and in what quantities Poland would import [Douglass, 1972, pp 754-758, footnotes omitted]

In essence, it appears that in the case of Poland's accession to GATT, Poland agreed to increase its imports by 7 per cent per year from GATT contracting parties as a group, but maintained the right to allocate that increase across GATT members in proportion to its increased export volumes (and associated foreign exchange) to each GATT member, essentially in accordance with a bilateral reciprocity norm in the presence of MFN (see, for example, Bagwell and Staiger, 2005, 2010, and the discussion in chapter 4 of Staiger, 2022). And to better mimic MFN tariff cuts while relying on quantitative import commitments, Douglass suggests that the following technique for Poland might be considered when engaging in reciprocal bargaining over market access concessions:

> ... in exchange for a reduction in Country X's tariff on a product of which Poland is a substantial exporter - for example, coal or rolled metal products - Poland could commit herself to the importation of a specific quantity of some other specific commodity, but not necessarily from Country X, though typically X would be a major producer of this other commodity and would be likely to benefit from the concession. Under this approach the most-favored-nation principle would still be realized, since other nations who are large producers of coal or rolled pipe would enjoy the advantage of the tariff reduction in Country X, as would Country X's competitors enjoy the advantage of bidding for Poland's import commitment, a purchase which Poland's importing foreign trade enterprise must base solely on "commercial considerations" anyway. [Douglass, 1972, p 764, footnotes omitted]

Whether or not something similar might work in the case of China is an open question. Relative to the Polish accession to GATT, there is at least one obvious and potentially important difference with the case of China's commitments in the WTO, namely, the sheer size and dominance of China in the world economy relative to Poland, who at the time of its accession to GATT was characterized as a "medium-sized planned economy nation" (Douglass, 1972, p 762).

On the other hand, unlike Hungary, who in preparation for its accession to GATT implemented a new system of economic management in 1968 that was intended to elevate the use of tariffs as the primary instrument of trade control

in relations with market economies, Poland was not expected to transition in any meaningful way toward a market economy at the time of its accession.[25] In fact, along this dimension it could be argued that at the time of its accession China's case was expected to be more like that of Hungary, but in hindsight has turned out to be closer to that of Poland.

More specifically, in the case of Hungary's accession to GATT, Kostecki (1974) observes that

> The new system of economic management, implemented in Hungary in 1968, introduced the customs tariff as a chief instrument of trade control in relations with the market economies. The functions and effects of the Hungarian tariff were at the centre of interests of the contracting parties due to the fact that Hungary, when acceding to GATT, intended to negotiate its level of protection exclusively on the basis of tariffs, without including in the Hungarian protocol for accession any quantitative import commitments. If the tariff had not been recognized as an essential element of the Hungarian system of trade control vis-a-vis the market economies, Hungary would have been treated in GATT along the Polish pattern. As it was, some members of the working party expressed their doubts as to whether the effects of the Hungarian tariff were not weakened by other instruments of trade control. If this were so, a quantitative import commitment would be required. In the opinion of some representatives such a commitment could be replaced by Hungarian tariff concessions after a transitional period. [Kostecki, 1974, p 406]

Hence, at least in the opinion of some as Kostecki notes, the Hungarian accession protocol to GATT should have been designed as a transitional agreement during which time Hungary should be treated as a planned economy until its "new system of economic management" had proven effective in introducing the tariff as its primary instrument of trade control in relations with market economies. The Hungarian accession to GATT therefore shares important features with how industrialized countries approached negotiations over China's protocol of accession to the WTO; whereas the expectation that China will eventually transition to a market economy is now no longer widely held, moving the issues associated with China's market access commitments in the WTO now closer to those associated with Poland's accession to GATT.

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OPENING STATEMENT OF TERENCE STEWART, FORMER MANAGING PARTNER, STEWART & STEWART LLP

MR. STEWART: Thank you. I appreciate the opportunity to testify today.

The WTO is in problems, whether or not you consider China as part of that deal. It has not been able modify the structure of the international trade rules over the last 25 years to the significant extent.

And that flows both from the size of the membership now and the fact that the membership has lost focus on what the core purpose of the core obligations of membership are. So, with that said, many of the things that the WTO could do to help address the deficiencies that we face vis-a-vis China are not likely to occur.

It is the case that disputes could be brought. And there have been many people who have advocated that the broad-based attack on Chinese systems, whether it be of the nonviolation sort or otherwise, could be brought and that that might assist, obviously at the moment, the dispute settlement system is operating in a two-stage level.

Although there was a two-stage level among some countries. And that includes China with regards to the Europeans and Canadians and some others.

What the U.S. and the EU and Japan are doing in terms of looking at possible modifications to the subsidies agreement to address both the industrial subsidy problems, and it led to mass of access capacity, the targeting of industries, the role of state, owned state investigator process is an important part of a potential WTO reform. But WTO reform, as virtually all other aspects of the WTO, are carried out on a consensus basis.

And so while China has indicated a willingness to sit in and look at all subsidies, including their agricultural subsidies, it was unclear that you will get a meaningful result that will start to address some of the aspects of the Chinese economy that do not mesh with the WTO rules.

Former Deputy Director General Alan Wolff, while he was at the WTO, put out a number of papers in which he basically identified the key principles of the GATT and WTO. And one of which was the importance of convergence of economic systems, taking the position that the system could not, did not support coexistence of different economic systems.

So if you look at the core differential that exists and the tensions that have arisen for the United States and many other countries who are trying to deal with China, first and foremost is the fact that you have a different economic system which is skewing the outcome of many aspects of global trade, global trade flows, global investment because of the distortions in the internal market in China and what that does to trade flows internationally.

There are aspects of the WTO which are proceeding which have some potential to be helpful in some areas. There is a series of plurilateral negotiations that are ongoing at the WTO, what are called Joint Statement Initiatives. Most of these were initiated at the 11th Ministerial Conference in December 2017 down in Buenos Aires.

There is one on electronic commerce. There is one on domestic regulation of services. There are some on environmental issues, such as plastic problem in the oceans and others.

The United States is participating in several, but not all. China is participating in all. In my view it is a major mistake for the United States not to be participating in each of these endeavors.

Some of them will be included now and will be presented at the 12th Ministerial meeting

June in Geneva. Others, they are well advanced and are hoping that they will, that most major issues resolved by the end of this year. That includes e-commerce where the U.S. citizen is actively gone.

While China's participation in those issues, along with other developing countries, as well as most other developed countries, means that in all likelihood the level of ambition will be lower than perhaps we would see on the e-commerce under the USMCA or that we would be looking to do with our Asian colleagues in the Biden Administration's Initiative.

Though nonetheless, it would be important because you would have 86 countries, currently 86 members of the WTO who would be signatories to that arrangement. And that could provide some significant improvement and predictability in the world of e-commerce.

So, there are things that are positive. The dispute settlement process, obviously, has been characterized by both the prior administration and this administration as impeding the ability of the United States to address many of the trade distorting practices that China is engaged in.

And that has been true. And some of the proposals that have been made by the U.S., Japan and EU would presumably address that. And the U.S. has been blocking reform of – not reform, but has been blocking the restarting of the Appellate Body.

There may never be Appellate Body in the future but it has been focusing on getting meaningful reform of the settlement system which requires an understanding of why the Appellate Body felt at liberty to deviate so much from what the limited role was when it was originally created.

A lot of the things that we talk about in terms of being able to bring disputes against China, in part depend upon our willingness to bring cases. The Biden Administration has not yet brought a case against China. It's been working very hard to resolve other disputes where we are a defendant or where we are a co-complainant, such as the U.S. CEO aircraft disputes. So with that I will stop.

PREPARED STATEMENT OF TERENCE STEWART, FORMER MANAGING PARTNER, STWEWART & STEWART LLP

April 14, 2022
Terence P. Stewart
Retired lawyer, current blogger (Current Thoughts on Trade)
Testimony before the U.S.-China Economic and Security Review Commission
Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers and Innovators
Panel IV: China and the WTO

Since joining the WTO at the end of 2001, China has risen to become the world's largest exporter and has generally outperformed the world economy becoming the world's second largest economy. China will likely overtake the United States in terms of national GDP in the coming years. So WTO membership has been of enormous benefit to China including through encouraging foreign investment, transfer of technology, improved productivity and quality and higher living standards. Indeed, hundreds of millions of Chinese have been lifted out of poverty over the last decades.

When China was admitted to the WTO, the Chinese economy was not yet market oriented nor consistent with a wide range of WTO obligations. The result was a Protocol of Accession and Working Party Report that were the most complicated in terms of additional efforts needed by China and a timeframe for making additional wide ranging modifications to its economic system.

While China adopted many of its obligations at the beginning of WTO membership in 2002 and worked for a number of years to implement further important structural changes, China has moved away from its efforts to reform its economy to be more market driven and has reembraced its state-directed economic model over the last decade or so.

Because of the size of the Chinese economy and the enormity of the government's involvement and distortions imposed on the functioning of the economy, the distortions caused to trading partners operating on market principles have been massive. These have included massive excess capacity in many industries flowing from state plans and subsidies, restricted market access to foreign products, theft of intellectual property and forced technology transfer, and the creation of false market signals in terms of costs of production. There have been many critiques of China's WTO membership. My reflections are contained in a recent post. *See* December 11, 2021: 20 Years of China's Membership in the WTO — a brief critique, https://currentthoughtsontrade.com/2021/12/11/20-years-of-chinas-membership-in-the-wto-a-brief-critique/.

Even without China, the WTO has struggled since its creation to update global trade rules. The inability to have successful negotiations on a range of topics flows from a variety of reasons including the consensus based decision making, large differences in views of purpose of and direction for the WTO among Members, and a dispute settlement system that has often deviated from its limited role encouraging members to file disputes instead of negotiating. The organization has struggled to maintain its relevance in a rapidly changing world. For many market economies, the WTO is not viewed as able to adequately address the distortions created by a state-directed economy the size of China's.

From the beginning of China's WTO membership, other Members have worked to help China conform its system to the WTO requirements. For example, major trading partners of China, including the U.S., European Union, Japan, Canada, Australia and others spent years working with Chinese agencies to help them bring laws into compliance with WTO obligations and worked bilaterally to resolve problems as they arose. Such activity has not been unusual for WTO Members in the early years of membership to help new Members understand what additional changes are appropriate or to resolve practices of concern bilaterally.

Where China was unable or unwilling to bring practices or laws/regulations into conformity, the U.S., EU and others have brought disputes at the WTO. As of April 8, 2022, China is or has been a respondent in 49 WTO disputes. It has also brought 22 cases against the U.S., EU and others and participated as a third party in 192 disputes. Most of the cases that have brought against China consisted of situations where China's actions were facially inconsistent with WTO obligations. Where cases weren't resolved through consultations and China lost the dispute, China has typically implemented the loss although in a narrow fashion. China has brought cases to address what it considered to be "discriminatory" provisions of its Protocol of Accession (country specific safeguard; continuation of treatment as a non-market economy after 15 years) or to attempt to weaken trade remedies of major trading parties like the United States and the EU. Some of these efforts were unsuccessful. However, China has been able to obtain weakening of trade remedy practices with reports by WTO panels and the Appellate Body viewed by the U.S. and others as changing the rights they had under the trade remedy agreements.

As the 2020 USTR report on the WTO Appellate Body made clear, dispute settlement at the WTO has had the unintended consequence of changing the bargain reached in the Uruguay Round for the United States. *See* February 14, 2020: USTR's Report on the WTO Appellate Body – An Impressive Critique of the Appellate Body's Deviation from Its Proper Role, https://currentthoughtsontrade.com/2020/02/14/ustrs-report-on-the-wto-appellate-body-an-impressive-critique-of-the-appellate-bodys-deviation-from-its-proper-role/.

Moreover, as articulated by the prior Administration and the present Administration, the current WTO agreements and dispute settlement don't adequately address the global distortions caused by the state-directed economy of China and those copying its practices. *See, e.g.,* December 14, 2020: WTO December 14th Heads of Delegation meeting – parting comments of U.S. Ambassador Dennis Shea, https://currentthoughtsontrade.com/2020/12/14/wto-december-14th-heads-of-delegation-meeting-parting-comments-of-u-s-ambassador-dennis-shea/.

There have been efforts by the U.S., EU and Japan to start an evaluation of possible modifications to the Subsidies and Countervailing Measures Agreement to address the massive industrial subsidies, global excess capacity and state-owned, state-invested enterprises that characterize some of the important ongoing distortions created by the Chinese state-directed economy. While China has indicated it would be open to a reexamination of all subsidy practices, it is unclear what agreement could be reached within the WTO. In any event, agreement on any changes will take years to accomplish and will almost certainly be less than what is needed because of the consensus approach to decision making at the WTO. Presumably the first panel today reviewed the eforts at WTO reform on industrial subsidies, excess capacity

and state-owned enterprises. Several posts of mine have addressed some aspects of the issue. *See, e.g.,* January 14, 2020: WTO Reform – Joint Statement of January 14, 2020 of Japan, the U.S. and the EU, https://currentthoughtsontrade.com/2020/01/14/wto-reform-joint-statement-of-january-14-2020-of-japan-the-u-s-and-the-eu/.

China has been viewed by many WTO Members as retaliating against WTO Members who bring disputes or who use trade remedies by bringing disputes themselves or bringing trade remedy cases. They also resort to intimidation through wide ranging and often non-transparent actions to punish trading partners who take positions China strongly disagrees with. China's actions against Australia and more recently Lithuania are just two examples. I have looked at both cases in posts in the last several years. *See* January 27, 2022: The European Union requests consultations with China at the WTO for restrictions on Lithuanian goods imposed by China, https://currentthoughtsontrade.com/2022/01/27/the-european-union-requests-consultations-with-china-at-the-wto-for-restrictions-on-lithuania-goods-imposed-by-china/; January 7, 2022: China's "bullying" of Lithuania — a repeating story inconsistent with WTO rules, https://currentthoughtsontrade.com/2022/01/07/chinas-bullying-of-lithuania-a-repeating-story-inconsistent-with-wto-rules/; December 22, 2020: China's trade war with Australia – unwarranted and at odds with China's portrayal of itself as a strong supporter of the WTO, https://currentthoughtsontrade.com/2020/12/22/chinas-trade-war-with-australia-unwarranted-and-at-odds-with-chinas-portrayal-of-itself-as-a-strong-supporter-of-the-wto/.

The lack of transparency in the Chinese system permits a wide range of trade distortions to arise (e.g., when state, provincial or local governments ban imports without formal notice or explanation, when technology transfer is required to operate but not included in documents, etc.). China's submissions to the WTO in areas such as subsidies have been viewed by the U.S., EU and others as woefully incomplete and have led to counternotifications being made by the U.S. *See, e.g.,* USTR Press Release, United States Details China and India Subsidy Programs in Submission to WTO, October 6, 2011, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2011/october/united-states-details-china-and-india-subsidy-prog; SUBSIDIES, Request from the UNITED STATES to CHINA, Pursuant to Article 25.10 of the Agreement, G/SCM/Q2/CHN/42 (11 October 2011).

While China has long been cited as having major human rights problems, in recent years, the trade implications of forced labor and other human rights issues have led to increased activity in an effort to cut off imports into the U.S. of products made from forced labor (in part or total). *See, e.g.,* February 13, 2022: February 10, 2022 release of ILO report and subsequent U.S. State Department press release on forced labor and other human rights issues in Xinjiang Autonomous Region of China, https://currentthoughtsontrade.com/2022/02/13/february-10-2022-release-of-ilo-report-and-subsequent-u-s-state-department-press-release-on-forced-labor-and-other-human-rights-issues-in-xinjiang-autonomous-region-of-china/; February 11, 2022: Stopping imports made in whole or in part from forced labor — U.S. law and the looming challenge on goods made from cotton and polysilicon, https://currentthoughtsontrade.com/2022/02/11/stopping-imports-made-in-whole-or-in-part-from-forced-labor-u-s-law-and-the-looming-challenge-on-goods-made-from-cotton-and-polysilicon/; December 19, 2021: Forced labor and trade — U.S. Congress passes legislation to address China's treatment of Uyghurs,

https://currentthoughtsontrade.com/2021/12/19/forced-labor-and-trade-u-s-congress-passes-legislation-to-address-chinas-treatment-of-uyghurs/; January 25, 2021: Child labor and forced labor in cotton production — is there a current WTO mandate to identify and quantify the distortive effects?, https://currentthoughtsontrade.com/2021/01/25/child-labor-and-forced-labor-in-cotton-production-is-there-a-current-wto-mandate-to-identify-and-quantify-the-distortive-effects/; January 24, 2021: Forced labor and child labor – a continued major distortion in international trade for some products, https://currentthoughtsontrade.com/2021/01/24/forced-labor-and-child-labor-a-continued-major-distortion-in-international-trade-for-some-products/.

The array of inconsistencies with WTO norms are reviewed annually in the USTR Report to Congress on China's Compliance with the WTO. *See, e.g.,* February 16, 2022: USTR's 2021 Report to Congress on China's WTO Compliance — a recognition that all of China's distortions to competition cannot be dealt with within the WTO, https://currentthoughtsontrade.com/2022/02/16/ustrs-2021-report-to-congress-on-chinas-wto-compliance-a-recognition-that-all-of-chinas-distortions-to-competition-cannot-be-dealt-with-within-the-wto/.

Prior Administrations have engaged both bilaterally with China and through disputes to get China to live up to its commitments under the WTO. The Trump Administration sought to address global excess capacity in steel and aluminum through use of Section 232 of the Trade Expansion Act of 1962, as amended, on national security concerns and conducted a section 301 investigation on a range of Chinese practices in, *inter alia,* the intellectual property area which resulted in additional tariffs being imposed on most goods coming from China. WTO challenges and court challenges in the U.S. have been testing the breadth of the U.S. national security law and the WTO consistency of such actions.

While some observers have called for excluding China from the WTO or forming a separate grouping that excludes China, the WTO has no identified process for removing countries from membership, although the current crisis caused by the Russian Federation's invasion of Ukraine has shown the willingness of a number of major economies to remove most favored nation status on a Member for national security reasons. *See, e.g.,* January 16, 2022: Is it time for a new approach to bilateral trade with China?, https://currentthoughtsontrade.com/2022/01/16/is-it-time-for-a-new-approach-to-bilateral-trade-with-china/; March 2, 2022: A former Appellate Body Chair argues WTO Members have the ability to remove the Russian Federation from WTO Membership; other proposals to strip MFN benefits from Russia and services restrictions, https://currentthoughtsontrade.com/2022/03/02/a-former-appellate-body-chair-argues-wto-members-have-the-ability-to-remove-the-russian-federation-from-wto-membership-other-proposals-to-strip-mfn-benefits-from-russia-and-services-restrictions/; March 20, 2022: Banned imports, higher tariffs, other actions by trading partners as Russia and Belarus lose most favored nation treatment by G-7 countries and EU during the conflict in Ukraine, https://currentthoughtsontrade.com/2022/03/20/banned-imports-higher-tariffs-other-actions-by-trading-partners-as-russia-and-belarus-lose-most-faovered-nation-treatment-by-g-7-countries-and-eu-during-the-conflict-in-ukraine/.

The Biden Administration has expressed the intention of working with allies to improve the WTO while looking at additional tools to address the distortions caused by the Chinese system.

See, e.g,. Testimony of Ambassador Katherine Tai Before the Senate Finance Committee Hearing on the President's 2022 Trade Policy Agenda, https://ustr.gov/about-us/policy-offices/press-office/speeches-and-remarks/2022/march/testimony-ambassador-katherine-tai-senate-finance-committee-hearing-presidents-2022-trade-policy (March 31, 2022). Thus, the Biden Administration will engage bilaterally with China, will focus on strengthening the U.S. economy (e.g., improved infrastructure, more resilient supply chains, more domestic production of key products, improved Buy America), explore new tools to address distortions (e.g., the U.S.-EU efforts on steel and aluminum to address excess capacity), and will work regionally and through the WTO to address issues of importance where possible.

Questions of interest to the USCC for this panel

1. **China has repeatedly refused to abide by the spirit of the World Trade Organization. Is the WTO still relevant to addressing the challenges posed by China's policies?**

The fundamental problem posed by China in the WTO is its state-directed economic system which is fundamentally at odds with market economies. Former Deputy Director-General of the WTO Alan Wolff has opined on a number of occasions that a core principle of the WTO is the need for convergence of economic systems of WTO Members. Coexistence of different economic systems is not dealt with by the WTO Agreements and is not compatible with WTO rules. *See, e.g.,* November 10, 2020: The values of the WTO – do Members and the final Director-General candidates endorse all of them?, https://currentthoughtsontrade.com/2020/11/10/the-values-of-the-wto-do-members-and-the-final-director-general-candidates-endorse-all-of-them/ August 19, 2020 [updated August 27]; August 19, 2020 [updated August 27]: The race to become the next WTO Director-General – where the candidates stand on important issues: convergence vs. coexistence of different economic systems; possible reform of rules to address distortions from such economic systems – Part 2, comments by the candidates, https://currentthoughtsontrade.com/2020/08/19/the-race-to-become-the-next-wto-director-general-where-the-candidates-stand-on-important-issues-convergence-vs-coexistence-of-different-economic-systems-possible-reform-of-rules-to-addre/; August 17, 2020: The race to become the next WTO Director-General – where the candidates stand on important issues: convergence vs. coexistence of different economic systems; possible reform of rules to address distortions from such economic systems – Part 1, background on issues, https://currentthoughtsontrade.com/2020/08/17/the-race-to-become-the-next-wto-director-general-where-the-candidates-stand-on-important-issues-convergence-vs-coexistence-of-different-economic-systems-possible-reform-of-rules-to-address-dist/.

While the U.S., EU and others have raised the need to address the myriad distortions caused by non-market economies (or state directed economies) as part of WTO reform, it is highly unlikely that WTO Members will agree to broad based changes, although some changes to the Subsidies Agreement may be accomplished over the medium term (5 years or more).

2. **Can the WTO meaningfully address the repeated problem of Chinese subsidies? In particular, with subsidies emanating from state-owned companies, is it feasible to**

overcome the WTO's definition of what constitutes a "public body"? Was the WTO's decision correctly decided based on negotiated commitments?

While the U.S. lost the dispute on "public bodies," the U.S. has continued to pursue countervailing duty cases against imports from China, typically with large countervailable subsidies found. Thus, U.S. countervailing duty law can likely still be effective in many cases despite the adverse public body decision. That does not protect U.S. export interests both in China and in third countries.

The WTO adverse decision will almost certainly be part of the package of proposals for reform coming from the U.S., EU and Japan. Because of China's interest in maintaining the Appellate Body's reading of "public body", it is unclear if revision at the WTO will be possible.

The United States identified the public body decision as one of the most egregious Appellate Body overreach decisions in its 2020 report on the Appellate Body. See USTR, REPORT ON THE APPELLATE BODY OF THE WORLD TRADE ORGANIZATION, February 2020, https://ustr.gov/sites/default/files/Report_on_the_Appellate_Body_of_the_World_Trade_Organization.pdf, pages 82-88 ("The Appellate Body's Erroneous Interpretation of 'Public Body' Threatens the Ability of WTO Members to Counteract Trade-Distorting Subsidies Provided through SOEs, Undermining the Interests of All Market-Oriented Actors"). I concur that the decision is inconsistent with the underlying WTO Subsidies and Countervailing Measures Agreement.

The decision has been widely criticized, including by people who were actively involved in the negotiations (Jan Woznowski, Director of the Rules Division; Michael Cartland, Permanent Representative of Hong Kong who served as the Chair of the Subsidies and Countervailing Measures negotiations, and Gerard DePayre, negotiator for the European Union on Subsidies and Countervailing Measures). *See* Cartland, Michael, Depayre, Gérard &Woznowski, Jan. "Is Something Going Wrong in the WTO Dispute Settlement?" Journal of World Trade 46, no. 5 (2012): 979–1016, at 996. USTR characterized the paper as follows in its 2020 Report (pages 86-87):

"Commentators have also criticized the Appellate Body's interpretation. For example, in an article in the Journal of World Trade, Michael Cartland, Gérard Depayre, and Jan Woznowski – each of whom participated in the Negotiating Group on subsidies and countervailing measures in the Uruguay Round – present a detailed discussion of the Appellate Body report in US – Anti-Dumping and Countervailing Duties (China) and raise a host of concerns with the Appellate Body's interpretation of the term 'public body,' calling the analysis 'internally contradictory' and 'disingenuous.'"

3. **As national security becomes a higher priority for both the United States and China, how can the WTO remain relevant or useful in breaking down barriers to trade?**

Since the GATT started in the late 1940s there has always been a national security exception to obligations assumed under the GATT and now under the WTO. GATT 1994 Article XXI reads:

Article XXI
Security Exceptions

Nothing in this Agreement shall be construed

(a) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or

(b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests

(i) relating to fissionable materials or the materials from which they are derived;
(ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
(iii) taken in time of war or other emergency in international relations; or

(c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

Similar provisions are in the Services and TRIPS Agreements.

The bulk of the actions taken by the United States against China have not been premised on national security. Trade remedies (antidumping, countervailing duty, safeguard), Section 301 actions have not been premised on national security but other statutory bases. Section 232 actions, such as on steel and aluminum, have been based on national security concerns.

Similarly, U.S., EU, UK, Canada, Japan and others who have removed most favored nation treatment from the Russian Federation after its invasion of Ukraine have justified such action on national security (presumably GATT 1994 Art. XXI (b)(iii) for goods).

Many WTO Members, including China, the EU, Canada, Mexico and others, took unilateral action without WTO authorization when the U.S. imposed duties under Section 232, some claiming that such action was supported by the Safeguard Agreement where imports had not increased. Such actions by U.S. trading partners were not justified on national security grounds.

U.S. 232 action is currently subject to panel review at the WTO with panel reports currently due by the end of the first half of 2022. *See, e.g.,* UNITED STATES – CERTAIN MEASURES ON STEEL AND ALUMINIUM PRODUCTS COMMUNICATION FROM THE PANEL, WT/DS544/12 (China as complainant)(10 December 2021).

The U.S. has long contended that when a Member claims national security as the basis for action, there is no role for the WTO dispute settlement system. National security actions by other countries whether involving goods or TRIPS have been found by WTO panels and the Appellate Body as subject to review and permissible if in accordance with the provisions of GATT 1994 Article XXI (or comparable provisions in the TRIPS Agreement). *See, e.g.,* World Trade

Institute Working Paper No. 03/2020, Peter Van den Bossche and Sarah Akpofure, The Use and Abuse of the National Security Exception under Article XXI(b)(iii) of the GATT 1994, https://www.wti.org/media/filer_public/50/57/5057fb22-f949-4920-8bd1-e8ad352d22b2/wti_working_paper_03_2020.pdf.

If the panel report finds the U.S. not having complied with WTO obligations, the U.S. will have the option of seeking a resolution with the complainants or filing an appeal.

To the extent that the U.S. views an increased need to invoke national security justification for action contrary to other WTO obligations and such actions would not fall under the exceptions as construed by panels, the U.S. will be left with seeking modification of GATT Art. XXI (and the comparable GATS and TRIPS provisions) as part of WTO reform or can hold up reacceptance of binding dispute settlement, or can simply accept the retaliation likely to follow.

It is not my view that national security will be the major tool used going forward to address distortions from China.

4. **Katherine Tai recently posed the question of whether U.S. policy is aiming for a greater quantity of liberalized trade or "for smarter and more resilient trade." Is the WTO compatible with a latter vision?**

The GATT and now WTO have always had provisions permitting members to deviate from obligations in certain circumstances and to adopt laws and regulations to address health, quality and other national concerns. Thus, there is nothing in the WTO that prevents countries from engaging in smarter or more resilient trade.

The U.S. during the Trump Administration, had raised a series of issues concerning whether the existing system was sustainable as being tilted against the United States. The issues included self-selection as a developing country (with entitlement to special and differential treatment), lack of transparency by some Members, the need to rebalance tariff commitments in light of current level of economic development, revised agreements to address distortions created by state-directed economies like China. See, e.g., August 24, 2020: USTR Lighthizer's Op Ed in the Wall Street Journal – How to Set World Trade Straight, https://currentthoughtsontrade.com/2020/08/24/ustr-lighthizers-op-ed-in-the-wall-street-journal-how-to-set-world-trade-straight/. These types of changes, if made to the WTO, would make the international trading system smarter and more resilient. Most observers believe such changes are unlikely to be achievable.

The Biden Administration has been putting a push on trading partners to take action against forced labor within the ongoing negotiations on fisheries subsidies. While it is unlikely that such provisions will be accepted by all WTO Members (particularly China) as part of the fisheries subsidies negotiations, such action is being pursued within USMCA countries and some others. Eliminating trade based on forced labor would be smarter and more resilient trade.

The WTO and the GATT before it have historically been reluctant to embrace labor and environmental issues, though there has been a trade and environment committee for many years

and there are now a range of environmental plurilateral negotiations taking place. Dealing with environmental issues and to the extent possible labor issues would make for smarter and more resilient trade. The environmental negotiations are likely to be plurilateral but open to all to join.

In short, it should be possible for WTO Members to adopt at least many aspects of "smarter and more resilient trade" without running afoul of WTO obligations.

5. **What is the promise of other initiatives taking place in the WTO related to digital trade and what is the likelihood that they can change Chinese practices?**

WTO Members launched a series of Joint Statement Initiatives (JSIs) among the willing at the 11th Ministerial Conference held in Buenos Aires in 2017. While countries like India and South Africa have not joined any of the JSIs and have raised questions about the propriety of the WTO incorporating plurilateral agreements without consensus of all Members, there has been a lot of effort over the last four years on moving the negotiations forward, seeking some completions by the 12th Ministerial Conference this June.

Ongoing JSI include those on electronic commerce, investment facilitation for development, plastics pollution and environmentally sustainable plastics trade, services domestic regulation, informal working group on MSMEs, and trade and environmental sustainability. The WTO issues periodic press releases on developments in the talks. *See, e.g.,* JOINT INITIATIVE ON E-COMMERCE, E-commerce negotiators seek to find common ground, revisit text proposals, 21 February 2022, https://www.wto.org/english/news_e/news22_e/jsec_23feb22_e.htm (hoping to have convergence on majority of issues by end of 2022)(86 WTO Members participating accounting for 90% of e-commerce trade including China, U.S. and most other major countries); INVESTMENT FACILITATION FOR DEVELOPMENT, Investment facilitation negotiators take steps to assess needs of developing countries, 15 February 2022, https://www.wto.org/english/news_e/news22_e/infac_23feb22_e.htm (looking to complete by end of 2022)(over 100 WTO Members participate including China and most developed countries, but not the U.S.); INFORMAL DIALOGUE ON PLASTICS POLLUTION AND ENVIRONMENTALLY SUSTAINABLE PLASTICS TRADE, Plastics dialogue emphasizes need for international collaboration, cooperation, 30 March 2022, https://www.wto.org/english/news_e/news22_e/ppesp_31mar22_e.htm (70 Members participate including China and most major developed countries but not the U.S.); Joint Initiative on Services Domestic Regulation, Negotiations on services domestic regulation conclude successfully in Geneva, https://www.wto.org/english/news_e/news21_e/jssdr_02dec21_e.htm (67 Members participated including China, the U.S. and other major developed countries); . MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES (MSMES), Working group on small business welcomes three more members, 8 February 2022, https://www.wto.org/english/news_e/news22_e/msmes_08feb22_e.htm (94 participants including China and most major developed countries but not the U.S.).

Since the Doha Development Agenda reached an impasse in 2008, U.S. Administrations have participated in WTO activities but have also pursued free trade agreements and other regional and plurilateral activities. There is good progress being made in Geneva on the various JSIs,

although the impact of the Russian Federation's invasion of Ukraine may create challenges to forward movement in some talks.

The U.S. is obviously pursuing important topics like e-commerce in multiple fora. While the WTO may result in a plurilateral agreement that is less robust than U.S provisions with Canada and Mexico or that get achieved with other trading partners, the plurilaterals at the WTO are an important effort to maintain relevance for the WTO in a rapidly changing world.

PANEL IV QUESTION AND ANSWER

COMMISSIONER CLEVELAND: Thank you. We're going to start the questioning with Chairman Wong.

CHAIRMAN WONG: I think I'll yield my time, but I may claw it back at the end.

COMMISSIONER CLEVELAND: Only if you talk about Kaldor-Hicks, Mr. Wong. Mr. Wessel.

COMMISSIONER WESSEL: Thank you all. And thank you both for being here. And, Terry, I remember fondly many trips to, during the Uruguay Round negotiations, learning from you and working with you on those agreements, on that agreement. And I have above my desk in my office a thank you letter from President Clinton, and a signature pen, signing the Uruguay Round implement bill and the law.

So, maybe I don't know that Clyde Prestowitz earlier, who touted his support for China's WTO accession did enough of a mea culpa. I still believe that was the right thing to do.

But my question now is, has the WTO lost its relevance to the China problem? Dr. Staiger, you talked about an NVNI case. And, Terry, I would like your comments on that as well. As I recall, the first NVNI was the Fuji-Kodak case where we had a partial win but not a full win.

Tell me how we measure injury, impairment or violations against what metric are we doing that?

The expected value of trade that we thought we would get when we agreed to the accession protocol, is it what China thought it would have to give?

Would a case be effective at all, but again, if we were to bring it, how long would it take? And during that period we'll have all the continued distress that we currently have. How do we measure it?

And if we were to win, what would we get?

So, Dr. Staiger and then Terry, if you could both respond.

MR. STAIGER: Yes. Thank you, Commissioner Wessel. Very good question. And the NVNI, or the non-violation complaint, had a history before the Fuji case in the GATT years.

COMMISSIONER WESSEL: Okay.

MR. STAIGER: And it was used relatively more frequently in the GATT years than the WTO years. And essentially it was used to address the introduction of new subsidies.

So in the GATT years the subsidy rules were extremely benign. They were essentially reporting rules.

And so early on a introduction of a new subsidy was a classic non-violation kind of argument that I negotiated a concession with you. You lowered your tariff on a product. And then subsequently you surprised me by introducing a subsidy to the producers of your input.

COMMISSIONER WESSEL: But just so I understand. So post-WTO an NVNI would not be measured just against subsidy issues, but would it also be measured against performance criteria and all the various other issues that have damaged us? Or we view as damaging us.

MR. STAIGER: Right. And in fact, even pre-WTO it wasn't explicitly limited to subsidies but the practice was, that was the classic kind of case.

COMMISSIONER WESSEL: Okay.

MR. STAIGER: But just to frame, maybe let me read, very quickly, what one of the drafters of the GATT said about essentially the non-violation code. Or non-violation article. He said, we shall receive, if our negotiations are successful, we shall achieve, if our negotiations are successful, a careful balance of the interest of the contracting parties. This balance rests upon certain assumptions as to the character of the underlying situation in years to come.

And it involves a mutuality of obligations and benefits. If, for the passage of time, the underlying situation should change or the benefits supporting any contracting party should be impaired, the balance would be destroyed. It is the purpose of Article XXIII, and its broader non-violation, to restore this balance by providing a compensatory adjustment in the obligations which the contracting party had assumed.

So that's a very broad statement. It's not about subsidies per se it's about anything that might have happened that we didn't write explicit rules about. That are not covered in the articles.

COMMISSIONER WESSEL: So using the language you just read, it is the value of China's WTO accession that I assumed would be the value of compensation where I to win, is that correct?

MR. STAIGER: As long as it is proven to be or argues to be my legitimate expectation. So I can't expect crazy things.

But if I can say when China joined the WTO we expected that in addition to its tariff commitments and its other commitments, like its export restriction commitments, we expected China to evolve into a market economy and those commitments were going to actually mean something, if 20 years later China has not evolved into a market economy, that was not written into a rule of the WTO that they had to, but that is a, that would be in my view, and others too, and I'm not a legal expert I'm an economist, but before this panel Jennifer Hillman has argued a similar case and she was an Appellate Body Judge, that would be a classic non-violation sort of case to make.

Now that said, it's a difficult case to make. It's supposed to be --

COMMISSIONER WESSEL: Let me, if I can, now turn to Mr. Stewart who actually has written the textbook, or a set of textbooks, on the GATT.

Terry, what are your responses to that?

And also, the likelihood that we could bring a case, what would we need to do to bring that case?

I'm going a bit over. Help us out with that.

MR. STEWART: Yes. First of all, I have long believed that there is a large violation set of issues that have not been raised, that could be raised, that would be an easier set.

The language from some of the originators of the article, in terms of nullification and non-violation of cases, the panel's body of now rejection use of negotiating history, and they go simply off of the language. And there haven't been any cases that would do it, the kind of broad-based non-violation effort the professor has mentioned, even if it is theoretically a possibility. That said, one could do a case so that both elements and violations, and possibly non-violation, it would be extremely difficult. And we would want to get as many countries as possible to join. It's not clear that you would have much success. Perhaps you would be able to get the Europeans to come

on board with it.

COMMISSIONER WESSEL: Thank you. I also remember you and I talking bringing up one of these cases many years ago so I appreciate it. Thank you.

COMMISSIONER CLEVELAND: Dr. Scissors's.

COMMISSIONER SCISSORS: Now that I know who is sitting in front of us, because there is a name tag there, I feel emboldened to go forward.

I previously asked the co-chairs for extra time at some point. First, Staiger, thank you for coming in. Thank you for making a pro-WTO argument that isn't based on, no, you can't do that. Which is what we get some defenses of the WTO from.

Also, thank you for taking a step towards differentiating China from other actors by saying, hey, it's okay domestically if we don't presume market mechanisms. I am going to say your differentiation is inadequate and that's why you get the conclusion that you do. And I very much want to hear you tell me I'm wrong and where I'm wrong.

I'm going to start with, I don't know the answers to these questions. These are absolutely honest questions. I looked up your, some other work, but I didn't have very much time. I found a slide deck with a couple of equations in it, I didn't find the full model. So please direct me if that would be helpful.

Is the externality of the trade, that trade agreements try to address fixed in nature, one, and two, contingent in any way on some degree of similarity in the optimization problem of the participants?

And by the optimization problem I mean the problem, I don't mean the implementation mechanism. So that's a question about your assumptions, number one.

And question number two, are you assuming that international market clearing and conditions are always competitive or at least fixed and exogenous to the actor's behavior?

And those are my couldn't find the full model questions for you.

MR. STAIGER: Okay, great. Thank you for those questions. And if I forget one of those, I think you've asked three, come back at me.

So first of all, on the externality, it's very important, for the argument that I make, that economists also make, that this externality does have a very particular form. It's not like an environment externality of global warming which is in the atmosphere and there is no particular economic structure that you can harass.

The externality that I'm talking about, that trade agreements are meant to address, is what economists would call the pecuniary externality. It travels through prices.

And when we think about the difficulty of dealing with a country that has low labor standards, for example, and very cheap labor, why do we normally worry in the U.S. that this is hurting us.

Well, it's probably not so much because we care deeply about the welfare of the workers in China, it's about the fact that that trade is being produced very cheaply and coming over and hurting our workers. That is a pecuniary externality because it's traveling through markets, it's traveling through goods and effecting prices. That's the externality that I'm talking about.

So it is fixed in that sense. But other than that, it's very, very general. And what I think many people don't realize is that in trade agreements almost any international agreement is going to be trying to internalize some spill over between countries.

But in trade agreements that spillover is very structured with a pecuniary structure. And that gives economists the ability to look at the design of the trade agreement, in particular the GATT and WTO, and say, are the rules under the GATT and WTO, do they look like they are actually really well designed to handle this very specific spillover and neutralize it.

And my statement, written statement, is in fact the answer is yes. That is exactly, you hit right to the core of the argument. So that's, I think, your question one.

Second question is always tremendously important question. You're asking whether we're assuming, as economists, that the problems that the governments are solving are similar. And I think by that what you mean, or I'll interpret it that way, is one of the objectives of the U.S. is that we care very much, now anyway, about redistribution and about the income distribution effects of trade.

And what if in China there is not so much of a care perhaps. I'm making it up. I have no sense if that's true or not.

But supposed that it were true, that, well, their system of government, they don't need to respond to the injury of citizens and so they don't care so much about income distribution. Or it could be that one country does care about income distribution but it has ample tools to handle it. Like income supplements and redistribution.

All of that is fine. So not imposing any kind of uniformity or harmonization of what different countries do.

And that's extremely important because the GATT, from the 1947, and now the WTO from 1995, has always prided itself and stated explicitly that it is a member driven organization. And what that means is, it is not a free trade organization.

If you look at the statements on the WTO website and GATT before it, you will not find that the statement, the purpose of the agreement is to achieve free trade. That is never said.

Which is sort of ironic since there are other international institutions that do push free trade on countries. But not the GATT or WTO. It never has.

Instead, it is a member driven organization that acknowledges that different countries are in different states of development, have different preferences. And simply says, we are a negotiating forum that tries to get a deal that all countries can mutually benefit from given their own preferences and their own states of development.

So that's the answer to question two. I think it's very robust in that sense.

And then your third question, also an excellent question about the market clearing process because that's important for determining the externality. And what you asked, it has to be competitive, and in fact, no.

The market clearing process is just a process of equating supply and demand. But the industries don't have to be competitive. They can be monopolistic, all monopolistic, differentiated products. Essentially any kind of industry that economists will be looking at fits into this framework.

COMMISSIONER SCISSORS: So I have follow-up. This is a good time to break and I can come back with follow-up comments based on this or like go through?

COMMISSIONER SCISSORS: All right, thank you.

COMMISSIONER CLEVELAND: For a period of time we will, yes.

COMMISSIONER SCISSORS: Okay. Is anybody hungry for dinner because I am.

So I appreciate your answers and I'm going to try to say there is something wrong with what you just said, but I'm going to use it by example rather than any sort of proof to the relief of all my colleagues.

And so, I'm looking for you to tell me where I'm mischaracterizing the problem. So I think you're still assuming too much conformity among the actors. That China is so sufficiently different. That the conclusions you get about the ability of the WTO to respond are incorrect.

And I'm going to try to illustrate that very briefly. And there are two aspects to this. Their domestic optimization problem is so different than ours because of the politic considerations of keeping the economist party in power no matter what. That we can't work with them in the way that we could obviously work with the members of the GATT.

And then the second part is that the barriers against China deliberating distorting their international markets are so weak that, again, the WTO provides insufficient discipline even theoretically.

But what I want to, the illustrations I want to throw at you are, the compensating actions that China would need to take for its partners now to offset the adverse international effects of its policies that we did not expect are prohibitively large. It's just completely unreasonable to think this would ever happen.

And the reasons are, the current direction of Chinese policy, which is quite different than the direction of Chinese policy when they exceeded, which is why a lot of us screwed up, the size of China, which is also quite different from than when they exceeded, which is why a lot of us screwed up, but a third thing that was brought up in the first panel by me ranting, which is, among other things, China would see it as, these negotiations, as completely non-credible. It would dismiss the consequences of any non-compliance because we have given it no reason to think there is any consequences for its noncompliance.

So we would be having a negotiation, asking for the Chinese for some extremely large, unprecedented large set of changes. And they would just look at us and say, that's laughable. You don't do anything to respond to our behavior.

So that's, I'm going to give you, I want you to respond. So that's illustration number one. You might say because you did, it's in China's own interest, as is in the case of each WTO member's own interest and part of the world trading system that is effective in permitting the priority, pardon me, effective in permitting the voluntary exchange of secured negotiated market access. Your words.

The extent of the differences in the priority China attaches to this interest versus others and its size make it an outlier. And I'm using Lithuania here as an example.

What the Chinese want to do with Lithuania is teach them a lesson about talking about Taiwan. Which is really not going to be, it's very difficult for the WTO to discipline that.

And worse, if like, Latvia were trying to teach Lithuania a lesson, it would not have systemic consequences. But the Chinese doing it, as we heard in Panel III, there is a precedent where they will try to do it again.

They're already sort of tried to do it to the Australians so it's not just limited to one country. So that's my second comment. The conversation is too big and that the Chinese, the priority of the Chinese attached to this gain from the WTO is too distorted as compared to ours.

And the final one goes beyond your oral testimony to written testimony. Renegotiating for

less market access, as you discuss something we can do to address an equality, that's also not treating China as a sufficient differentiated actor in my opinion.

Because in my view, our income and equality problems in most of the WTO, large WTO members, are due to China. They're just China.

So I don't need to renegotiate my market asset commitments to the WTO, I only need to renegotiate my market access commitments to the Chinese in order to get my to an income and a quality level that I'm happy. Now obviously that's a possibility. I'm not saying it's true.

But if that's true, the problem here is not that we, that we all, the U.S., EU, et cetera, should change our market access commitments because we have too much inequality, the problem is, we can keep our market access commitments exactly as they are and stop applying reciprocity to the Chinese as an alternative to the proposal that you make.

So there is a, what I'm trying to get at with those examples are ways in which China is different than it was when we negotiated the access and then any other country is. And I want to have you tell me it's not that different, as you like.

MR. STAIGER: Okay, great. All right. So let me try to sort out of the rant from the questions.

COMMISSIONER SCISSORS: I can remind you of the examples if those got lost in my wildly --

MR. STAIGER: No, that's good. It's very interesting. Okay, so just stepping back for a second.

The spirit of that part of the proposal, at some level, is to kind of change the narrative that U.S. and China and China and most industrialized countries are stuck in at the moment.

And to me, changing that, the narrative at some level is saying to China, either you need to bring market principles into your economy or you need to decouple. And it's sort of black and white. Like as mentioned, I think by Terence perhaps.

People, there are definitely legal or policy makers who are saying that the WTO is simply not set out to handle a nonmarket economy. I don't think that's true, that it's not set out.

And I think the way to change the narrative is to, instead of saying the WTO is for market economy so either China has to become a market economy or leave is to say, what really is needed for the WTO? Being a good citizen.

And what's needed is, as a starting point anyway, and a major starting point, to have a reciprocity of balance between the rights and obligations. And what does that ultimately mean?

In market access it means, essentially growing your imports by the same value and quantity as you're growing your exports over time. And I'm not just making that up historically. There were nonmarket economies who did join the GATT and the WTO. In fact, Czechoslovakia was an original signatory of the GATT and then became a nonmarket economy. And its negotiations with the other GATT members essentially allowed it, for example, to be excluded from articles which otherwise might have addressed currency manipulation.

And the argument Czechoslovakia made was, we are a nonmarket economy. We are, by monopoly, telling you how much we're going to import and how much we're going to export, so what difference does it make how we set our currency.

And the GATT members agreed. That as long as Czechoslovakia was willing to import the growth and imports that match the growth and its exports, that currency manipulation type rule

just didn't apply to it.

Well, what I'm suggesting is, there are similar ways to think about China and get around these very thorny issues of currency manipulation, it's non market economy status in the antidumping case, whether a public body issues in subsidy cases. Suppose that China were able to commit to grow as imports by a certain amount as in relation to the growth of its exports. Well that's what Poland did when Poland joined the GATT.

And it's a very simple alternative that doesn't focus on saying, if you want to be part of the GATT/WTO you have to change your economic system. It says, you need to basically achieve a balance of rights and obligations the way other countries do. And if you want to do it in a particular way, that's okay.

And as a law professor, the late great law professor John Jackson referred to that as the interface principle. That was the view, at the time, that nonmarket economies could be members of the WTO, or the GATT at the time.

And the key question was, how do you interface, how do you adjust the rules to each situation so that each country can interface with the market economies.

Now, your point is exactly right that China is orders of magnitude bigger than any of these other countries so I totally agree with you there that this is a new, you know, at the time Poland exceeded it was considered a medium sized nonmarket economy. So this is clearly, you know, Poland is only so much of a model for the possibilities for China.

But I do think that if, you know, to change the narrative to, rather than say the only way that China can be a good citizen is to become marketize, to rather focusing on what really matters for WTO membership, at least in terms of market access. And that is, figuring out a way to make commitments to market access that are secure.

And to me that's a problem that China has created is that, what countries thought they were getting was secure market access commitments that would achieve a balance ended up not. And in that sense, it is in China's interest to figure out a way.

And perhaps, if the narrative were changed, instead of feeling like if it doesn't change its market system, it's non market system into a system, it's going to be kicked out of the WTO. If instead it were a more constructive type of negotiation that could be initiated by a non-violation claim of this kind that said, we just all need to figure out, China and its trading partners, how we can productively do this, there might be more progress.

Now, having said that, I totally agree that non-violations are very difficult. But this whole issue of China has proven extremely difficult. So it's not like we have an easy alternative.

And I don't know, let me say one more thing because this sort of gets your point, maybe. Here is an olive branch.

I like your question very much. I think they're exactly the kind of questions we need to be asking and talking through.

But here is a way. This morning it came up, somebody asked, what about subsidies? We're talking about limiting China's subsidies but why, how are China's subsidies any different than anybody else's subsidy?

And there is actually an interesting way that China's subsidies are different. And that is, according to economics, as long as countries are armed with countervailing duties, so that they can block the impact of subsidized trade if they don't like what it's doing to their workers and their

income distribution, of course they might like it for their consumers, cheap goods, but if they don't like it for the income distribution, then they need to have some way to block it.

If they can block it with the countervailing duty, then the economic stories that I tell would say, that's exactly the right way to handle those subsidies. Let countries countervail. Those that want the cheap goods don't have to countervail. Those that don't want them can.

The problem with China, as we know, is the U.S. found it very difficult now to use countervailing duties because with public body disputes at the U.S.'s loss, it's sort of lost its ability to easily countervail against a subsidy because that subsidy is so non-transparent.

And that, to me, would distinguish those subsidies from the subsidies of an industrialized country that the U.S. could always countervail. And I'm not talking about export subsidies, I'm talking about subsidies domestically that could just be countervailed.

So I do think there are differences that are related to China that I'm not emphasizing so much in this written testimony, but one could bring up. But there are differences that are subtle in that way and that can be handled.

Again, through negotiations. So those specific things could be handled in a more specific way. Okay, let me stop there.

COMMISSIONER SCISSORS: I thank you. And I thank everyone for your tolerance. I could keep going, and I would rather stay alive. Thank you.

COMMISSIONER CLEVELAND: Well, other people may cede their time to you, Dr. Scissors's. Commissioner Schriver.

COMMISSIONER SCHRIVER: Thanks to the witness. I'll pass on the opportunity to ask questions.

COMMISSIONER CLEVELAND: I should have asked, Mr. Stewart, did you have any comment in response to Dr. Scissors's dissertation?

MR. STEWART: Well, I would have a lot of comments. Considering how long the answers and the questions went, perhaps it would save you all not to have to listen to my responses as well.

It is certainly, it is certainly the case that the U.S. continues to bring countervailing duty cases, let me just take the last point, it will just be done very briefly.

U.S. continues to bring countervailing duty cases against China. And while we've lost the public body issue through the kind of overreach that the Appellate Body here has become famous for and has caused it to cease to exist, the reality is that the arguments that are found in most cases continue to be quite robust.

And so, the countervailing duty law is not basically challenged yet even though it is more difficult to get all of the subsidies addressed. Part of that is due to the fact that China instructs its companies not to respond to lots of parts of the questionnaires that come from the Commerce department. So let me stop there.

COMMISSIONER CLEVELAND: Feel free, for the record, to answer any of the additional parts of the questions Dr. Scissors's provided.

Commissioner Mann.

COMMISSIONER MANN: I will pass as well.

COMMISSIONER CLEVELAND: There is a pattern emerging. Senator Goodwin.

COMMISSIONER GOODWIN: I will not pass. But, Madam Chair, you did step on my

joke. I was going to yield my time back to Derek but I'll ask a question instead.

COMMISSIONER CLEVELAND: He'll be grateful for that.

COMMISSIONER GOODWIN: Actually, I want to talk a little bit about this notion of a non-violation case and approach it from the perspective of my day job as a practicing attorney. What does the case look like? Obviously, the benefit, as you describe it, would you be you avoid a lot of the thornier evidentiary and factual issues of having to prove specific violations or examine the specific contours of any substances and the like.

But what would you have to prove? Mr. Staiger, you indicated it would be a difficult case, but is the claim, what has to be alleged, what is the burden of proof that has to be demonstrated and is there any historical precedent for these sorts of cases and what sort of guidance do they provide for a big bold step like this?

MR. STAIGER: Yes, very good question. And I would agree with Terence's comment that, and also Jennifer Hillman in front of this committee from a few years ago, that it wouldn't be a non-violation alone, it would be a non-violation in combination with perhaps a number of violations. Maybe many violation cases.

So I'm not saying that there aren't violation cases to bring, but as Hillman said in her testimony, and I would agree with this, there is a limit to what violation cases can do, even if we win them against China, as long as the underlying nonmarket aspect is there because there is just too many non-transparent things that can be done.

And that's where a non-violation can kind of bring the provider arc that is carrying the violation and all of the other things to the table.

And so, what is the case? Well, the case is that one has to argue that there were legitimate expectations back when the, when China's accession was negotiated on the part of the U.S.

In this case, that there would be market access improvements in China that were not realized over time. Meaning, that there was a legitimate expectation that China's markets would be open in a way that was similar to what the U.S. was offering to China through permanent MFN.

And so, there is sort of those two things that, first of all, one has to show that there sets of measures taken. They don't have to be explicitly defined as a subsidy, but some kinds of measures, administrative guidance, et cetera, that have the effect of undercutting the market access that otherwise would have been granted to the U.S. and other countries as part of the accession negotiation.

So those are, you know, that's kind of the legal case to be made. And I would defer to Terence to describe in more depth exactly what the legal hurdles are.

But they are relatively short and terse because it is a general non-violation claim, not a very specific claim that you have to prove that an actual subsidy has been offered. And to do that you have certain steps that there was a public body or a government body, et cetera.

So, that, to me, is the key thing. Is that the case itself would be based on legitimate expectations that were frustrated.

And that's where, perhaps, China could even been seen to, in some sense, cooperate with this in the sense that not fighting so much a case, if they simply were to say, well, we can acknowledge that things have not worked out in a reciprocal way since 2001 and that we agree that there is some way that we need to, going forward, re-balance our commitments.

And why would China ever do that. Well, again, if the alternative is that with China's size,

and this goes back to Mr. Scissors's point, with China's size I think they're aware, as many countries are, that this dispute and this friction between China and many countries could really make the WTO collapse. I think it's that serious that if it isn't, if a way isn't found to correct it, the WTO could essentially founder.

And in that sense, if there were a reboot of the narrative that said, you know, this is not as adversarial as it normally would be, it is something that we all have this interest to figure out and let's find common ground, you know, my belief is that this could have an impact that would be partly legal, partly negotiated, partly diplomatic.

And in some sense that's how the GATT used to work. It was a, it wasn't a legalistic, nearly as legalistic as the WTO has become in dispute settlement, it was a kind of a shared interest that this was working a lot better than what happened under Smoot-Hawley and let's-- we all have skin in this game.

Well, in some sense I think China understands that actually. They have huge skin in this game.

And to the extent that a non-violation could kind of defuse things a little bit and set the stage for some kind of combination of legal diplomatic negotiations, I think that could work. If it couldn't work at least it's worth trying relative to all other options we have right now.

COMMISSIONER GOODWIN: Thank you. Mr. Stewart.

MR. STEWART: Thank you. The reality, in my view, is that China is enjoying the WTO exactly because they can block anything that tries to take away the artificial advantage that their failure to conform their system gives them.

And so, a non-violation case, even if combined with a violation case, would be seriously fought by China. And there is no, in my view, there is no plausible scenario in which they would say, oh, we have displayed having outgrowing the world, basically two to three to one over the last two decades. Since we joined the WTO.

The good news is that we've managed to run a trade surplus which economists historically always said was impossible to do. If you were outgrowing the world you'd be sucking in more imports.

So the proof, the proof element would be very high. It's very high in the violation case. Whether or a non-violation case would be even higher.

The non-violation cases have been filed in the past, as the professor indicated, tended to be very simple cases. In an negotiation, tariffs were X in this product, they were Y on this product. I lowered my tariffs on this product but then you gave a big subsidy to this other product which meant that all of the demand went to this other product and I was denied the benefit.

If you're going after the entire Chinese economy and the entire set of distortions that have been created, if you try to do that in a non-violation framework, the proof would be gargantuous.

Now, most of the issues that people are concerned about would almost certainly be violations of the commitments that they made under their working party report, which were incorporated into the protocol. But those require a huge amount of proof. And they require cooperation from companies who are invested or traded to China and who historically have refused to provide any.

COMMISSIONER GOODWIN: Thank you.

COMMISSIONER CLEVELAND: Commissioner Friedberg.

COMMISSIONER FRIEDBERG: Thank you. Mr. Stewart, when I was reading your written statement, sort of following along, you described how China has not adhered to its commitments, the WTO has not been successful for the most part in compelling it to do so. The processes that exist now are extremely slow and unlikely to produce remedies in any reasonable period of time.

And then at the end, you say, but the United States should stick with the WTO. So I wondered if you could explain to me a little bit more why you come to that conclusion.

Can the WTO, as it's presently constituted, help to deal better with the problems that China possess than it has?

If it can't, does the continuation of the status quo, and in particular our participation in the WTO, inhibit us from doing things to defend our interest, does it shield China from efforts by others to use other means to compel it to change its policies?

MR. STEWART: Thank you for the question. I, in my paper, basically indicate that it is my view that the U.S. is going to stay in the WTO. And that that was true, even under the Trump Administration.

Mr. Lighthizer at the time said if there wasn't a WTO we'd have to create one. The fact that it's not functioning well has a lot of elements to it. But there are positives that can come out of the WTO in some areas.

For example, there is a lot of work that the committees do in both the standards and in the sanitary, phytosanitary areas. And typically we'll find governments saying that the work in the committees is very useful to reducing barriers that flow from different trading partners, potentially including China and other people. Just from the negotiations that take place in the committee in terms of understanding what's going on, et cetera.

China would say that the cases has been brought against it, where it has lost it has complied. And that would be true. Statistically you could run that and say that that's absolutely true.

What they tend to do is they tend not to change some of the underlying approaches. They eliminate the specific lost that they had, but they won't necessarily take it farther.

So there are benefits in the dispute settlement process that is there. Even if there are problems for us, even if we want there to be substantial reforming.

So, our withdrawal from the WTO would not necessarily lead to significantly other countries withdrawing. So you would be taking yourself out of a system.

And as I said, the U.S. and Europe and Japan and others are looking at things from a WTO reform point. But the system over there has basically become almost inoperable.

The fishery subsidies have been going on for 20 years. The concept that you can't accomplish a discrete negotiation two decades on something that's important as that and the fate of fishing is as such high risk it's kind of symptomatic of the problems. And you certainly have countries other than China who do not want there to be any new agreements.

So, I don't view it as the only game in town. I think that the Biden Administration, in terms of things they're trying to do to increase domestic competitiveness in terms of infrastructure investing and reassuring and sort of things, those are all positive.

I think efforts in the bilateral negotiations with China in terms of trying to get some enforcement on phase one and address other issues, those you have to have both a faucet and arrangement. But my task was to talk about the WTO. And there is some value in the WTO. It's

nowhere near the value it could have, but it is a value that's there.

COMMISSIONER FRIEDBERG: Okay. One last quick question, although it's a, I guess, it's a big one to tackle at this late in the afternoon.

But, could one of the other venues, if WTO continues to exist for the reasons you suggest, might it be possible to create alongside it an organization that would consist of countries that were primarily liberal democracies that adhered to the principles of free trade and so on, would it be possible to create something like that and would there be benefits to doing so?

MR. STEWART: Well, I think that one of your earlier panels talked about CPTPP. And obviously you've a lot of the countries who have applied to join that.

The former trade commissioner for the European Commission has urged that Europe apply to join the CPTPP and that they work to try to get the U.S. to go and join. So if you had Europe and the U.S. join CPTPP, there are higher standards on a range of issues. It's a more up to date agreement than what otherwise would be there.

And if you blocked China from joining until such time as it was much more compatible with the global system, than yes, you would have competing systems that were there. And you could be a member of both and have added benefits in terms of the countries you're dealing with there.

COMMISSIONER FRIEDBERG: Thank you very much.

COMMISSIONER CLEVELAND: Thank you. Commissioner Fiedler.

COMMISSIONER FIEDLER: Yes. I just have a comment. And it's only half in jest.

COMMISSIONER CLEVELAND: It's late in the day, Jeff.

COMMISSIONER FIEDLER: For a brief moment, as I was listening to this arcane discussion of the intricacies of WTO law, if you will, I was thinking about whether or not we could bring a non-violation case on the basis that the Clinton Administration and its fellow travelers legitimately believed that capitalism brings democracy and trade brings reform. Which have never, have not happened in the case of China.

No, but that I could, I mean, I see the political value in the WTO ruling that that was not a legitimate expectation for historical reasons.

I'm still miffed by the reality, and I'm not naive, that China lies and agrees to all kinds of stuff and then doesn't live up to any of its agreements.

I've spent my life negotiating with employers. I'm met liars. But we've always reached agreements that people have had to keep up, I mean, live up to.
They don't seem to worry about living up to their agreements. So I don't understand how this can continue to function in a way that is in the United States interest. I just don't see it.

There either has to be a replacement, okay, or there has to be a change that allows dispute settlement to be real, quick and definitive. I mean, am I being naive here?

MR. STEWART: I think that part of the challenge that the U.S. and Europe face in having let this country into the system and there being no formal way to get the country out of the system.

COMMISSIONER FIEDLER: Yes.

MR. STEWART: What do you do. There have been any number of papers written by former negotiators talking about either throwing China out or starting a new organization that would exclude China.

Warren Buffett, I think ten years ago, 14 years ago, proposed having a system of selling

licenses to import, to people who wanted to import, that would be limited to the value of U.S. exports as a way to get trade balance.

And you had a paper last year from an economist that said that what you could do would be to do some type of a cap and trade system where you would do that vis-a-vis China over a period of years to get yourself back to reciprocity. There is no reciprocity requirement per say, again, in the WTO.

So, that nullification case, not in violation nullification case, simply based on the fact that there is not reciprocity in the results somebody has greater, you would find that most countries would not support because many countries have surpluses with certain parts of the world trading system and not, perhaps not all.

So, your question is correct, what do we do, is this game over? And that's why you need to have a series of bilateral, unilateral and efforts in terms of separation. A complete and partial separation because as long as there is a WTO and as long as the major countries of the world choose to belong in it, we are not going to be able to deal and get China to a point where reciprocity is the name of the game. That alone is not going to do it.

So you are correct that it is a problem. I would simply say this, back when the Clinton Administration was involved, you had a great bipartisan interest to see who could get through the door first with a China deal.

So it was, while the Democrats may have their fingerprints in terms of the papers that got negotiated, there was a lot of interest, on both sides --

COMMISSIONER FIEDLER: Well, that's why I said Republican fellow travelers. Yes.

MR. STEWART: Yes. And so, China was moving in the right direction for probably the first ten years after joining. And since the current Chinese President has been in power they have reversed course and embarked on much greater adherence to national champions to state directed to economies, all that sort of thing.

So, we're in a difficult situation. But the outcome is hard to say. But at the moment, there is going to be a WTO. This administration is trying to support the WTO.

Europe is a steadfast supporter of the WTO. Virtually every other country that's a member steadfastly is a supporter. So talking about getting rid of the WTO, in my view, is not a realistic scenario. At least in the short or near term.

COMMISSIONER FIEDLER: Thank you.

COMMISSIONER WESSEL: Jeff, I'd also just point out quickly that we have the phase one trade deal that the Chinese have not complied with. And there has still been no full enforcement. So it is not simply WTO, we have our own problems.

COMMISSIONER CLEVELAND: I will yield my five minutes to Dr. Scissors's.

COMMISSIONER SCISSORS: I promise, there is only one point here and it fits with what Mike just said. And this is back to you, Professor Staiger. And I don't mean to ignore our other very helpful witness but I got so much to say to you.

One of the things you say is that the Chinese would cooperate in principle with a lot of obstacles because they don't want to see the WTO fall apart because it's benefitted them. Certainly it's benefitted them.

But that raises the question of what the reversion point is. It's not the reversion point they

face when they negotiated access in 2002.

And I could just go on and on about how it's different, but let me highlight one area which has been brought up by other Commissioners. They are active predators now.

They are much better at intimidating our firms from the disclosures we need to build up evidence for cases in acquisitions. They are better at intimidating other countries.

They are, let me try to make this more concrete. I see China, a major aspect of China's international economic engagement is relocating economic activity to China to allow exports to earn the foreign exchange to offset capital flight caused by domestic repression. Right.

That is a very unusual thing to think about in economic activity, but that's what you have to do if you have an economist party. Because when people get rich and they are in China, they don't want their money in China because they don't trust the party.

That money leaves. You have to keep bringing in money to offset its departure, you need to locate economic activity in China through, if necessary, predatory behavior.

So I'm giving it, you know, that's just to give a sense of this. Tell me what you think the reversion point is. Right/?

So when we say China wants to stay in the WTO because the alternative is X, I don't think they see the alternative of not the WTO as much different than what they're doing now. Because we've never caused them to face any consequences.

So that's, you know, sorry, long question. They're going to stay in the WTO because if they don't, what will happen. And being specific about that is very important to their willingness to comply with any sort of WTO remediation.

MR. STAIGER: Yes. Okay, thank you. Yes, let me back up one thing and just comment on a point Terence made. And or maybe two points.

First of all, I think Terence said, and I would agree, in response to one of the earlier questions that the data suggests that China is actually fairly compliant with WTO rulings.

It's just that then those rulings ultimately don't change the underlying things that are going on in China. But in the letter of the law, I think China is relatively compliant. So it's not a question of China blatantly flaunting the violations and simply not doing anything.

And secondly, on reciprocity, it is true that reciprocity in the WTO and in GATT before it, has two, two directions really. On the one hand, when countries are negotiating liberalization there is no requirement that they establish reciprocity in their tariff cutting, market access. I mean, it's whatever countries want to achieve. If they are happy with it, that's good by the WTO. But there is definitely a strong norm that when countries are negotiating the negotiators seek to achieve reciprocity. Which is a balance between the increase in the imports that I'm going to let into my country and the increase in exports that my exporters will get in other countries.

And it's that expectation of the balance defined by reciprocity that I think is the possibility of the basis of a non-violation in the sense that if legitimate expectations that the market access concessions that the U.S. thought China was given, combined with this expectation that those were going to be meaningful because China was going to be moving toward a market economy, if those are frustrated, while those were part of the equation that was going into the U.S. expectation that this was going to be a reciprocal deal. And that was the expectation for the U.S.

And it actually was quite explicitly the expectation for China and its negotiations. If you go back and look at the negotiating record, China is constantly saying that it wants to be, wants to

achieve reciprocity in its accession negotiations with other countries.

On the other hand, reciprocity actually is defined in renegotiations. If you're going to be going up and negotiating higher tariffs, then under the Article XXVIII negotiations, if you achieve a deal with your trading partners than that's fine, but supposed that you want to raise a tariff and you're trading partners who originally negotiated it or were the main suppliers of those products are not willing to take the deal that you're offering, well then you can still go ahead and raise your tariff. It's what legal scholars would call the liability rule.

The market access commitments that countries make of the WTO, you can ultimately walk away from them, legally, at a price. And what is that price? That price is the reciprocal withdrawal of concessions by your trading partner. So that's the price to find by reciprocity.

And when that happens, then the reciprocity does need to be defined by the WTO or the panels, or the appellate body or the arbiters, because what I think is the right price to pay may be different than what you think. So you need a third party.

And that's where the WTO dispute procedures do define, try to define the equivalent withdrawal of market access as essentially matching the quantity impacts of what you're going to be doing with what you're trading partners are able to do.

So that's the content of reciprocity, in my view, both going down, which is the norm, and going up, which is more of a rule.

So now that comes to your question, what does China think is the alternative. Well, I think if we keep going on with the problems we have, we haven't yet seen the cost that China will pay. Because so far as have continued on in this muddle through.

But I do think that we're getting to the point where the status quo is not sustainable. And either we're going to solve this as a world and the WTO, or it's going to cause major disruptions to the WTO membership. And perhaps the decline of the WTO and the failure of the WTO.

And in my view that, that does have a huge cost. Because now I come back to what I expanded on in my written statement that as an economist I think the design of the WTO is extremely prescient and well designed to handle the kind of spillover effects from policy that countries want to try to handle in a trade agreement.

And the two key pillars of the WTO that do that are reciprocity and most favored nation. And the reason the reciprocity does is it keeps a balance --

COMMISSIONER SCISSORS: I'm sorry, I need to interrupt you. You're talking about the trade system and the loss to the trade system of the WTO. That's not relevant. What's relevant is the loss to China, not the world, not the U.S., not the aggregate economic benefits, right? So just, I've taken up so much time. If you want to make a very short response to this.

MR. STAIGER: Sure.

COMMISSIONER SCISSORS: I'm asking, what's the -- I don't want you to get into China's head, what's the cost to China?

China is going to have to make a huge adjustment to meet your requirements to preserve the WTO, what do they think is going to happen to them if they just say, I'm not making that adjustment? They could lie of course, but one option is they just don't do it.

COMMISSIONER CLEVELAND: If you just take one minute, Dr. Staiger.

MR. STAIGER: Yes. And I think the huge adjustment that they'd be asking to make is to bring their balance of rights and obligations in line with what everyone else has. So that's a huge

maybe but it's not unusual to ask.

What do they lose? Well, that's what I was trying to articulate is, I think what they lose would be the rules-based trading system. And in that case, while they're a major trader, as we know, there are major gains from trade.

And if they were to lose this system, you might argue now they are exploiting the system and getting more gains than they should, but without the system they are going to get far fewer gains than they would be even if they were in the system reciprocally.

So I think they understand it. They have a huge stake in preserving some of a rules-based system.

COMMISSIONER CLEVELAND: Perhaps that the point on which we may disagree. But Dr. Scissors's will ask additional questions for the record no doubt. Commissioner Borochoff?

COMMISSIONER BOROCHOFF: I'm going to pass. Thank you.

COMMISSIONER CLEVELAND: Okay. Commissioner Bartholomew has checked out. Okay. I think, Mr. Stewart, do you have any additional thoughts before we close out on, again, Dr. Scissors's? I think you're muted.

You're good? Okay. I want to thank the witnesses. I very much appreciate the engagement. With that, we are adjourned until --

COMMISSIONER WESSEL: May 12th.

COMMISSIONER CLEVELAND: -- May 12th. So thank you.

(Whereupon, the above-entitled matter went off the record at 4:56 p.m.)

QUESTIONS FOR THE RECORD

Response from Clyde Prestowitz, Founder and President, Economic Strategy Institute

In the 1980s the United States confronted a number of policies implemented by Japan that limited access to that market. In partial response, the U.S. engaged in Market-Oriented Sector Specific (MOSS) talks seeking to enhance U.S. access for particular products in that market. Do you believe that a similar approach could be effectively used in terms of access to China's markets? If such an approach is desirable, would it be an alternative or supplement to the approach used in the Phase One trade agreement?

The answer to the question is that the Market Oriented Sector Specific (MOSS) trade negotiating technique with Japan was a complete waste of time. It would also be a complete waste of time with to China.

It assumed that the U.S. negotiators could identify all the barriers in specific Japanese markets and negotiate away their existence. This was a naïve and simplistic assumption. In many cases the barriers were implicit in the way Japanese society works. In other cases, the barriers were part of broad reaching Japanese industrial policies. Removing them would have required Tokyo to do an about-face in a wide range of industries. The only way the U.S. could have forced some of those changes would have been to threaten to nullify the U.S.-Japan mutual defense treaty which Washington was never going to consider doing.

In the case of China, a country that explicitly rejects Western values and practices of freedom and that openly pursues policies such as Made in China 2025, the MOSS approach would be even more silly than it was in Japan.

At some point, U.S. leaders will have to recognize that Washington cannot for American style markets and free trade on a global basis. They will have to wake up and begin dealing with the world as it is rather than as they would like it to be.

1. *Which countries in the Indo-Pacific do you think should participate in the Indo-Pacific Economic Framework (IPEF) being advanced by the Biden Administration. Are there any countries that are not suitable for inclusion in the IPEF in terms of strengthening U.S. economic and national security interests vis-à-vis China?*

This question underscores the tensions arising between different agencies in the U.S. government and between different interests engaged in trade and foreign policy with respect to what countries should be part of the IPEF. Historically the State Department and NSC have supported the view that it is in the national security interest of the United States to gather the largest number of countries into the membership of an initiative led by the United States if only for the optics of affiliation and association with the United States. This perspective prioritizes what list of countries are willing to sign up to which "team" roster. Yet, given the countries involved in IPEF, with the exception of India and Fiji, are also in RCEP and in APEC, the politics of affiliation seem to indicate very little in practice. And indeed, many IPEF countries have explicitly said that they are unwilling for IPEF to become an "anti-China" exercise. Thus, especially in the IPEF context, the 'the more the better' approach seems to be of limited value. (Notably, some of the same interests and observers who try to raise concerns about the RCEP as a worrisome sign of China's role in the region view as relevant such optics/affiliation with a U.S. project. Of course RCEP is an ASEAN project, not a Chinese one. Moreover it is a largely symbolic exercise with its rules of origin being the main concrete trade feature with none of the standard features of past trade pacts, including RECP not covering agriculture, not zeroing out tariffs etc.)

In contrast a deeper analysis of national security interests takes into consideration the actual strength of our domestic economy and US economics resilience to withstand shocks both internal and external as well as the depth of partnerships with specific countries and actual commonalities with respect to values and goals. First, given part of the IPEF project is to contest choices between governing philosophies – democracy versus autocracy – then collecting a list of governments such as Vietnam and Brunei or Thailand under military dictatorship et al seems contrary to U.S. goals. Second, given part of the plan is greater economic integration, it is contrary to U.S. national security and economic security goals to increase reliance on countries that may not share common values and/or geopolitical goals. And indeed, it is undermining of the Biden administration's smart 'worker-centered' trade policy to conduct trade negotiations or engage in infrastructure funding and projects that are not premised on the fundamental principles of that policy agenda, such as strong and enforceable labor rights. Yet, both India and Malaysia have been leaders at the WTO against the very notion that labor standards should be connected to trade terms.

From this deeper perspective, having the current roster of 13 countries in IPEF seems less than strategic. Perhaps as it becomes clear what countries will join which IPEF pillars, what seems like many obstacles to success will be resolved. But today, the very purpose of the IPEF project, beyond the extremely superficial "team roster" exercise, seems undermined by the lack of criteria for membership. An approach that prioritizes economic strength of the United States as part of our national security interest would focus on ensuring inclusion in the trade and supply chain and climate infrastructure pillars are premised, and indeed conditioned on, agreement that countries would make the obligations of international labor standards, such as those of the ILO,

and environmental standards in the Multilateral Environmental Agreements they have signed and the UN Human Rights treaties. Agreement in advance that these international standards would form a floor on which trade between the parties will be premised would be an effective means to select which of the 13 countries are suitable partners for the trade, supply chain and climate infrastructure pillars.. This approach supports both the values that the U.S. is seeking to promote in contrast to China, as well as an economic model that is worker centric and focused on producing the strong middle class here and in partners countries that is vital to a living democracy as well as fostering U.S. domestic manufacturing capacity and diversified import sources to increase resilience and reduce long-term, climate destroying shipping from far-flung single-source hyper globalized production regimes.

2. *The key trade approach being advanced as part of a potential Indo-Pacific Economic Framework is a digital trade agreement. What opportunities and challenges are poised by such an agreement for U.S. producers and workers and what specific provisions should be included in such an agreement to maximize opportunities and minimize the challenges?*

May I please request that Rethink Trade's formal comments on the IPEF agenda, which mainly focus on digital trade, be incorporated as an answer to this question? https://rethinktrade.org/wp-content/uploads/2022/04/Rethink-Trade-IPEF-USTR-Submission.pdf

Response from Mark Cohen, Senior Fellow and Director, Berkeley College of Law and Technology Asia Intellectual

Our courts have struggled with Chinese firms, Chinese courts, and Chinese law all being entirely subordinate to the Communist Party. Can Congress do anything to improve the understanding of US judges? If so, what are the most important steps to take?

Answer:

We have seen several recent articles and reports that address the problem of how US judges can better apprehend how China's legal system functions. I think Mark Jia's article in the U of Penn Law Review (citation below), addresses this well. The Ascorbic Acid case at the US Supreme Court also considered the impact of China's assertions regarding the operation of its legal system on US antitrust law, and Angela Zhang in her book on Chinese Antitrust Exceptionalism has also looked at the role of SG in US antitrust cases involving China.

There are several ways of approaching this topic:

I think that Congress can ask the SG regarding how it handles issues of foreign law involving autocratic societies, and if it has the resources, etc. to present USG positions before US courts, and to report back to Congress on its involvement on legal issues involving autocratic societies. I think simply asking the SG will stimulate the discussion.

Federal and state judicial centers can be asked to provide more resources, training and assistance to judges on this topic, including training for newly appointed judges.

US laws should be reviewed to determine if current approaches towards such issues as choice of law, enforcement of foreign judgments, forum nonconveniens, antisuit injunctions, etc. are in accordance with US understanding of the nature of a foreign legal system. For example 28 USC 1782 might be revised to include consideration of whether any discovery conducted by a US court for a foreign proceeding will have adequate confidentiality measures in place/ensure adequate independence in the adjudication of US interests. The Uniform Foreign Money Judgments Act might also be revised to clarify when foreign money judgments should not be enforced, including whether "the judgment was rendered under a judicial system that does not provide impartial tribunals or procedures compatible with the requirements of due process of law." Congress has generally let states consider these laws, but there is also a federal interest in not having Americans subject to arbitrary foreign legal proceedings. Frankly, I also think there may be ethics problems in Americans hiring lawyers from China who are admitted in the US and China: in China their ethical responsibilities are to the party, while in the US, they are to the client. Bar Associations may wish to clarify those responsibilities, and judges may want to ensure that clients are well protected. Perhaps GAO, the ITC or another oversight agency can look into this issue.

Are American lawyers being treated reciprocally in China? The answer is generally, "no." American law firms in China are highly limited in the types of legal services that they can provide, and they are taxed at a higher rate than Chinese law firms. They cannot be admitted to their bar, and their Chinese lawyers have to suspend their licenses when they work for them. They also compete with American lawyers working in Chinese law firms, who do not suffer from the same disadvantages. USTR should make access to US counsel in challenging

overseas markets a higher priority in its trade agenda, as it has a multiplying effect in securing the legitimate expectations of American businesses when they hire counsel, and it also creates a reservoir of expertise in the foreign legal system in the United States.

E) Knowledge of foreign legal systems in the United States Government is low. For example, USTR, in the past, has often made mistakes by extracting non-binding "concessions" from the Chinese government. See, e.g., Jamie Horsley, Revitalizing Law and Governance Collaboration with China (https://www.brookings.edu/wp-content/uploads/2020/11/Jamie-P-Horsley.pdf). Efforts should be made to improve interagency training and collaboration of shared foreign law challenges.

Jia, Mark, Illiberal Law in American Courts (July 24, 2019). University of Pennsylvania Law Review, vol. 168, Available at
SSRN: https://ssrn.com/abstract=3426223 or http://dx.doi.org/10.2139/ssrn.3426223

Responses to Questions for the Record Following the April 14, 2022 Hearing
"Responding to China's Trade Practices: Promoting U.S. Workers, Producers and Innovators
Panel 2: Innovation, Technology, and Intellectual Property Rights Concerns"

Emily Kilcrease[1]
Senior Fellow and Director of the Energy, Economics, and Security Program
Center for a New American Security

Thank you for these questions, and again let me express my appreciation for the opportunity to provide testimony to the Commission on critical issues related to the U.S.-China economic competition. My responses are below. Please do not hesitate to reach out if further information would be helpful.

In your testimony you recommend that a new multilateral investment and export controls regime be implemented. As one of the objectives, you identify the use of such a regime to protect human rights and democratic institutions. Can you provide specific information as to how you would design such an approach and what the standards would be?

The protection of human rights and democratic institutions is an important objective for a new multilateral investment and export controls regime. Current regimes do not include a mandate related to this objective, though individual countries have begun to implement unilateral controls, in recognition of the potential for non-democratic states to abuse technology for illiberal purposes, as well as imposing financial sanctions on specific entities engaged in human rights abuses or undermining of democratic institutions. Incorporating a human rights/democratic institutions objective into a new regime would strengthen coordination amongst democratic states, allow members to set new norms on the appropriate use of these tools, and reinforce the impact of existing unilateral measures. A new regime could include multiple different pathways to pursue this new objective.

On export controls, members could consider how to apply a human rights/democratic institutions policy to each of the existing three components of an export controls system: list-based controls, end user controls, and end use controls. Members could use the regime process to develop lists of technologies that are likely to be used to abuse human rights or undermine democratic institutions. The lists would likely include many technologies that would be considered purely commercial in nature and that cannot be distinguished on the basis of technical specifications alone. For example, facial recognition software can provide useful and legitimate identity verification capabilities for online activities, yet the same technology could be used to conduct surveillance. To address this complexity, a list-based approach must also incorporate elements of an end-use approach, so that the regime accounts for both the type of technology and its likely

[1] This testimony reflects the personal views of the author alone. As a research and policy institution committed to the highest standards of organizational, intellectual, and personal integrity, the Center for a New American Security (CNAS) maintains strict intellectual independence and sole editorial direction and control over its ideas, projects, publications, events, and other research activities. CNAS does not take institutional positions on policy issues and the content of CNAS publications reflects the views of their authors alone. In keeping with its mission and values, CNAS does not engage in lobbying activity and complies fully with all applicable federal, state, and local laws. CNAS will not engage in any representational activities or advocacy on behalf of any entities or interests and, to the extent that the Center accepts funding from non-U.S. sources, its activities will be limited to bona fide scholastic, academic, and research-related activities, consistent with applicable federal law. The Center publicly acknowledges on its website annually all donors who contribute.

end use in a given jurisdiction. That is, these types of controls must be designed to automatically trigger more restrictive controls for nations that are known to abuse human rights or undermine democratic institutions, in a marked shift from the current country-agnostic regime process. It also means that developing a shared licensing policy amongst members takes on added importance, as the judgments on end use will involve more subjectivity than the current approach to lists that rely solely on objective descriptions of technology. Agreement on a more restrictive licensing policy, with extensive use of a "presumption of denial" policy is likely necessary.

End user export controls will also be an important component of using a new regime for human rights/democratic institutions purposes. End use controls would facilitate additional restrictions – beyond those included in list-based controls – for specific entities that present heightened risk of abusing technologies. In the United States, the Entity List is the primary vehicle with which to restrict technology exports for human rights/democratic institutions reasons. In other jurisdictions, sanctions authorities may be used to restrict the flow of technology to specific end users. The value of a new regime process would be to seek greater alignment for which entities are subject to such controls and to ensure that the scope of restrictions is comparable. A regime could also work to align end user technology controls with more traditional financial sanctions tools, such that flows of both technology and capital from member states is restricted to known bad actors.

For any of these types of controls, members will need to consider a range of criteria to determine whether imposing a control is an effective approach and what unintended consequences may arise from the imposition of a control. For example, the recent reporting that the U.S. administration may place Hikvision (a Chinese company that designs surveillance systems) on the SDN list has raised questions about whether the United States should pursue a "company killer" approach to companies known to be complicit in China's human rights abuses, or whether such an approach is unnecessarily escalatory. Regime members will need to decide whether their objective is to ruin these companies financially through measures such as SDN listings, or whether to pursue a more limited objective of ensuring that such companies do not enjoy the support of western technology or capital. In another example, regime members will need to determine whether to impose human rights/democratic institutions controls for technology exports into other markets – besides China – if doing so would create a lucrative market opportunity for Chinese firms to backfill. Finally, the broader question of whether similar technology is widely available on the commercial market presents unique concerns in the context of human rights/democratic institutions controls. It has typically been difficult to justify traditional export controls on technology that has wide foreign availability, since the controls would largely be ineffective. However, human rights related controls have a unique moral dimension that may warrant the imposition of controls as a part of a diplomatic strategy to raise the reputational costs for human rights abusers.

You referred in your testimony to the possibility that, in addition to a possible future multilateral export control regime, the U.S. small handfuls of other countries may be able to form informal, mini-lateral groupings to restrict export of critical "chokepoint technologies" to China. In addition to the hardware and software necessary to manufacture high-end semiconductors, can you give some examples of where this might be possible?

At the present time, I have not conducted the necessary analysis to propose controls on specific chokepoint technologies. The recommendation to pursue ad hoc groupings of countries willing to impose controls on chokepoint technologies is primarily a recognition of the length of time it will take to negotiate a formal new regime and to urge governments to continue examining how best to collaborate under existing authorities, including authorities that permit them to coordinate the use of their own unilateral controls outside of existing regime processes.

You mention that federally funded research and development centers could support creating emerging and foundational technologies lists. Which of them have this expertise and do they already have an applicable mandate?

Federally funded research and development centers (FFRDCs) could play a role in addressing the current difficulties in identifying emerging and foundational technologies for controls. The mission of FFRDCs is to provide long-term technical support to federal agencies, supplementing government expertise and capacity and providing an independent perspective on technical issues within their competence. In particular, the ability to provide an independent assessment is an important complement to existing avenues for the export controls agencies to receive information from the private sector, which may inherently include a bias towards particular commercial interests. The Export Control Reform Act of 2018 (ECRA) provides the Department of Commerce with guidance to seek multiple sources of information when developing new controls, recognizing that information from the private sector and academic can play a valuable role in assessing the effectiveness and impact of any new controls. While it may not be appropriate to recommend one particular FFRDC over another in this context, important criteria for establishing an FFRDC relationship to support the technical work on emerging and foundational technologies lists would include the ability to conduct detailed technical assessment of technologies under consideration for control, as well as analysis of foreign availability of comparable technology and the short- and long-term impact on U.S. producers if new controls restrict their foreign sales.

For your proposal of outbound investment controls, who would determine what development of technology is "against U.S. interests" and how should they make such a determination? By what criteria or metrics?

A determination of what development of technology is "against U.S. interests" may depend on the specific design of an outbound investment regime. Under an approach that is linked to existing export control classifications, as I recommend in my testimony, an outbound investment regime could avoid the need to make such determinations in certain cases. For example, if a technology is already prohibited for export to China (e.g., items on the U.S. Munitions List, controlled under the series 600 controls of the Commerce Control List, or space related items), then a prohibition could be applied universally to any U.S. investment into a Chinese firm that produces such technology. For investments into companies making technologies controlled for national security purposes on the Commerce Control List, but not subject to an outright embargo, one could consider imposing a presumption of denial policy. Designing a regime in this manner allows the government to leverage the existing export control process rather than creating a wholesale new approach to making national interest determinations.

Even under such an approach, however, there may be instances in which there is a strong case to impose controls to capture investments that support China's indigenous development of technology even if such technology is not controlled for national security purposes. For example, many emerging technology areas are not yet subject to high levels of control, but the United States may seek to impose outbound investment controls to prevent U.S. capital from supporting China's indigenous growth in these areas. In these scenarios, a determination of national interest should be tied to a broad and flexible concept of national security, accounting for the impact of the investment on U.S. technological leadership, the potential relevance of the technology to future national security, military, or intelligence capabilities, and the potential role of such technology in physical and critical infrastructure. This roughly aligns with how national security determinations are made in the U.S. inbound investment screening process, implemented through the Committee on Foreign Investment in the United States (CFIUS), which uses a flexible concept of national security to allow the Committee to more adeptly respond to emerging national security issues.

Ideally, the Congress would legislate to establish a targeted outbound investment controls regime, establishing the parameters for factors to consider when making national interest determinations as outlined above. The lead agencies for implementing an outbound investment screening regime should then promulgate further regulations and guidance on how such a determination would be made. An appropriate lead agency for this effort would be either the Department of the Treasury, given its broader expertise on sanctions and investment security, or the Department of Commerce, given its expertise on technology controls and other economic security tools. Other agencies with relevant expertise and equities that should be engaged in this process include the Departments of Energy, Justice, Homeland Security, State, and Defense, along with the White House Office of Science and Technology Policy and the Office of the U.S. Trade Representative. Additionally, the intelligence community should provide intelligence assessments to inform the national interest determinations.

Response to Questions for the Record

Regarding Testimony Before the U.S.-China Economic and Security Review Commission

Hearing on Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators

June 3, 2022

Timothy Meyer
Professor of Law and Director, International Legal Studies
Vanderbilt University Law School

1. *What kind of changes in law would be required to give the President the power to compel U.S. companies to divest from China (or other countries deemed hostile to the United States)?*

If the United States were to pursue a foreign divestment authority, I would suggest that it be done via a new statute. That new statute could be included in, and build upon, the existing legislation contained in the America COMPETES Act that would establish a mechanism for reviewing outbound investment.[1]

Before discussing in more detail what a new foreign divestment authority might look like, it is worth considering whether any existing authorities could support a foreign divestment authority. The most natural existing statutory authority that might plausibly support divestment orders is the International Emergency Economic Powers Act (IEEPA). In relevant part, IEEPA allows the President, upon the declaration of a national emergency, to

> investigate, block during the pendency of an investigation, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest by any person, or with respect to any property, subject to the jurisdiction of the United States.[2]

This language—the power to "nullify, void, prevent, or prohibit any . . . holding, . . ., use, or dealing in . . . any property in which any foreign country or a. national thereof has any interests . . . "—could be read to support the authority to order U.S. companies to divestment

[1] America COMPETES Act, § 104001.
[2] 50 U.S.C. § 1702(a)(1)(B).

themselves of any assets owned jointly with a foreign national or government. Indeed, on August 23, 2019, President Trump purported to order U.S. companies to exit their investments in China, citing IEEPA as relevant statutory authority.[3] And in Executive Order 13974, President Trump prohibited possession of certain Chinese securities, effectively requiring U.S. parties to divest themselves of such securities in order to avoid penalties.[4]

However, IEEPA suffers from several significant drawbacks as a source of divestment authority. First, by its express terms the authority is limited to property in which a foreign country or national thereof has an interest. It would thus arguably not apply to property that is wholly owned by a U.S. company and is merely located in a foreign country.[5] Second, even with respect to property owned in part by a foreign country or national, IEEPA does not expressly authorize divestment. Because other statutes, such as Section 721 of the Defense Production Act (codifying the authority of the Committee on Foreign Investment in the United States (CFIUS)), do explicitly authorize divestment, litigants challenging a divestment order under IEEPA might have some hope of success in arguing that IEEPA does not authorize divestment as a remedy.[6] The more common use of IEEPA is to prohibit transactions. Indeed, President Biden repealed the divestment provisions of E.O. 13974 before they ever came into effect, perhaps indicating the Administration's view as to the scope of IEEPA's authority.[7]

A divestment authority founded on IEEPA also suffers from at least two potential constitutional problems. First, courts have held that CFIUS divestment orders can be challenged under the Due Process Clause of the 5th Amendment.[8] The D.C. Circuit has held that due process requires, at a minimum, advance notice that the government is considering ordering divestment and an opportunity to contest any unclassified information supporting the potential divestment order.[9] Courts might very well extend these protections to apply to orders directing U.S. companies to divest themselves of foreign business operations. Although the President could order a process created under IEEPA to address constitutional concerns, IEEPA itself contemplates no process associated with Presidential orders.

Second, IEEPA may be vulnerable to constitutional challenge. A majority of the current Supreme Court appears to favor doctrines, such as the nondelegation doctrine and the major questions doctrine, that would limit the ability of Congress to issue broad, amorphous grants of authority to the executive branch.[10] Instead, the Court appears poised to hold in a widening range of cases that Congress must make the major policy decisions itself. Historically, the courts have

[3] J.R. Reed, *President Trump ordered US firms to ditch China, but many already have and more are on the way*, CNBC (Sept. 1, 2019), https://www.cnbc.com/2019/09/01/trump-ordered-us-firms-to-ditch-china-but-many-already-have.html.
[4] E.O. 13974 (Jan. 13, 2021).
[5] This assumes that "interest" refers to a property interest.
[6] 50 U.S.C. § 4565(d)(3)
[7] E.O. 14032 (repealing and replacing E.O. 13974 & 13959).
[8] *Ralls Co. v. Comm. on Foreign Investment in the United States*, 758 F.3d 296 (D.C. Cir. 2014).
[9] *Id*. at 318.
[10] *See, e.g.*, *Gundy v. United States*, 139 S. Ct. 2116 (2019).

been reluctant to apply these doctrines to foreign affairs.[11] However, their contemporary application to statutes such as IEEPA, which can be used to regulate the economic activity of U.S. nationals, is unsettled. Several justices have suggested that these doctrines would apply to international trade statutes, for example.[12]

If the Court does apply these doctrines to international economic statutes, IEEPA presents a particularly vulnerable statute. Violations of presidential orders under IEEPA are crimes punishable by fines and up to 20 years in prison.[13] IEEPA's expansive powers are triggered by an emergency declaration, and under the National Emergencies Act the President has unfettered discretion to decide what constitutes an emergency.[14] Together, these two features mean that the President can simply make up crimes that Congress never contemplated under IEEPA by 1) declaring an emergency, and 2) then regulating transactions related to that emergency under IEEPA. As Justice Gorsuch has explained, this kind of executive creation of crimes is precisely what the nondelegation doctrine is designed to prevent.[15]

For these reasons, Congress would be well-advised to create a new statute that 1) explicitly authorizes the President to order U.S. companies and nationals to divest themselves of assets in foreign countries determined to be hostile to the United States, 2) defines the conditions under which the President's authority to order divestment is triggered, as well as the scope of sectors subject to a potential divestment order, and 3) establishes a process by which such divestment orders are considered and evaluated, including the right of any specific subjects of the order to contest unclassified evidence supporting the order.

The America COMPETES Act's provisions establishing a Committee on National Critical Capabilities (CNCC or the Committee) would go part way toward achieving these objectives, but is substantially limited in certain respects. First, the CNCC's authority is not primarily a divestment authority. Rather, the CNCC would be charged with conducting ex ante review of outbound investments in sectors that are determined to be critical. The statutory scheme calls for a decision to review such investments within 60 days of mandatory notification, followed by a Presidential decision 15 days after a review's completion. The Committee may also initiate an investigation on its motion of any covered transactions that are not properly notified to the Committee.

The President may direct the Attorney General to enforce the provisions of the statute in court, including through divestment. In practice, though, this scheme means that divestment will primarily be a remedy in cases in which a transaction does not go through the mandatory ex ante review or in which the participants to a transaction do not adhere to mitigation conditions

[11] *United States v. Curtiss-Wright Exprt Corp*., 299 U.S. 304 (1936).
[12] *Gundy,* 139 S. Ct. at 2139 (Gorsuch, J., dissenting).
[13] 50 U.S.C. § 1705.
[14] 50 U.S.C. § 1601 *et seq*.
[15] *Gundy*, 129 S. Ct. at 2135 (Gorsuch, J., dissenting)("Without the involvement of representatives from across the country or the demands of bicameralism and presentment, legislation would risk becoming nothing more than the will of the current President.").

imposed on the transaction after review (this is similar to how divestment works under CFIUS). In short, the CNCC provisions would allow the United States to block a transaction, and it would allow the United States to compel U.S. investors to divest themselves of foreign investments that do not comply with conditions imposed upon CNCC review, but it would not authorize the President to order divestment of existing investments that are either not covered by the CNCC's provisions or which have complied with conditions imposed after CNCC review.

By contrast, a true divestment authority would authorize the President to order U.S. investors to divest themselves of foreign assets regardless of whether ex ante review of the investment occurs. Granting the President a true divestment authority recognizes the limits of ex ante review. U.S. investments in a hostile country may represent a threat to U.S. national security if, for instance, that foreign country invades or threatens military action against another terrritory, especially a U.S. ally. The Russian invasion of Ukraine, and the decision of many foreign companies to exit the Russian market, has highlighted the power of divestment as a tool of foreign policy in these situations. Yet CNCC provisions would not authorize a divestment order in these circumstances. Indeed, the CNCC provisions would not seem to authorize divestment in response to changed circumstances that may create new risks from existing investments.

The America COMPETES Act's CNCC provisions are limited in another respect: they apply only to transactions that would shift the production, manufacture, design, etc., of "national critical capabilities" to a country or entity of concern. The bill gives an initial definition of such sectors, but delegates to the CNCC the responsibility to engage in rulemaking (pursuant to the Administrative Procedure Act) that could expand the covered sectors and transactions. Although the CNCC could apply these provisions in a way that would be expansive, the thrust of the CNCC's provisions is to prevent the offshoring to countries or entities of concern of a limited and defined set of capabilities.

This authority is sensible, but again is narrower than might be desirable to manage geoeconomic competition with rivals in at least two respects. First, it's application is limited to preventing further offshoring. It does not provide authority to encourage or compel U.S. companies to shift supply chains away from countries or entities of concern if the supply chains are already located there. Second, the national security of the United States could be implicated by U.S. investment in sectors beyond those defined as "national critical capabilities." This is especially true where the digital economy is concerned. The rapid development of new means of digital exchange means that CNCC regulations may struggle to keep pace with developments and threats on the ground. And although a broad construction of CNCC authorities, such as the terms "national security" and "national critical capabilities", could address these concerns, relying on such a broad construction raises the possibility that courts will strike down executive action as exceeding the scope of delegated authority.

For this reason, a more effective divestment authority would be one that explicitly authorizes the President to order U.S. persons to divest from 1) *any* investments or business operations (broadly defined) 2) in designated countries or with entities determined to have a connection to the governments of those designated countries 3) when specified conditions are determined,

through an appropriate process, to exist. Congress could itself designate an initial list of countries and include criteria for the executive branch to expand the list of countries.

The conditions triggering divestment authority could be defined in a number of different ways. One possibility would be to divide the authority into two categories. First, the President could be authorized to order economy-wide divestment within a designated country in the event that country uses military force or commits genocide or other crimes against humanity (or some other set of especially egregious conduct). Such an authority would recognize that economic entanglements with countries that violate core U.S. values does not serve U.S. national security interests.

Second, divestment could be ordered for particular businesses or sectors of the economy when the CNCC and President determine that divestment is an appropriate sanction for a designated country for actions that pose a threat to U.S. national security, as further defined in the legislation. In practice, the United States uses financial sanctions, such as those imposed against Russia and Russian banks, to a similar effect. Explicitly authorizing divestment as a sanction would thus allow the United States to do directly, and potentially more effectively, what it currently does through financial sanctions.

Finally, legislation could establish a process through which affected U.S. investors could contest unclassified evidence relevant to a potential divestment order, present evidence and argument about the conditions attached to a divestment order (e.g., the length of time permitted for divestment), and the potential scale of economic losses associated with divestment. This process would achieve two objectives. First, as compared to existing financial sanctions procedures, it would create a more transparent process through which U.S. companies could contest and influence the government's use of economic tools for foreign policy and national security purposes.

Second, creating such a process would also protect Presidential divestment orders from subsequent review on the grounds that they violate the Due Process Clause of the 5th Amendment. As discussed above, the Due Process Clause has been held in the CFIUS context to require some process before the government orders divestment (although it does not prevent divestment orders).

Congress would have the ability to control other forms of judicial review. For instance, making the CNCC or a similar agency's rulemaking subject to the Administrative Procedure Act (APA) would make review of rulemaking available under that statute. Divestment orders themselves, however, would not be subject to APA review if issued by the President, because the Supreme Court has held that the President is not an "agency" within the meaning of the APA. Congress can thus control the scope of APA review by designating the President or an agency as the decisionmaker. More directly, Congress could prohibit judicial review of divestment orders on non-constitutional grounds, or Congress could permit such review only in limited circumstances.

A divestment authority could, of course, be designed in a number of different ways that would be more or less expansive. Different designs would strike different balances between the Administration's flexibility to respond to emerging geoeconomics threats and the interest U.S. investors have in a stable business environment. Ultimately, though, the more guidance Congress can give the executive branch in terms of the conditions and countries subject to a potential divestment authority, the more notice U.S. businesses will have when making investment decisions and the more security the executive branch will have that its actions will not be overturned upon subsequent judicial review.