

April 14, 2022

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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

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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

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?

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

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

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

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

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 acquirer 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

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

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 borders. 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

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 through 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.