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"

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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.