Prepared Testimony of Michael Wessel before the
Senate Committee on Commerce, Science & Transportation Subcommittee on Security
"The China Challenge: Realignment of U.S. Economic Policies to Build Resiliency and Competitiveness"
July 30, 2020

Chairman Sullivan, Ranking Member Markey, Members of the Subcommittee. I want to thank you for the invitation to appear before you today on "The China Challenge: Realignment of U.S. Economic Policies to Build Resiliency and Competitiveness." This is a critical issue for U.S. economic and national security interests and directly affects every one of our citizens.

My name is Michael Wessel and I am appearing before you today as a Commissioner on the U.S.-China Economic and Security Review Commission (Commission), where I have served since its creation in 2001. But, as a disclaimer, I am speaking for myself, although my comments are informed by my service on the Commission and other work I have been involved in for many years.

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

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

The Commission is a somewhat unique body: We report to and support Congress. Each of the four Congressional leaders appoint 3 members to the Commission for 2-year terms. In 7 of the last 10 years, we have issued unanimous reports. In the 3 years where it was not unanimous, there was only one dissenting vote. In many ways, the evolving challenges and opportunities posed by the relationship with China have united us in our analysis. All of our hearings, testimony, annual reports and research are available at our website www.uscc.gov.

Today's hearing raises the critical issue of how to respond to the China challenge. While China's policies and actions pose the greatest current threat to our competitive posture, other nations are watching America's response to determine whether they should emulate China's actions or whether America will stand tall and defend its interests. The long-term question is whether we will shed an ideological, outdated approach to trade and competition in favor of an approach based on pragmatism and reality that focuses on our economic, health, food and national security interests.

The China Challenge:

There is substantial documentation on the unfair, exclusionary and predatory trade and economic policies that China has used to promote its own interests, at the expense of the U.S. and other countries. China, indeed, has been very public in its plans—ranging from its Long and Medium Plan for Scientific and Technological Development (which included calls for indigenous innovation) to its five-year plans, to the Made in China 2025 Initiative, the Standards 2035 program, and numerous other industrial policy blueprints. Economists, academics and the press have often discounted China's statements, all-too-often to the detriment of our own national and economic security.

The U.S.-China Economic and Security Review Commission has documented China's plans, and their impact since China's entry into the World Trade Organization in 2001. China has identified the industries and sectors it wants to excel in, and often, dominate. China indicated that it would allocate more than $1.5 trillion to support the goals of its 13th Five Year Plan (2016-2020).

The USTR's Section 301 "Investigation into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation" is the most comprehensive government study on those topics done to date. Various estimates over the years have identified hundreds of billions of dollars of lost intellectual property due to China's legal and illegal policies. As Dennis Blair and Keith Alexander stated in an op-ed for the New York Times upon the initiation of the USTR's investigation, "All together, intellectual-property theft costs America up to $600 billion a year, the greatest transfer of wealth in history. China accounts for most of that loss."[1]

China's IP policies have enhanced their economic and military competitiveness and undermined our own. Companies have found their ability to profit from their investments in research and development undermined by the transfer of technology, which is often a requirement based on market access rules and other provisions adopted by the Chinese government. And, coupled with exclusionary as well as preferential policies, many companies have expanded their R&D and production in China, at the cost to our country.

China has identified market-share allocations for key sectors. For example, in robotics, China has indicated that it wants to be 70% self-sufficient by 2025 and has invested money in the sector[2], supported it with preferential policies, identified key foreign companies for acquisition (e.g., Germany's Kuka) and engaged in other legal and illegal activities to acquire key technologies.

In 5G, a critical communications area, China has a broad array of policies in place to advantage its leading players—most notably, Huawei. China has allocated a minimum of two-thirds of its telecommunications market to domestic companies. Over time, it sought, and won, leadership positions on more subcommittees at the standards-setting International Telecommunication Union than any other nation seeking to ensure that international standards promoted and preferred the equipment and designs of Chinese manufacturers. It has engaged in subsidization, dumping and other policies to spread its technologies across the globe—including as part of its efforts via the Belt and Road Initiative to create a Digital Silk Road.

But, let's understand, before 5G is even fully realized or deployed at even a fraction of its eventual geographic reach, experts are already talking about 6G. Both of China's leading companies—Huawei and ZTE—have made public announcements about their work on 6G. We can not afford to be left behind.

As any good soccer player knows, you need to focus not on where the ball is right now, but where it will be as you move down the field and seek to score. China has a long-term strategy and is committed to winning—it's focusing on where the ball needs to be. We need to have a similar mindset, be just as committed and define and implement an industrial policy to win.

Impact on U.S. Jobs:

The debate about the impact of China's policies and practices on the U.S. continues to be divisive. There are some who believe that China's willingness to subsidize and dump products into the U.S. with lower consumer costs should be the primary measure and, by this measure, our people are better off. While fewer and fewer people subscribe to this view, some still cling to it.

I couldn't disagree more and believe that the wealth of opinion has come to the conclusion that China's predatory and protectionist trade and economic policies undermine U.S. interests. The cost of products cannot be the only measure of economic benefit. The public understands that, while the flat screen television in their living room may be cheaper, that the production jobs to support that product are not here in the U.S. They know, all too well, that globalization has increased the downward pressure on wages and our standard of living. It has contributed to rising income inequality.

And, predatory pricing can lead to loss of capacity with the outsourcing of jobs and offshoring of production. Industry after industry has faced this problem. Steel. Aluminum. Solar cells. Rare earths. Many others.

The Economic Policy Institute estimated that "the growing trade deficit with China eliminated 3.7 million U.S. jobs between 2001 and 2018."[3] In their research for "The China Shock" a number of noted economists found that "(a)t the national level, employment has fallen in the US industries more exposed to import competition, as expected, but offsetting employment gains in other industries have yet to materialize."[4] While classic trade theory would suggest that displaced workers would migrate to other sectors, many of which would be expected to be higher value-added, that has not been the case. China has also targeted those sectors for development as well—putting pressure on a much broader cross-section of our economy than classical theory accounts for.

And, as we have seen, the jobs at stake are not only in the manufacturing sector. China's non-market economic policies have threatened and undermined our agricultural interests as well. Over time, China has used exclusionary and arbitrary policies to limit access to many of our agricultural products. In soybeans, for example, they have managed their purchases for political gain and have also largely refused to allow crushed-soy exports into their country as those are value-added jobs.

In pork, a preferred protein source for the Chinese people, they have limited access to their market. As their level of income rose, hitting a tipping point where protein consumption increased significantly and demand for pork exceeded domestic supply, rather than open their market to U.S. exports broadly, a state-supported company purchased one of our preeminent pork producers--Smithfield Foods. A free-market approach would have produced more general benefits for all U.S. producers, rather than a select producer. In the first year after their purchase of Smithfield, 97% of all China's imports were from that company. The percentage has dropped, but the preference is still there. And, the Chinese company that purchased Smithfield also acquired intellectual property in the form of genetic stock and farming techniques—which will advance Chinese domestic production capabilities rather than U.S. jobs and economic interests. Only the swine flu epidemic has mediated those concerns for the moment.

In many other sectors, we see the corrosive impact of CCP policies and practices on U.S. interests that are hollowing out U.S. production and adversely affecting U.S. employment.

Resilience:

More than ever, the American people are uniquely focused on our dependence on China for critical supplies and materials. The COVID-19 crisis has put a spotlight on supply chains for medical supplies, medical devices, and Personal Protective Equipment. The outsourcing and offshoring of production and jobs and the decline of productive capacity in that sector has garnered attention on China as a supplier like never before.

The public learned not only about our loss of production capacity, but China's ability to control supplies and use them as foreign policy leverage. The failure to have adequate inspections and limited quality control all became nightly news stories. Masks sold as meeting the N95 standard were often found to be almost ineffective—possibly less effective than simply using a bandana as a face mask.

And, in the early days, as we all know, the offshoring of manufacturing limited our capacity to surge production of ventilators and other critical equipment.

While the COVID-19 crisis brought all of this to the front pages and to the nightly news, the threats to our economic health and security have been building for years. In 2014, the Commission held a hearing entitled "China's Healthcare Sector, Drug Safety, and the U.S.-China Trade in Medical Products." Last July, former Senator Jim Talent and I co-chaired a hearing at the Commission, "Exploring the Growing U.S. Reliance on China's Biotech and Pharmaceutical Products". Our work, and the witness testimony we heard, along with staff research, identified broad and deep dependence on China for our medical needs and deep vulnerabilities.

We no longer have the fermentation capacity in the U.S. to make penicillin and are completely dependent on foreign sources. Eighty percent of the active pharmaceutical ingredients (APIs) we use come from abroad, with a substantial portion coming from China. Of the 10 active ingredients in Remdisivir, one of the therapeutics reportedly showing promise for treating COVID-19, 8 come from China.[5] For many other products, we are partially, or entirely, dependent on China.

As Christopher Priest, the Acting Deputy Assistant Director of the Defense Health Agency told our Commission, "the national security risks of increased Chinese dominance of the global API market cannot be overstated."[6]

Today, the focus is on medical supplies, but our dependence on China for many products—some of them critical products—is broad and deep.

As you know, China has in many ways cornered the market on rare earth minerals—the input needed for rare earth magnets used across the defense sector and in critical technology products. Years ago, the U.S. mined rare earths in California, but China's predatory pricing policies contributed to that facility going bankrupt. That occurred after CFIUS approved the sale of Magnequench, a rare earth magnet supplier, to a Chinese entity in 1996. The production equipment acquired in that deal was moved to China in the early 2000s.

China has shown its willingness to weaponize these supply chains, as it threatened to do with Japan because of a dispute in the East China Sea. While that was a decade ago, recent writings show the intent is still there: Research by Horizon Advisory shows a Chinese government funded research institute indicated that, "Amid the heated trade conflict between China and the United States, China will not rule out using rare earth exports as leverage to deal with the situation."[7]

Mr. Chairman, your home state, along with several other states, has rare earth deposits that could be mined, separated, melted and transformed into magnets. We should not continue to rely on China for these critical minerals.

After Hurricane Sandy, the East Coast found that rebuilding the electric grid, replacing transformers and providing power to many communities was hampered by inadequate supplies of grain oriented electrical steel. A dumping and subsidy cases to address China and other countries unfair trade proved unsuccessful. This Administration initiated a Section 232 investigation related to these products because our electric transmission system is critical to our economy and national security. It's critical that we ensure that there is the capacity to meet our needs in this sector.

Our nation's reliance on other products from China continues to grow, reducing our potential resilience. Last year, despite rising trade tensions and the imposition of Section 301 tariffs, the U.S. ran a trade deficit in advanced technology products with China of more than $100 billion and an overall goods deficit of $345 billion. As has been seen with 5G, the predatory actions of China's Huawei have undermined the ability of market-oriented firms to develop the technology to ensure safe sources of supplies. Our dependence on China for telecom products has created dangerous vulnerabilities that our nation is only now really grappling with.

Reliance on China extends to many other sectors. While work has been done by this Administration and other entities on single sources of supply from China, or dangerous sourcing dependence, Congress should carefully evaluate supply chain risks to determine what the potential impact is on our national and economic security.

U.S. Business Activity in China and Its Security Implications:

At the beginning of July, the Commission issued a staff paper entitled "Trends in U.S. Multinational Enterprise Activity in China, 2000-2017."[8] Since China's accession to the WTO in 2001, U.S. business operations in China have expanded dramatically. The staff report found that "as U.S. MNE [multinational enterprise] activity in China increasingly focuses on the production of high-end technologies, the risk that U.S. firms are unwittingly enabling China to achieve its industrial policy and military development objectives rises."[9]

Summarizing the finding of the report:

- **China's vast consumer market and the Chinese government's coercive policies have incentivized many U.S. MNEs to move their manufacturing operations to China**. U.S. Department of Commerce Bureau of Economic Activity (BEA) data explored in this report indicates the major destination for goods and services supplied by U.S. MNEs in China is the Chinese market itself. In 2017, U.S. MNE foreign affiliates in China sold 82 percent of the goods and services produced in China directly to Chinese customers. At the same time, trade barriers, including localization requirements and export restrictions on key raw materials, have further induced production within China. Sales to Chinese consumers may also constitute sales of intermediate goods and services which might be used in final goods for export to the United States.
- **U.S. MNEs employ more people in China than in any other country outside of the United States, primarily in the assembly of computers and electronic products.** As of 2017, U.S. MNEs employed 1.7 million people in China, a 574.6 percent increase from the 252,000 people employed in 2000. China ranks as the top destination for all U.S. MNE employment across all manufacturing categories with the exception of food and transportation equipment. Outside of manufacturing, U.S. MNE employment in China is

second highest in accommodations and food services, likely due to growing disposable income levels of China's rising middle class, who purchase more services.

- **China is the fourth-largest destination for U.S. MNE research and development (R&D) expenditure and increasingly competes with advanced economies in serving as a key research hub for U.S. MNEs.** The growth of U.S. MNE R&D expenditure in China is also comparatively accelerated, averaging 13.6 percent year-on-year since 2003 compared with 7.1 percent for all U.S. MNE foreign affiliates in the same period. This expenditure is highest in manufacturing, particularly in the production of computers and electronic products, but has diversified over time. For example, R&D expenditure on the improved manufacture of chemicals, including pharmaceuticals, surged nearly 30-fold from a low base of $13 million in 2000 to $392 million in 2017.
- **U.S. MNE capital expenditure in China has focused on the creation of production sites for technology products.** This development is aided by the Chinese government's extensive policy support to develop China into a hub for electronics production, address gaps in the domestic production of technology goods, and maximize access to the technical expertise of multinational firms. For example, U.S. MNE capital expenditure in China for the production of semiconductors, a strategically important electronic component, accounted for nearly a third of all U.S. MNE global capital expenditure on semiconductor manufacturing assets in 2017.
- **China has grown from the 20th-highest source of U.S. MNE affiliate value added in 2000 ($5.5 billion) to the fifth highest in 2017 ($71.5 billion), driven primarily by the manufacture of computers and electronic products as well as chemicals**. The surge is especially notable in semiconductors and other electronic components, which accounted for $5.6 billion of total manufacturing value added in 2017, up 250 percent from $1.6 billion in 2009. Separately, pharmaceutical manufacturing serves as the largest chemical sector in terms of value added, accounting for $2.6 billion in 2017.

It is important to recognize that the staff report was prepared based on the Department of Commerce's annual Multinational Enterprise survey. In my view, the findings understate the impact of U.S. multinational outsourcing and offshoring to China as well as business relationships with Chinese entities. There are many questions left unanswered by the Commerce data. Has outsourcing displaced U.S. exports to China and, if so, by how much? What are the overall sourcing patterns of U.S. MNEs in China? Are the products they sell in China and elsewhere products that could have been produced in the United States, but were shifted to China as a result of policy incentives and direction? That's just the tip of the iceberg.

For example, while the MNE survey indicates that firms sold 82 percent of their products to Chinese customers, that does not tell the entire story. Many of those sales are of products that may simply be inputs into goods sold to the U.S. As Mary Lovely testified before the Commission, 46 percent of China's overall exports emanate from foreign-invested enterprises with 60 percent of China's exports to the U.S. coming from such enterprises.[10] Foreign firms, all-too-often, use China simply as an export platform. Is it really in our interest to see more U.S. firms move to China?

In aerospace one of the two critical limitations on Chinese state-owned aerospace companies' ability to field competitive commercial aircraft has been substandard avionics and limitations on engine capabilities. A number of years ago, General Electric was allowed to form a joint venture with China's AVIC to share avionics technology. In my view, that was a blow to our long-term competitiveness as it has assisted China in its development of commercial aircraft which, when normal economic conditions return, may enable Chinese-owned firms to win more aircraft sales. In addition, the avionics technology can potentially assist China in the development of its military capabilities.

In auto production, U.S. firms have, through joint ventures, provided enormous technological and production boosts to Chinese firms. This was a requirement for market access imposed by China but the advantages provided to indigenous Chinese firms cannot be discounted. The benefits of this relate not only to direct production and development, but in assisting local parts suppliers to become world-class competitors. Before the outbreak of the pandemic, we saw increased plans to ship Chinese-produced vehicles into the U.S. market.

In terms of market access for U.S. financial services firms, a key component of the recently signed Phase One China trade deal, U.S. firms will be assisting China in accessing capital from world markets—a critical issue as China's rising debt levels demand new sources of funds. In combination with China's access to world capital markets—and U.S. markets in particular—this advances China's interests while potentially jeopardizing the financial security and interests of our people.

For example, MSCI, a financial firm that develops investment indexes, expanded its emerging market index to cover equities issued in China and increased the weighting of those securities in that fund. Included in the index are Chinese firms that have been placed on the U.S. "Entities List" as well as firms that are engaged in Chinese "military-civilian fusion" activities. As the Senators know, there has been concern about the use of the MSCI index in the Thrift Savings Plan's "I fund" which is an investment vehicle for federal employees and military servicemembers. Thus, their retirement funds could be contributing to the development and success of Chinese firms directly challenging our own security interests. Between the MSCI equity and bond indices, the opening to Chinese firms will result in hundreds of billions of foreign funds supporting that country's development.

And, as we all know, larger investments by U.S. firms in China make them susceptible to pressure from the Chinese Communist Party (CCP) to engage on policy matters here in Washington. China has made clear that it will use every tool in its toolbox to advance its interests and can use exclusionary and preferential policies to get its way. China, just last week, indicated that it may sanction Ericsson and Nokia as many countries seek to protect their security interests by limiting Huawei products in their communications networks. Wall Street firms are not shy about seeking to influence policymakers as they seek trading and deal making fees. And, China has begun to roll-out its Corporate Social Credit Score system which may advantage or disadvantage firms based on their actions in support of, our counter to, CCP interests.

In many of the sectors where U.S. companies have invested and operate in China, they have helped promote China's rise. Of course, we all support the betterment of the Chinese people and the fact that hundreds of millions have risen out of poverty is a tremendous success. But, increasingly, activities by U.S. firms in China pose risks to our economic and national security interests, and we must carefully evaluate what policy course must be charted for the future.

Undermining Private Industry in the U.S.:

There is very little work that has been done regarding the activities and operations of Chinese companies operating in our market. While the investment by Chinese companies in our market has hit some speedbumps in the last two and a half years, the presence of these companies in our market is extensive. And, while Rhodium, a leading investment tracking firm, has indicated that the amount of new Chinese foreign direct investment (FDI) in the U.S. has dropped significantly since its high of $45.6 billion in 2016, investments are still occurring. Indeed, at $444 million, investments in biotech by Chinese firms were significant last year. Furthermore, Chinese companies are using U.S. markets to raise capital in significant amounts. The Commission staff prepared an inventory of listings by Chinese firms on our three major exchanges which totaled more than $1.2 trillion in capital raised last year.[11]

Investments by Chinese companies in the U.S. market, the capital they raise, and the operations they maintain, need greater scrutiny. The Commission has tried to assess this issue, with limited results. There are few sources of comprehensive case studies examining the activities of Chinese firms in our market. Do they operate based on market principles? What are their key objectives? What are their employment practices? Are they profitable? These and other issues are of critical interest.

The last time I checked data from the Internal Revenue Services Statistics of Income publication for foreign controlled corporations, data indicated that Chinese-controlled entities operating here in the U.S. filed 7,360 returns. With total receipts of more than $49 billion, their total income tax after credits was only $227 million. That, to me, deserves further examination not only to understand and identify the more than 7,000 entities filing returns, but to determine how they operate. In an earlier period, Congress passed legislation to address transfer pricing schemes where foreign input costs were inflated to reduce the tax payments here in our market. I believe scrutiny on Chinese-controlled entities operating here is also appropriate.

During a hearing at the Commission we questioned the potential negative consequences of Chinese state-owned, state-controlled or state-directed entities operating here after potentially receiving support from the government in the form of loan subsidies, no-cost capital or subsidized inputs. We heard from witnesses that there is no provision in U.S. competition law that would allow action by a U.S. competitor against what I would view as unfair competition.

As an example, take a Chinese state-owned steel pipe firm that is receiving low-cost, or no cost-financing and, potentially, getting subsidized inputs in the form of what is known as "green pipe" (i.e., pipe that has to only undergo minor finishing operations here). The parent company in China could sell that pipe, which is not directly entering U.S. commerce, at a subsidized price. Coupled with not having to go to the capital markets, their cost of capital would also be dramatically lower. The result? They could underprice any of our domestic firms, potentially putting them out of business.

U.S. competition laws require that, to be actionable, a company would have to seek "recoupment." As I understand that, it means that they would have to have a plan to raise prices later to "recoup" lost profits for it to violate our laws. If they never planned to recoup lost profits because they were acting on behalf of the CCP, their domestic competitor would have no recourse.

CRRC, the State-Owned Chinese rail company has been winning subway contracts in major cities in the U.S. by dramatically underbidding their competitors. This is supported by massive state subsidies and a plan to dominate the world's rail systems. CRRC reportedly already has 83% of world's rail market. This is anticompetitive and it is dangerous.[12]

The impact of the CCP's programs is broad and deep. They use an "all of the above" approach to advancing their interests. For example, work by private sector forensic accounting experts[13] uncovered acts of espionage to undermine the market value of firms which were later acquisition targets for Chinese firms. In other words, they undermined a company's value to put it into a "distress" situation, to reduce its attractiveness to other companies and to make it cheaper for them to acquire.

Chinese state directed and controlled entities have engaged in massive cyber incursions in the U.S. The first major indictment on this was brought forward by David Hickton, U.S. Attorney for the Western District of Pennsylvania, in 2014 alleging that five People's Liberation Army hackers had accessed the computer networks of the United Steelworkers union and five major U.S. firms to obtain trade secrets and other information. The next year, President Obama reached an agreement with General Secretary Xi where China agreed that they would not engage in hacking for economic gain. The premise of the agreement was faulty from the start as China treats economic and national security as inextricably intertwined: In short, all hacking was for national security reasons and therefore, not covered by the agreement.

Massive hacking continued with incalculable harm. Indeed, press reports indicate that China, as well as Russia, have been trying to hack into our major medical firms to obtain vaccine information. As former FBI Director James Comey said, "There are two kinds of big companies in the United States. There are those who've been hacked by the Chinese, and those who don't know they've been hacked by the Chinese."[14] The current FBI Director, Christopher Wray, recently said "The greatest long-term threat to our nation's information and intellectual property and our economic vitality is the counterintelligence and economic espionage threats from China…It's a threat to our economic security and, by extension, to our national security."[15]

In the area of medicine, multiple hacks attributed to actors in China, have obtained the longitudinal health data of U.S. citizens. While today's medicines are largely composed of APIs and chemical compounds, tomorrow's medicines are likely to be biosynthetics. With the massive amount of data that Chinese entities collect—legally and illegally—they have the opportunity to develop new drugs and biosynthetics as a faster pace because of "big data." Industries that fall under the umbrella of biotechnology are worth hundreds of billions of dollars annually, and their development will have a profound impact on U.S. economy and national security. There is also the potential to enable personalized medicine, to produce vaccines faster and more effectively and develop other products which have enormous national security implications. Earlier this year, the Theodore Roosevelt aircraft carrier was sidelined because of COVID-19. The implications are endless.

Chinese-directed researchers are aggressively working to obtain America's secrets. Through China's Thousand Talents Program—with bounties of $150,000 or more—China's government seeks to obtain the support of some of our best researchers. Chinese-affiliated venture capital funds—more than 1,000 according to some estimates—seek to invest in, and obtain, technology and trade secrets to support the CCP's industrial policies.

In many other areas the Chinese government and the CCP are aggressively pursuing opportunities to advance their interests, often at the cost to our own national and economic security.

Recommendations:

The policies of the Chinese Communist Party and the actions of their government have already triggered a reaction by the U.S. While the honeymoon period after China's entry into the World Trade Organization lasted too long, and the period of engagement and dialogue yielded too few results, policy makers have identified many actions that will make a difference. Among these are provisions advanced by Congress to tighten up the underlying authority for the Committee on Foreign Investment in the U.S. (CFIUS) and actions to limit the impact of China's major telecommunications firms--ZTE and Huawei—to supply our critical telecommunications systems. Other provisions are under consideration as a vast array of legislative proposals have been introduced in both Houses and the National Defense Authorization Act for FY 2021 includes additional provisions.

But the challenges posed by China's policies and practices are broad and deep and countering their negative impact on our interests will require concerted action. Action is needed not only in the economic policy realm, but on the diplomatic, human rights, health policy, military and other fronts. Let me, however, offer several recommendations for the Subcommittee's consideration. First, I will identify some of the recommendations of the Commission in our last two annual reports. Second, I will offer several of my own recommendations for your consideration. While I would be happy to discuss recommendations and issues relating to the pharmaceutical and medical supply chain issue, a topic the Commission has addressed, I have not included those recommendations here.

Commission Recommendations

Congress enact legislation to preclude Chinese companies from issuing securities on U.S. stock exchanges if:

- The Public Company Accounting Oversight Board is denied timely access to the audit work papers relating to the company's operations in China;
- The company disclosure procedures are not consistent with best practices on U.S. and European exchanges;
- The company utilizes a variable interest entity (VIE) structure;
- The company does not comply with Regulation Fair Disclosure, which requires material information to be released to all investors at the same time.

Congress enact legislation requiring the following information to be disclosed in all issuer initial public offering prospectuses and annual reports as material information to U.S. investors:

- Financial support provided by the Chinese government including: direct subsidies, grants, loans, below-market loans, loan guarantees, tax concessions, government procurement policies, and other forms of government support.
- Conditions under which that support is provided, including but not limited to: export performance, input purchases manufactured locally from specific producers or using local intellectual property, or the assignment of Chinese Communist Party (CCP) or government personnel in corporate positions.
- CCP committees established within any company, including: the establishment of a company Party committee, the standing of that Party committee within the company, which corporate personnel form that committee, and what role those personnel play.
- Current company officers and directors of Chinese companies and U.S. subsidiaries or joint ventures in China who currently hold or have formerly held positions as CCP officials and/ or Chinese government officials (central and local), including the position and location.

Congress direct the U.S. Department of Justice to reestablish a higher education advisory board under the Federal Bureau of Investigation. In concert with the U.S. Department of Commerce's Bureau of Industry and Security, U.S. Department of Homeland Security, and U.S. Department of State, the higher education advisory board would convene semiannual meetings between university representatives and relevant federal agencies to review the adequacy of protections for sensitive technologies and research, identify patterns and early warning signs in academic espionage, assess training needs for university faculty and staff to comply with export controls and prevent unauthorized transfer of information, and share other areas of concern in protecting national security interests related to academic research.

Congress direct the U.S. Government Accountability Office to conduct an assessment on the risks posed by Beijing's efforts to co-opt foreign researchers or students at U.S. universities to unlawfully appropriate research and other knowledge for the benefit of the government, companies, or interests of the People's Republic of China. This report should:

- Include the number of foreign students and researchers from China studying in science, technology, engineering, and mathematics fields; past and current affiliations; primary areas of research; duration of stay in the United States; and subsequent employment;
- Identify whether federally funded university research related to emerging technologies may have been unlawfully appropriated by individuals acting on behalf of Chinese entities; and
- Evaluate the efficacy and ability of the U.S. Department of State's visa screening mechanism to mitigate the risk of inappropriate technology transfer to China, including but not limited to: assessing the ability of that process to identify students, researchers, and research entities, through a visa disclosure requirement, that are receiving funding from the government of China or an intermediary entity acting in support of China's government.

Congress amend Internal Revenue Code Section 41 to extend the research and development tax credit to initial stages of deployment for new products, processes, computer software, techniques, formulae, or inventions that increase the production of final and intermediary goods manufactured primarily in the United States. The tax credit should also extend to precompetitive commercial development of basic and applied research performed in the United States, particularly in industrial sectors where the People's Republic of China threatens the technological leadership of the United States.

Congress direct the U.S. Geological Survey, in coordination with the U.S. Department of Energy, U.S. Department of Commerce, U.S. Department of the Interior, and U.S. International Trade Commission to develop and maintain a risk assessment framework that identifies materials used in manufacturing industries critical to both national security and commercial vitality. Such a framework should provide an early warning mechanism for any threats to the U.S. supply of these critical materials, including an increasing concentration of extraction and processing by another country or entity and acquisition of significant mining and processing facilities; increasing export restrictions by another country; large gaps between domestic prices for these materials in another country versus prices on international markets; sharp increases or volatility in price; and substantial control in supply of minerals used within the same industry or related minerals that serve as substitutes by another country.

Congress direct the National Science Foundation, in coordination with other agencies, to conduct a study on the impact of the activities of Chinese government, state-sponsored organizations, or entities affiliated or supported by the state in international bodies engaged in developing and setting standards for emerging technologies. The study should examine whether standards are being designed to promote Chinese government interests to the exclusion of other participants.

Congress direct the Government Accountability Office to conduct an assessment of U.S.-China collaborative initiatives in technical cooperation. This assessment should describe the nature of collaboration, including funding, participation, and reporting on the outcomes; detail the licensing and regulatory regime under which the initiatives occur; consider whether the intellectual property rights of U.S. researchers and companies are being adequately protected; examine whether Chinese state-owned enterprises or the military are benefitting from U.S. taxpayer-funded research; investigate if any Chinese researchers participating in the collaboration have ties to the Chinese government or military; investigate if any U.S. companies, universities, or labs participating in U.S. government-led collaboration with China have been subject to cyber penetration originating in China; and evaluate the benefits of this collaboration for the United States. Further, this assessment should examine redundancies, if any, among various U.S.-China government-led collaborative programs and make suggestions for improving collaboration.

Additional Proposals:

Automatic trade cases. While this and the past Administration have initiated action on illegal trade policies, a significant enforcement burden still falls on private parties. Existing trade law is expensive to access and time consuming to pursue. Relief, when granted, is only prospective in nature allowing illegal trade practices to inflict considerable harm. A more automatic approach to trade complaints--primarily antidumping and countervailing duty cases—can be data driven and provide more timely and effective relief and create some "automaticity" in the process. There is substantial trade data which, coupled with data from other government sources, could identify increasing imports, looking at per-unit pricing and domestic demand. Where imports are increasing, prices are dropping and domestic demand is constant, trade officials could use that as an early warning of unfair trade and engage in additional review. Business leaders, and the employees, should not have to be significantly injured before market forces are restored.

Review and Reform of Competition Laws: As noted earlier, the non-market actions of certain Chinese state-owned, state-supported or state-directed companies operating in the U.S. market could inflict considerable harm without domestic firms having an effective tool to respond. Coupled with the fact that the authority for CFIUS is limited to acquisitions of existing U.S. firms, rather than establishment of new firms, this problem is expected to grow in intensity, should current trade tensions diminish. Domestic firms should not have to compete here, or internationally, with countries masquerading as commercial firms.

Net economic Benefit Test: Economic and national security interests are inextricably intertwined. While the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) strengthened and expanded the authority for CFIUS additional authority should be considered to include a net economic benefit test such as Canada and Australia have in their laws. The interpretation of the term “national security” can be too narrowly defined so as to allow for certain transactions to proceed although the underlying corrosive impact could be considerable.

Tax Attributes: As noted, there are more than 7,000 Chinese-controlled entities filing tax returns in the U.S. Understanding the nature of those businesses and their tax attributes is an appropriate area for examination by the Internal Revenue Service. There is substantial opportunity to mask the true economic returns and resulting tax liabilities for companies where intra-company transfers occur.

Conclusion:

America was faced with similar challenges in the 1980s in terms of competition with Japan, although the threats from, and impact of, that country’s policies at that time pale in comparison to the China challenge today. I was deeply involved in that debate as a staffer for former Democratic Leader Richard Gephardt. Remember that Japan’s exports of automobiles, — supported by a sanctuary market and industrial policies, were a major threat to our Big Three auto companies. In semiconductors—an industry where the U.S. had been a leader—Japan was threatening our lead. Other sectors were challenged as well.

Bipartisan calls for action helped invigorate our approach to competition. I was one of the lead House staffers helping to put together the 1988 Omnibus Foreign Trade and Competitiveness Act which cobbled together discreet, but vitally important provisions from a variety of committees, to address the problems our country faced. The original bill, H.R. 3, was introduced by my former boss. This Committee was one of the key Senate Committees involved in the legislation.

That legislation enhanced the authority for the Committee on Foreign Investment in the U.S. (CFIUS). It included a number of other provisions including: the creation of what was known as “Super 301” to help prioritize action on key foreign unfair trade barriers; it dealt with export promotion; national security impacts from trade; currency manipulation; expanded authority for the National Institute of Standards and Technology and created an Advanced Technology Program; reformed the Trade Adjustment Assistance program; expanded STEM education and language literacy and included a variety of other policy initiatives.

During this period, President Reagan initiated trade negotiations with Japan to address their predatory and protectionist policies across a range of industries. One of those negotiations was on the so-called MOSS talks, or “market-oriented sector-selective” negotiations. As part of negotiations on semiconductors, a market-share target was used as a basic metric to gauge the openness of Japan’s market and whether “success” was being achieved.

The U.S. government also led an effort through a public-private partnership known as Sematech to revitalize the domestic semiconductor industry and invest in its future. That effort was a key step in sending signals to the market, and supporting the industry, that America wanted to ensure that an industry it led did not vanish.

President Reagan, a conservative, joined with liberal Democrats in fostering many of those policies. The lessons of that time can help guide some of our thinking today, including the focus on bipartisanship and Congress playing a leading role in updating our laws and ensuring the resources needed to compete are available. In addition to the recommendations I have outlined, and the work of this Subcommittee, a broader engagement by Congress and a comprehensive set of provisions to promote production, employment and innovation is needed.

I have tremendous faith in America's ability to restore its economic footing, to meet the China challenge, and to prosper. But, that requires, as your hearing today addresses, a recognition of what the problems are and what are some of the solutions that should be considered.
I look forward to your questions and working with you and your staff in the coming days.

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