July 30, 2020

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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

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[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

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

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

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

RESHORING CRITICAL SUPPLY CHAINS

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

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

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

Understanding what has led to the degradation of our supply chains, then it stands to reason that a comprehensive reshoring strategy must remedy those causes. At the outset, the United States must systematically and routinely identify all products, goods, and technologies that are critical to national security to address the country's dependency on imports from strategic competitors, whether in a time of war, cyber-attack, pandemic or other national emergency. This Administration – my office in particular on behalf of the White House – has begun doing this. We need to continue this on a permanent basis. An additional component here is measuring the flow of technology if it is now as equally as important, and in many instances more important, than the traditional "national security good."

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

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

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

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

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

CONCLUSION

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