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Statement before the House Ways and Means Committee, Subcommittee on Trade

"Countering China's Trade and Investment Agenda: Opportunities for American Leadership"

A Testimony by:

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Chairman Smith, Ranking Member Blumenauer, distinguished Members of the Subcommittee, thank you for this chance to offer my thoughts on opportunities for American leadership on trade and investment. The views represented in this testimony are my own and should not be taken as representing those of my current or former employers.

I have been asked to focus my remarks on China's economic coercion, a topic on which the CSIS Economics Program recently published a report entitled *Deny, Deflect, Deter: Countering China's Economic Coercion.*[1] I would like to frame my remarks by first talking about the broader economic and strategic benefits of trade and trade agreements to the United States, which include but are not limited to responding to China's coercion. I will put a particular emphasis on the Indo-Pacific region, where the stakes are arguably highest and the competition most intense.

Why Trade Matters

Trade is a driver of economic growth and prosperity for the United States.[2] In 2019, the United States exported goods worth approximately $1.646 trillion[3] and services worth $891.2 billion.[4] These exports create employment, supporting almost 10.5 million American jobs in 2019.[5] Access to foreign markets is important for a number of sectors of the U.S. economy but especially for agriculture, which sees nearly a quarter of its products by value exported annually.[6]

On the import side, international trade provides not only U.S. consumers but also downstream producers access to a wider variety of goods and services at more competitive prices, which enhances consumer welfare and helps control inflation. Increased competition with international firms and producers drives domestic innovation and encourages specialization, leading to a more efficient allocation of resources and contributing to a healthier, more productive economy.

While trade brings many economic benefits, it is important to recognize that there are also downsides. Indeed, the negative consequences of trade have been brought into sharp relief in recent years due to several factors, not least of which are China's rise and the supply chain disruptions engendered by the Covid-19 pandemic. The result has been a precipitous rise of protectionist sentiment in the United States dating to the 2016 election cycle and continuing through today. Where the benefits of trade are often diffuse—the average American is unlikely to notice their increased purchasing power due to trade—the costs of trade are often localized. Sectors and industries unable to compete are displaced by foreign competitors, resulting in job losses. Competition with lower-cost foreign labor may contribute to wage stagnation, while lax environmental regulations abroad contribute to harmful emissions and unfairly undercut U.S. firms and producers.

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1 https://www.csis.org/analysis/deny-deflect-deter-countering-chinas-economic-coercion
2 https://www.project-syndicate.org/magazine/biden-trade-agenda-emphasizes-resilience-by-janet-l-yellen-2022-12?barrier=accesspaylog
3 https://www.census.gov/foreign-trade/statistics/highlights/top/top1912yr.html
4 BEA Interactive Data Application
5 Jobs Supported by U.S. Exports (trade.gov)
6 Fast Facts About Agriculture & Food | American Farm Bureau Federation (fb.org)

However, while the costs of trade are real, they must be placed in context. For example, the 156,250 manufacturing jobs lost annually between 2001 and 2016 due to trade account for less than one percent of all annual job losses over that same period.[7] The solution for job dislocation and the other costs associated with trade, then, is not protectionism, which would deny us the benefits of trade. Instead, a greater focus on policies that help dislocated workers and industries adjust is needed, as are more robust environmental and labor standards in free trade agreements.

A useful analogy here is automobiles, which provide tremendous benefits to the economy and society but also have downside costs, including accidents and carbon emissions. The answer to those costs is not to ban driving, but to require seatbelts, driver's education, speed limits, emissions controls, and other steps that reduce the risks. Similarly, we should let trade flourish and provide growth, jobs, and lower costs, and then intervene directly to address the specific costs of trade through effective worker-retraining initiatives and other meaningful adjustment policies.

From a national security perspective, critics of trade also point out that the hollowing out of American manufacturing capabilities and dependency on foreign imports of certain critical goods and materials has weakened the U.S. strategic position vis-à-vis China. However, putting aside whether trade is to blame, this line of reasoning ignores the "positive strategic externalities" that are also generated for the United States through its engagement in global markets. Nowhere are these strategic benefits of trade more apparent than in the semiconductor sector.

The globalization of the semiconductor manufacturing supply chain has not only helped the United States and its allies maintain a significant lead over China in chips technology, but it has also created critical dependencies for China on the United States and its allies. This became evident when the Biden Administration implemented export controls on advanced semiconductors and semiconductor manufacturing equipment on October 7, 2022.[8] In other words, although the U.S. share of advanced semiconductor manufacturing has decreased, trade has facilitated the technology's rapid advancement and created new "chokepoints" that the United States can exploit. This development emerged not from a deliberate plan, but rather from the inherent logic of markets and comparative advantage, with firms in different countries such as the Netherlands, Germany, Taiwan, Japan, South Korea, and the United States each specializing in different areas along the semiconductor manufacturing supply chain.

Why Trade *Agreements* Matter

Trade agreements help amplify the economic benefits of trade and investment that I describe above. Moreover, like trade itself, trade agreements have powerful strategic value, in at least three ways.

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[7] The Payoff to America from Globalization: A Fresh Look with a Focus on Costs to Workers | PIIE
[8] https://public-inspection.federalregister.gov/2022-21658.pdf
https://public-inspection.federalregister.gov/2022-21714.pdf

Creating economic alliances

First, trade agreements strengthen existing alliances and partnerships with key countries and help build new ones. This was one of the central motivations for the Trans-Pacific Partnership (TPP) concluded by the United States and 11 countries in the Indo-Pacific region in 2016. Both Washington and regional partners saw the trade agreement as a way to lock the United States into deeper, more permanent economic ties with a critical region. Partners there value the strong U.S. military and diplomatic presence in the region but want that complemented with robust and durable American economic engagement. As former Secretary of Defense Ash Carter famously said, "Passing TPP is as important to me as another aircraft carrier."[9]

Vietnam is one emerging partner that highlights this first strategic point. This vibrant country of nearly 100 million people is one of the greatest economic success stories of recent times, rising from poverty to middle-income status in just the past 20 years.[10] To be sure, Vietnam is an authoritarian state with which the United States fought a bitter war just half a century ago. But it has enormous strategic value as a growing economy and production base at the heart of Southeast Asia—as well as a country with deep historical tensions with China. The Obama Administration used TPP to incentivize market-based reform in Vietnam, better labor standards, and closer strategic alignment with the United States.

Supporting U.S.-preferred rules

A second, related strategic benefit of trade agreements is their role in upholding and updating the rules of the global economic order. After World War II, the United States led the creation of the institutions and rules of that order, which produced decades of rising global prosperity unprecedented in human history.[11] Yet the global economic order has been under severe strain in recent years, as a result of two primary forces: first, dwindling support in the United States and other advanced countries for its institutions and rules, based on a perception that they are no longer delivering broad-based growth; and second, challenges to both the substantive rules and institutional leadership from large emerging countries like China. Moreover, there are significant gaps in the existing order, as global economic rules have not kept up with fast-moving developments such as the explosive growth of the digital economy.

Against this backdrop, other powers—friendly and otherwise—have been offering their preferred economic rules, norms, and standards while the United States has been pulling back from leadership in shaping new and existing rules that it favors. The European Union, for example, has taken the lead in setting the global standard for data privacy with its General Data Protection Regulation (GDPR).[12] China's offerings under its Belt and Road Initiative—which are often non-transparent and reinforce Beijing's preferred standards—are another example of countries

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[9] https://thediplomat.com/2015/04/tpp-as-important-as-another-aircraft-carrier-us-defense-secretary/
[10] https://www.worldbank.org/en/country/vietnam/overview
[11] https://www.statista.com/topics/8096/post-wwii-economic-boom/#topicOverview
[12] https://gdpr-info.eu/

attempting to shape the global economic rulebook while the United States largely stays on the sidelines.[13]

This dynamic is particularly apparent in the Indo-Pacific region. In late 2020, a group of 15 countries—the 10 members of the Association of Southeast Asian Nations (ASEAN), plus China, Japan, South Korea, Australia, and New Zealand—signed the Regional Comprehensive Economic Partnership (RCEP), a shallow but far-reaching trade agreement that could shape regional trading patterns in ways unfavorable to the United States.[14] Meanwhile, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP),[15] which replaced TPP after the United States withdrew in early 2017, is continuing to evolve, with the United Kingdom likely to join this year, and five other countries—including China—having applied for membership.[16] China has also applied to join the Digital Economy Partnership Agreement (DEPA), another regional rulemaking forum where the United States is not present.[17]

As these developments show, new trade and other economic rules are being set in ways that may undermine U.S. commercial and other interests. There is a compelling strategic case for the United States to get back in the game. Before discussing pathways for the United States to do this, let me lay out a third strategic rationale for trade agreements: responding to China's economic coercion.

Countering China's economic coercion

As laid out in our new report, Beijing has had a serial habit of pressuring other countries economically in response to perceived slights to its interests. In our study, we looked at eight cases of China's coercion, from suspension of rare-earth-element exports to Japan in 2010 to a *de facto* embargo imposed on Lithuania in 2021. From these case studies, we concluded that Beijing's actions are disruptive to the rules-based international order, can be costly for the companies and sectors affected, and likely deter countries from taking positions that may draw the ire of the Chinese Communist Party (CCP). We argued that this behavior needs to be deterred.

However, we also noted that China's economic coercion is often ineffective or counterproductive to its own interests. In most of the cases we studied, Beijing struggled to achieve its near-term tactical goals and frequently caused harm to its strategic interests—including by driving other countries toward the United States. Thus, China's coercion needs to be viewed with a sense of perspective and countered with an appropriate strategy and tools.

We considered a counterstrategy based on "deterrence by punishment"—tit-for-tat retaliation through increased tariffs or other sanctions—but noted that this comes with several challenges. Most important is credibility: because China rarely imposes significant macroeconomic costs on target countries, a proportional response by the United States would be unlikely to change

[13] https://www.csis.org/analysis/higher-road-forging-us-strategy-global-infrastructure-challenge
[14] https://crsreports.congress.gov/product/pdf/IF/IF11891
[15] https://crsreports.congress.gov/product/pdf/IF/IF12078
[16] https://www.csis.org/analysis/united-kingdom-joining-cptpp-what-comes-next
[17] https://www.csis.org/analysis/depa-and-path-back-tpp

China's behavior; yet a U.S. threat of escalation would quickly become non-credible given the rising costs to the United States relative to the limited costs imposed on partners. Moreover, our conversations with senior officials in countries targeted in our case studies made clear that partners are wary of U.S. retaliation, since Beijing would likely respond with further coercion of them rather than the United States. Finally, a U.S. retaliatory approach would risk ceding some of the moral high ground back to China.

Instead, we propose a U.S. counterstrategy based on "deterrence by denial"—attempting to deny Beijing success in its attempted coercion. We called for two lines of action in this regard: enhancing the *resilience* of vulnerable countries to China's coercion, essentially by helping them find new markets or sources of supply; and providing *relief* to partners—diplomatic, financial, or otherwise—when they are coerced. Together, credible efforts by the United States to promote resilience and offer relief are designed to persuade partners that we have their back, and Beijing that its pressure tactics will fail.

While several of the 11 policy recommendations in our report touch on trade, one is particularly relevant to today's hearing: We argue that the United States should negotiate free trade agreements with allies and partners at risk of economic coercion from China. The goal here is to reduce Beijing's leverage by giving vulnerable partners alternative market opportunities, whether in the United States or in other large economies joining plurilateral agreements, e.g., Japan, Canada, and Australia in the case of CPTPP. More free trade among partners would also speed market adjustments when coercion does occur. All of this would promote resilience and relief and, by lessening Beijing's chances of success, deter it from its coercive behavior over time.

Assessing IPEF

The Biden Administration has made clear that it is not interested for now in negotiating traditional trade agreements that might produce these economic and strategic benefits. Instead, it is offering frameworks for economic engagement with regional partners, including the U.S.-EU Trade and Technology Council (TTC),[18] the Indo-Pacific Economic Framework for Prosperity (IPEF),[19] and the Americas Partnership for Economic Prosperity (APEP).[20] Let me offer a brief assessment of IPEF, the framework with which I am most familiar.

IPEF was launched by President Biden nearly a year ago with the stated purpose of "expanding U.S. economic leadership" in the Indo-Pacific region; "enabl[ing] the United States and our allies to decide on rules of the road that ensure American workers, small businesses, and ranchers can compete in the Indo-Pacific"; and "tackling inflation…by making our supply chains more resilient in the long term." IPEF negotiations are now underway on four pillars:

1. Connected economy (trade)
2. Resilient economy (supply chains)

[18] https://www.whitehouse.gov/briefing-room/statements-releases/2022/12/05/u-s-eu-joint-statement-of-the-trade-and-technology-council/
[19] https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/23/fact-sheet-in-asia-president-biden-and-a-dozen-indo-pacific-partners-launch-the-indo-pacific-economic-framework-for-prosperity/
[20] https://www.whitehouse.gov/briefing-room/statements-releases/2022/06/08/fact-sheet-president-biden-announces-the-americas-partnership-for-economic-prosperity/

3. Clean economy (clean energy, decarbonization, and infrastructure)
4. Fair economy (tax and anti-corruption)

There are three promising aspects of IPEF, in my view. First, the fact that 13 countries in the Indo-Pacific region—not just allies and other TPP partners but also India and Fiji—have joined the negotiations is a strong demand signal for U.S. economic engagement in the region. That by itself if useful.

Second, the IPEF agenda covers many of the critical issues that will shape the region's economic future, including digital trade, more resilient supply chains, clean energy solutions, and infrastructure. I expect that there will be meaningful agreements reached on some of these issues, especially in pillars 2 and 3, where there is arguably the greatest alignment of U.S. and partner interests. Progress is possible as soon as this fall, in the run-up to the annual Asia-Pacific Economic Cooperation (APEC) Leaders' Meeting in San Francisco in November.

The third promising aspect of IPEF runs through one of its major drawbacks, namely that it is being conducted as an executive undertaking rather than a formal trade negotiation subject to the authority and approval of the U.S. Congress. Among other problems, the lack of formal Congressional involvement deprives IPEF of two critical features: market access and durability. Only Congress can grant tariff reductions or other incentives for regional partners to agree to the high standards the United States is seeking. And only a treaty approved by Congress and other legislatures around the region will ensure the durability of IPEF commitments—and of the U.S. presence in the Indo-Pacific in the eyes of our regional partners.

Despite this shortcoming, if IPEF were to achieve greater alignment among Indo-Pacific partners on some of the issues it is addressing, the Framework could become an incubator for the kinds of provisions that might be included in a more formal regional trade agreement that includes the United States. The Biden Administration denies that this is the end goal of IPEF, but progress in elevating labor and environmental standards or establishing best practices on supply chains, for example, could *de facto* provide the building blocks for a new model trade agreement that would be more appealing to the United States than existing regional arrangements—and would do more to advance U.S. economic and strategic interests.

In a thoughtful paper for the Asia Society Policy Institute (ASPI) late last year,[21] Wendy Cutler and Clete Willems offers recommendations in 12 areas for improvements in CPTPP that could facilitate U.S. entry to the agreement. These include several of the areas under discussion in IPEF, including labor and environment standards, digital trade, and supply chain resilience. (The ASPI report also proposes adding provisions on economic coercion to an updated CPTPP.)

This approach is consistent with the idea of using IPEF as a pathway to a more formal regional trade agreement that the United States might eventually join. With TPP having become such a lightning rod for domestic criticism of trade agreements in general—and with China now having applied to join CPTPP—the latter may not be the most realistic vehicle for U.S. re-entry to the regional trade arena. Another possible approach would be to build on the U.S.-Mexico-Canada Agreement (USMCA), the last major trade agreement passed by the U.S. Congress (in a strongly

[21] https://asiasociety.org/policy-institute/reimaginingTPP

bipartisan vote). Or the United States might consider negotiating a formal trade agreement with Japan, which, despite remaining differences on automobiles and agriculture, is one of our closest allies and aligned with us on almost all economic rules and norms. A U.S.-Japan deal could perhaps then be stitched together with other bilateral agreements, including those with Singapore, Australia, and Korea.

Whatever the best vehicle, the point is that the United States needs to get back into the trade game in the Indo-Pacific. Others are moving ahead without us, establishing rules, norms, and standards that are likely to harm our economic and strategic interests. And our partners are looking for credible, durable U.S. economic engagement in the region that provides them tangible benefits as well.

Conclusion

Our report on economic coercion ends with the final paragraph of George Kennan's famous "Long Telegram" framing the Cold War with the Soviet Union, in which he admonished his countrymen to "have the courage and self-confidence to cling to our own methods and conceptions of human society."[22] More than 75 years later, the great diplomat's words still ring true today, even if the primary adversary has changed. Now, in the face of China's growing global economic influence, the United States must not lose confidence and turn inward, as doing so only cedes the playing field to China.[23] Instead, just as our market system proved superior to Soviet central planning, we must remain confident that what the United States has to offer today in our trade agreements is much better than what China is offering—especially its mix of coercion and non-transparent inducements. It is time for the United States to get back to an affirmative trade policy that advances U.S. economic and strategic interests.

Thank you for your attention.

[22] https://nsarchive2.gwu.edu/coldwar/documents/episode-1/kennan.htm
[23] https://www.csis.org/analysis/self-confidence-and-strategy