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"Standing United Against the People's Republic of China's Economic Aggression and Predatory Practices"

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Chairwoman Kim, Ranking Member Bera, distinguished Members of the Subcommittee, thank you for inviting me to testify at today's hearing entitled "Standing United Against the People's Republic of China's Economic Aggression and Predatory Practices." It is an honor to be here, and I look forward to sharing my thoughts on this important topic.

My testimony today will focus on summarizing and highlighting key findings and insights from a recent CSIS Economics Program report on China's economic coercion. I will conclude with some thoughts on how the United States can use our findings to inform a U.S.-led counterstrategy that advances U.S. interests, mitigates the costs of China's economic coercion to U.S. allies and partners, and deters China's economic bullying. My comments today are my own and should not be attributed to the Center for Strategic and International Studies.

Introduction

Since reform and opening, and especially after its entry into the World Trade Organization (WTO), China has experienced rapid economic growth, going from one of the world's poorest nations to the world's second-largest economy in approximately four decades. While lifting hundreds of millions of Chinese citizens out of poverty, China's rapid development and integration into the world economy has also provided Beijing the opportunity to weaponize its vast market to advance its geopolitical interests. Indeed, Beijing's use of economic coercion[1] is fast becoming a favorite foreign policy tool of the Chinese Communist Party.[2]

China's use of economic coercion challenges U.S. interests. Not only is it costly for targeted firms and sectors, it also undermines the norms and rules of the international economic system that have enabled decades of global economic growth, and which, paradoxically, have also contributed positively to China's own remarkable growth. In addition, China's economic coercion divides U.S. allies and partners as firms and producers in other allied countries at times awkwardly stand to benefit from the targeted ally's pain. Likewise, the threat of economic coercion arguably makes it more difficult for the United States to build coalitions to push back against Beijing's malign behavior in other domains as ally and partner governments may fear Beijing's economic retribution.

That said, it is important that China's economic coercion also be viewed with a sense of perspective. Although problematic, China's economic coercion has a decidedly mixed record at achieving its short-term goals, and more often than not, carries long-term, strategic costs for Beijing. Counter-intuitively, China's bullying behavior can actually also work in favor of U.S. interests by driving trade diversification, harming China's image around the world, and pushing targeted countries into greater policy alignment with the United States. A counterstrategy informed by a nuanced understanding of China's use of economic coercion therefore presents an opportunity for the United States to not only counter but also exploit China's bullying to our own advantage.

[1] Daniel Drezner defines economic coercion as a "threat or act by a sender government or governments to disrupt economic exchange with the target state, unless the target acquiesces to an articulated demand." https://www.jstor.org/stable/3594840

[2] https://www.axios.com/2023/02/21/economic-coercion-chinas-foreign-policy-tool

Economic Coercion with Chinese Characteristics

In March 2023, the CSIS Economics Program published a research report on China's economic coercion entitled, *Deny, Deflect, Deter: Countering China's Economic Coercion*.[3] In the report, the program examined eight cases of Chinese economic coercion, spanning approximately the last 13 years. Those cases—Japan (2010), Norway (2010), the Philippines (2012), South Korea (2016), Mongolia (2016), Australia (2017/2020), Canada (2018), and Lithuania (2021)—reveal certain patterns and characteristics of China's distinct brand of economic coercion.

China's use of economic coercion appears to be triggered by a challenge to one or more of five People's Republic of China's (PRC) interests: threats to territorial integrity, domestic political legitimacy, national security, economic security, and/or PRC citizens. Although not every infraction triggers a response from Beijing, when Beijing does decide to deploy coercive economic measures, it prefers to do so in an informal manner. This informality, on the one hand, may be in part due to China's lack of more formal tools, but on the other hand, it also importantly provides Beijing with a degree of plausible deniability in its actions. The case of China's import restrictions on Philippine banana's imports is illustrative.

During the 2012 dispute with Manila over the Scarborough Shoal, China masked its restriction of Philippine banana imports behind phytosanitary and sanitary concerns asserting that Philippine bananas were contaminated with mealybugs. The targeting of Philippine bananas also reveals another distinctive characteristic of China's economic coercion: China attempts to target items not just for their economic impact but also for their political and symbolic importance. Much of the Philippine banana production takes place on the island of Mindanao, an important region politically and home to former Philippine president, Rodrigo Duterte.[4]

Across the studied cases, Beijing simultaneously deployed other coercive tools alongside its coercive economic measures, including nonviolent military and paramilitary coercion, hostage diplomacy, diplomatic sanctions, and cyber-attacks. Again, against the Philippines, China deployed coast guard vessels to the Scarborough Shoal, cut off formal contact with the Philippine foreign ministry for two years, and targeted the University of the Philippines, the Department of the Budget and Management, and the Philippines News Agency with cyber-attacks. Although China did not engage in hostage diplomacy during the Scarborough Shoal dispute, Australia, Canada, and Japan all saw citizens arbitrarily detained after drawing the ire of Beijing.

China also demonstrates a preference for targeting items in which it enjoys an asymmetric advantage in the trading relationship. For example, when China blocked imports of Australian coal in 2020, Australia was sending approximately 20 percent[5] of its coal exports by value to China, whereas China not only had access to other coal suppliers but also only had an import dependency of around 10 percent for coal.[6] Likewise, when China cut off rare earth exports to Japan in 2010, Japan depended on China for nearly 90 percent of its rare earth imports. And when China curtailed

[3] https://www.csis.org/analysis/deny-deflect-deter-countering-chinas-economic-coercion
[4] https://www.ft.com/content/3f6df338-056b-11e7-ace0-1ce02ef0def9
[5] https://oec.world/en/profile/country/aus?depthSelector1=HS6Depth&yearSelector1=2018
[6] https://www.iea.org/data-and-statistics/charts/oil-gas-and-coal-import-dependency-in-china-2007-2019

tourism outflows to South Korea in 2017, Chinese tourists accounted for roughly half of South Korea's overseas tourist arrivals.[7]

China's preference for asymmetry reflects its absolute economic size and is accompanied by an aversion to incurring domestic costs. After African Swine Fever decimated China's domestic hog herds, Beijing dropped restrictions on Canadian pork imports which had been put in place after Canada detained Huawei CFO, Meng Wanzhou. Likewise, Beijing avoided restricting Australian iron ore imports, which would have had deleterious downstream impacts on its own economy in its dispute with Canberra over the origins of Covid-19. Perhaps unsurprisingly then, China also opted not to interfere with a $7 billion investment by Samsung in its Xi'an facilities, nor did it target Lotte's petrochemical operations[8] during the dispute with Seoul over the installment of the Terminal High Altitude Area Defense (THAAD) system despite shutting down almost all of the Korean firm's supermarket stores in China – for which, conveniently, domestic competitors existed.

An aversion to incurring costs domestically is mirrored by an unwillingness, or perhaps inability, to impose significant costs on the targeted countries at the macroeconomic level. This is despite the significant size advantage China typically enjoys over its targets. Indeed, with the exception of Japan,[9] China displayed a preference across cases for targeting much smaller economies—Mongolia and Lithuania together do not even equal one percent of China's GDP. Although China's coercive measures can be expensive for the specific firms and sectors targeted—it is estimated that Lotte lost $1.78 billion due to China's restrictions—in many cases initial losses are offset with gains in third markets. For example, although Australia saw a reduction of $4 billion in trade with China, this was accompanied by a $3.3 billion increase in exports to new markets. The resulting net loss of $700 million represented just 0.25 percent of the value of Australia's total exports.

While potentially painful at the firm level, without the ability or willingness to inflict significant economy-wide costs, China's economic coercion has proven to be quite ineffective. In perhaps the most surprising finding from the study, China has only had mixed success at achieving its short-term, tactical goals, and even when it does achieve its short-term goals, its use of economic coercion often carries long-term, strategic costs for Beijing. In the case of Australia, for example, China's restrictions on Australian wine, coal, and agriculture exports did not result in any significant policy changes in Canberra and have only pushed Australia into closer strategic alignment with the United States. The inking of the AUKUS security agreement in 2021 is emblematic of this stronger alignment.

The ineffectiveness of China's economic coercion can be linked to many of its aforementioned intrinsic characteristics. Informality is a double-edged sword. It can provide plausible deniability, complicating the targeted state's response. However, it also makes it more difficult for China to enforce its economic sanctions. This means targeted items often still find their way into China, mitigating costs for the targeted country. At the same time, without a network of allies, China lacks

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[7] https://www.forbes.com/sites/ralphjennings/2018/03/04/china-keeps-punishing-south-korea-with-tourism-cuts-for-now/?sh=67a5dd4366c4
[8] https://www.tandfonline.com/doi/pdf/10.1080/09692290.2021.1918746
[9] Japan is also unique as it is the only case surveyed where China relied on export restrictions, rather than import restrictions, as the primary coercive economic tool.

the ability, or at least the willingness, to multilateralize its coercive measures to prevent trade adjustment from offsetting costs for the target. Its preference for targeting commodities that are substitutable makes stopping this even more difficult. Likewise, advanced market economies are generally more robust to external shocks than poorer, non-market economies, while China's failure to credibly couple inducements alongside its coercive measures undermines incentives for targets to acquiesce to Beijing's demands.

Norway's experience with Chinese economic coercion highlights many of these weaknesses. Beijing blocked imports of Norwegian salmon on sanitary and phytosanitary grounds following the Oslo-based Nobel Peace Prize Committee's decision to award Chinese dissident Liu Xiaobo the Nobel Peace Prize in 2010. However, Norwegian salmon still found its way into China via Vietnam, with exports to that Southeast Asian nation increasing 17-fold. As a result, the economic impact of the restrictions on Norway was found to be "negligible."[10] Instead, it seems that Norway's moves to normalize relations were more motivated by the opportunity to restart negotiations on a Norway-China Free Trade Agreement. However, these negotiations again broke down in 2022.

Why Does China use Economic Coercion?

If China's economic coercion is so ineffective, why does China continue to do it? There are a couple possible explanations. First and foremost, there is likely a deterrent effect that China perceives it gains from punishing countries that violate certain interests. In making an example of violators, China is sending a message to other countries that crossing Beijing on certain issues is not cost free. While acknowledging this deterrent effect is likely to exist, it is difficult to quantify how substantial it is. At the same time, there exists examples where the threat of economic coercion has not deterred states from taking positions that cross traditional triggers of China's economic coercion, such as the European Union's increasing diplomatic activity with Taiwan.[11]

Another consideration driving Beijing's use of economic coercion may be propriety. That is, China as a great power, and a nation that views itself historically as the preeminent power in Asia, if not the world, cannot be seen to suffer slights from adversaries. A response is necessary, even if it carries costs for China, too. Relatedly, evidence has been put forward showing that China may see economic coercion as less escalatory than other coercive tools in the military domain. Taken together, this would help explain China's preference for targeting smaller countries with its economic coercion. A slight from a smaller country is both a greater insult, and all else equal, meting out economic punishment against a smaller country is less likely to result in escalation. In that way, China can be conceptualized as a "cautious bully."[12]

Looking ahead, Beijing's use of economic coercion is likely to continue. Through its Dual Circulation Strategy, Beijing hopes to enhance its position in the global economy, deepen its resilience to external shocks, and gain economic leverage over its trading partners by diversifying its supply chains and boosting domestic consumption. At the same time, China has grown more

[10] https://qz.com/1000541/norway-wants-china-to-forget-about-the-human-rights-thing-and-eat-salmon-instead
[11] https://ceias.eu/beyond-the-dumpling-alliance/
[12] https://direct.mit.edu/isec/article-abstract/44/1/117/12241/Cautious-Bully-Reputation-Resolve-and-Beijing-s?redirectedFrom=fulltext

nationalistic. The Party's sensitivity to challenges to its "core interests"—especially its One-China Principle—will likely increase. Assuming China's power increases, Beijing will become even less tolerant of slights from other states. Assuming geopolitical tensions between both the United States and China continue, a risk-averse Beijing will continue to prefer economic, rather than more escalatory military tools, in its efforts to coerce other states.

China's coercive tactics are likely to evolve along with its economic power. First, Beijing is likely to expand its economic toolkit to include a greater suite of formal coercion measures such as the Unreliable Entity List, the Export Control Law, and Anti-Foreign Sanctions Law. While it is possible this formalization could undermine China's plausible deniability, it could also enhance enforcement and provide firms operating in Beijing more clarity. Second, Beijing also seems likely to continue to use economic coercion in conjunction with non-economic coercive tools, including shows of force by the People's Liberation Army (PLA). Third, China might become more comfortable in challenging the policies of larger countries, including the United States, which it has previously been reluctant to challenge.

Indeed, recent reports of China's scrutiny of U.S. consultancies, Bain[13] and Mintz,[14] as well as the U.S. semiconductor firm, Micron,[15] has led some to question whether these moves are Beijing's retaliation against the United States for the October 7, 2022 export controls placed on high-end semiconductors and the manufacturing equipment needed to produce them by the Biden administration.[16] However, the harassment of these firms may also emanate from China's increasing suspicion of the United States and its drive for self-reliance more generally. Either way, these moves are also likely to carry costs for China, especially as it sends signals to foreign firms contradicting Beijing's claims that China welcomes foreign investment.

Toward a U.S. Counterstrategy

Based on the case study findings, we put forward a counterstrategy based on the logic of deterrence by denial.[17] The counterstrategy consists of two mutually reinforcing components: a proactive "resilience" component and a reactive "relief" component. Together these components will enable the United States to mitigate the costs of China's economic coercion for targeted allies and partners, speed market adjustments away from China, and increase the costs of exercising economic coercion for Beijing, while at the same time further undermining the tactic's effectiveness. Over time, the counterstrategy aims to demonstrate to Beijing the futility of its actions, forcing a reassessment of the utility of targeting U.S. allies and partners with coercive economic measures.

The United States can help allies and partners proactively build resilience to China's economic coercion in two primary ways. First, the United States can work to assist allies and partners in identifying potential vulnerabilities to China's economic coercion. The ongoing supply chain

[13] https://www.nytimes.com/2023/04/27/business/bain-china.html
[14] https://www.reuters.com/world/us-due-diligence-firm-mintz-groups-beijing-office-raided-five-staff-detained-2023-03-24/
[15] https://www.nytimes.com/2023/04/04/business/micron-china-investigation.html
[16] https://www.reuters.com/world/eu-ambassador-china-says-chinas-anti-espionage-law-not-good-news-2023-05-09/
[17] Deterrence by denial seeks to deter an adversary not so much from instilling in them a fear of punishment but rather a fear of failure and its associated costs.

resiliency initiatives which have emerged in the wake of the Covid-19 pandemic offer logical platforms in which to embed these assessments and coordinate efforts to mitigate vulnerabilities. Second, resiliency can be enhanced through the negotiation of free trade agreements that offer real market access to signatories. China has been expanding its presence in multilateral free trade agreements, with Beijing applying for membership in the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) in 2021 and the Regional Comprehensive Economic Partnership (RCEP) going into effect last year. Engaging in free trade agreements will not only help to offset China's growing global trade influence, but also make it easier for markets to adjust in response to China's economic coercion.

When coercion does take place, the United States should be ready to offer quick relief[18] to targeted allies and partners to mitigate economic costs and reduce political pressure affected firms and sectors may be placing on the targeted government. The United States has a number of existing tools that it could deploy to aid a targeted government in such a scenario. These include, but are not limited to, export financing, sovereign loan guarantees, and temporary tariff reductions. In addition, the United States should also consider creating a coercion compensation fund, which could be used to transfer funds to the targeted country to help offset costs, especially those associated with finding new markets or suppliers. These tools should be bundled together on a case-by-case basis depending on the specific characteristics of an instance of China's economic coercion. For example, it likely would not make sense to provide export financing to speed U.S. exports to a targeted country if that country is facing restrictions on its exports to China. In such a case, reducing U.S. tariffs on the targeted item would be more appropriate.

It is unlikely that these relief tools would have to be very expensive for the United States. As the case studies show, China has largely been reluctant or unable to inflict significant costs on the targeted countries. In addition, the goal of U.S. relief should not be to completely offset the entire cost incurred by targets, as that could create a moral hazard where firms are not accurately pricing in the risks of doing business in China. Instead, relief should be focused on speeding the market adjustments that are already taking place naturally in the face of China's economic coercion. For example, Canada provided just C$19 million in relief to its agriculture producers in the wake of China's import restrictions. This amount, combined with increased exports to new markets, proved sufficient, as Ottawa never caved to Chinese pressure. It also suggests that U.S. relief would be augmenting relief provided by targeted governments to their own domestic industry. Indeed, the United States should be encouraging its allies and partners to adopt similar counter coercion authorities. The G7 is a logical place to start and can serve as a platform for coordinating multilateral relief, enhancing the quality and amount of relief flowing to a targeted country.

Both the resilience and relief components of the counterstrategy should also be embedded in a larger diplomatic messaging campaign. First, the United States can draw attention to China's bullying tactics, the U.S.-led efforts to build resiliency, and the ineffectiveness of China's past usage of economic coercion. In doing so, the United States can increase the reputational costs for China, while also eroding the deterrent effect of China's threats of economic coercion and altering Beijing's calculus around the future use of economic coercion. Second, if China begins to coerce an ally country, the United States should seek to signal that relief is coming, rally multilateral

[18] Speed of reaction is important because sanctions are likely to bite the most before market adjustments can take place.

support, and join WTO cases if possible. Together, this should help the targeted government stand up to Beijing until the relief arrives.

Conclusion

China's economic coercion carries real costs for the firms and sectors that find themselves downrange of China's coercive measures. Likewise, the threat of China's use of economic coercion likely has some level of deterrent effect, possibly preventing countries from standing up to Beijing's malign behavior in other domains, whether that be human rights violations in Xinjiang or the suppression of democracy movements in Hong Kong. However, a careful review of eight cases of Chinese economic coercion by the CSIS Economics Program reveals a tactic that carries real costs for Beijing as well. With a well-informed counterstrategy, China's economic coercion can therefore be mitigated, if not deterred. This can be done in a way that primarily makes use of market forces to speed trade adjustments and provide relief to targeted countries. Over time, as it comes to be seen that economies prove themselves more resilient to China's coercive measures, the deterrent effect that China had received from its threat of economic coercion will likewise be eroded. In addition, by focusing on building resiliency and providing relief to allies and partners, countering China's use of economic coercion provides the United States the opportunity to assert leadership on the global stage and enhance its soft power vis-à-vis China.