

Testimony on “Transatlantic Cooperation on Critical Supply Chain Security”

January 19, 2022

House Foreign Affairs Committee

Subcommittee on Europe, Energy, the Environment and Cyber

by Derek Scissors

Main Points

Looking at global supply chains through the China lens generates three general and vital observations:

First, cutting China out of a supply chain must be done by mandate, not by financial or other incentives. China is often economically competitive and, when not, it has the world's most extensive subsidies scheme available to push into any supply chain considered to be a national priority. No genuinely commercial American or European business can compete with the range of subsidies China can bring to bear -- tax incentives and other support for those businesses will be overwhelmed. Where Beijing has set a national priority, production in China and by Chinese enterprises overseas must be banned by law or they will continue to participate.

Second, securing supply chains in this way will be costly for the US and unappealing for countries that do not see China as a major threat. The US should not raise costs for everyone by cutting our allies and close economic partners from supply chains along with China. These allies and close economic partners certainly include UK and much of the EU. China wants to split the transatlantic partnership, the US should not bring that goal closer.

Third, the problems in global supply chains certainly extend beyond Covid. Pre-Covid, Congress was rightly concerned about the dominance of Chinese chemicals in the manufacturing of active pharmaceutical ingredients (API), for example. The pandemic shows that even friendly countries will compete over supply in a crisis. This is important to American preparation, both for ourselves and "over-preparing" so that we can assist our friends in the next crisis. But if even Covid's impact on supply chains ends this year, China's ability to interrupt key chains will remain and evolve, as Beijing resets what it thinks is most important.

Relations with the EU

Taken as a whole, Europe is the most important of our economic partners, due to its size and technological competitiveness. NATO is also the most important security alliance. Unfortunately, most of Europe does not see China as a major security threat. If the US treats Europe as a partner in cutting China out of certain supply chains, Europe can benefit to some extent in the relocation of economic activity. This prospect will encourage cooperation. If America does not work to include Europe, countries may choose to keep their supply chains running through China, regardless of how that affects the US, or set up protected chains of their own.

Semiconductors are an illustration. The US has correctly pressured Dutch company ASML not to sell top-of-the-line equipment to China. It is important to include equipment-makers when considering supply chains, even if they make none of the products involved because they can make participants in the chains more or less competitive. In addition, Norway's Elkem is a silicon manufacturer. Britain's Arm is not only an advanced manufacturer of semiconductors, it has faced a rogue Chinese subsidiary, which went rogue in part because the Chinese government encourages illegal or quasi-illegal acts if they bring in chip technology.

These firms should definitely be allowed to participate in semiconductor supply chains that serve the US, as long as they are willing to follow any rules regarding China. It would hurt efforts to limit Chinese participation in semiconductor chains if Europe did not cooperate and, in return, these supply chains should not just be based in the US or North America. This is an excellent area for work by the US-EU Trade and Technological Council (TTC). Another example is solar energy, where Europe especially should not want to depend on China. But the US will not win cooperation from Europe or anyone else if we're not willing to act ourselves.

American Policy Priorities

Selling China valuable technology and investing in their firms undermines American credibility on supply chains and makes it more costly to establish independent chains because it makes China more competitive. The Congress voted on an overwhelming bipartisan basis in 2018 to reform export controls, including controlling foundational technology such as a good deal of medical equipment. The Department of Commerce's Bureau of

Industry and Security has not taken a single action with regard to controlling foundational technology. Sadly, there is no problem harmonizing controls with Europe in this area because we do not have any controls. There is a clear problem of the US assisting Chinese firms to outcompete American participants in medical and other supply chains.

Adding to this challenge, from 2016 to 2020, there was \$780 billion in new US investment in Chinese stocks and bonds, thus funding Chinese enterprises. The stock of investment more than tripled. The Department of the Treasury does not publish information on what sectors this money supports, but all of those sectors are more competitive than they would otherwise be. The US again has helped China enter or dominate supply chains.

Congress should decide what products matter most, where we must secure supply chains and stop boosting Chinese competitiveness. The National Critical Capabilities Defense Act, introduced on a bipartisan basis in the House last month, is a valuable step in this direction (which is not to say it's ideal). In general, Congress should choose a few 2022 priorities and take actions to quickly move the associated supply chains toward full independence from Chinese participation.

Semiconductors and medical supplies such as API have already been mentioned. Another possibility is some rare earth elements (REE). China has not yet been successful in controlling REE markets but it is continuing to try, most recently with a merger of the REE business of large state-owned enterprises. A bipartisan Senate bill was introduced last week banning the use of Chinese REE in defense purchases and it is certainly true that China should not participate in any defense supply chains.

Finally, when Congress sets its priorities and while the implementing steps are being taken, the executive branch should be encouraged to bring these priorities into the TTC. This Congressional guidance on trade could win bipartisan support. The Trump and Biden administrations (thus far) unfortunately only talk about supply chain independence, no action has been taken even two years after the blows from Covid first began to be felt. There is an urgent need for strong Congressional action.