TESTIMONY FOR THE HOUSE FINANCIAL SERVICES COMMITTEE
HEARING ENTITLED "COMBATTING THE ECONOMIC THREAT FROM CHINA"

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TESTIMONY BY PETER E. HARRELL

Thank you Chairman McHenry, Ranking Member Waters, and Members of the Committee. It is an honor to be here to testify alongside four distinguished colleagues at today's hearing on "Combatting the Economic Threat from China."

America's diplomatic, economic, and military competition with the People's Republic of China (PRC) represents an overarching challenge for this decade. The current government in Beijing is a competitor that seeks to undercut the political, economic and security interests of the U.S. and our partners. The PRC pursues policies—both domestically and around the world—that are in tension with American values. Unlike other U.S. competitors and adversaries, the PRC has the economic, technological, and military capability to mount a credible challenge to our security and our prosperity. Yet even as we compete with the PRC, we must simultaneously find ways to keep lines of communication open, cooperate on shared challenges like reducing greenhouse gas emissions, continue outreach to the Chinese people, and keep the door open to ties that benefit the U.S. and citizens in both countries.

In my view, the U.S. faces three primary sets of economic risks with respect to the PRC.

First, the U.S. and our allies risk losing our technological and economic edge. If we fail to maintain that edge—our technological leadership and the economic dynamism—we cannot ensure our security and the economic wellbeing of the American people.

Second, Beijing could use the China's control over data networks, supply chains, and key elements of the global economy to the detriment of the U.S. and our allies. As the current debate over TikTok here in Washington highlights, the Chinese Communist Party (CCP) can use Chinese control of telecommunications network infrastructure and over Chinese-controlled apps and software globally to collect sensitive data about Americans and impact our communications. The CCP could use its control of key supply chains, like the supply chains for certain critical minerals and clean energy technologies, to undercut the energy security of the U.S. and our allies. The U.S. and our allies need to strengthen our resilience against this set of risks.

Third, the PRC could divide the U.S. from our friends and build economic networks that pry countries away from the U.S. For example, China's government is working to increase the role of the renminbi in international finance and to weaken the centrality of the U.S. financial system. We need to defend our position. There is a similar dynamic regarding global development and infrastructure investment. In recent years countries around the world have begun to see the risks of taking on too much debt from the Belt and Road initiative, but absent an effective western alternative, the PRC's development financing will continue to expand.

The U.S. should respond to these threats with a three-pillar strategy.

First, the U.S. and our allies should promote our own technological leadership and economic strength. This includes making investments to strengthen our technological and industrial base. We must also avoid catastrophic self-inflicted wounds, such as defaulting on the U.S. national debt, which risks trillions of dollars of damage to the U.S. economy and would play straight into Beijing's efforts to portray the U.S. as irresponsible.

Second, we should protect our technological and economic advantages while limiting Beijing's ability to weaponize the leverage it has over the U.S. and our partners. We should be clear-eyed that a broad de-coupling would be extraordinarily expensive to both the U.S. and China, and we should not seek a complete decoupling. But we do need to ensure that U.S. and allied companies and experts are not inadvertently providing Beijing an edge in key technologies, giving the PRC access to our critical data, or creating dependencies for essential goods and products that the CCP could weaponize to its advantage.

Third, we should deepen our partnerships with existing allies while working to strengthen relations with new ones. The U.S. should continue to galvanize like-minded multilateral organizations like the G7 to develop shared approaches towards China, and to work with distinct groupings of countries to take joint action against specific risks, such as the recent Dutch and Japanese decisions to join the U.S. in imposing restrictions on semiconductor exports. We should pursue multilateral economic deals, including the Indo-Pacific Economic Framework. And we need to expand bilateral outreach to key emerging markets and swing countries, such as India and Indonesia, to deepen ties as we face a period of long-term competition with Beijing.

I will now elaborate on each of these three pillars of work.

I. Promoting the foundations of America's technological and economic leadership:

Our strategy should start by investing in the foundations of our technological leadership and economic strength. We cannot maintain our edge without investments in the U.S. and with our partners to spur technological innovation, ensure a resilient industrial and manufacturing base, secure critical supply chains, and promote our economic leadership globally.

Fortunately, over the past several years, Congress and the Biden-Harris Administration have taken steps to invest in the foundations of American technological and economic strength.

The bipartisan CHIPS and Science Act is providing tens of billions of dollars to promote the manufacturing of semiconductors—a key component of products from phones to cars—here in the U.S., and to ensure that the next generations of semiconductors are developed here. CHIPS and Science is also modernizing the National Science Foundation, the national labs, and other engines of innovation to make sure that U.S. is both investing in fundamental research and transforming new scientific breakthroughs into new technologies.

The Inflation Reduction Act will spur U.S. leadership in the clean energy ecosystem. As the world transitions to clean energy, the U.S. and our allies need to maintain our energy security by innovating and manufacturing key clean energy technologies rather than depending on China for key clean energy supply chains.

Finally, the Bipartisan Infrastructure Law provides a critical foundation for economic growth across a range of industries. Infrastructure literally lays the groundwork for investment. New factories need roads, power, and water. The next generation of tech entrepreneurs needs fast and reliable internet connectivity. Simply put, modernizing our infrastructure here at home is essential to our competitiveness with China.

The challenge now is to build on this foundation. Many of the policies the U.S. should pursue, such as ensuring STEM education, are beyond the scope of my testimony. However, I would like to offer three specific recommendations.

First, we need to multilateralize the clean energy agenda—and more broadly, the industrial policy—we are pursuing with the Inflation Reduction Act and other investments in the U.S. Some allies and partners have criticized the IRA as advantaging U.S. firms over their own. But the IRA actually offers a once-in-a generation opportunity to galvanize allies and partners to make their own complementary clean energy investments that will ensure both a speedy transition away from fossil fuels and a supply chain and industrial base that is not dependent on China or other competitors.

Much as Europe is enacting a European CHIPS Act to spur complementary semiconductor investments in Europe, U.S. allies should strengthen their own clean energy investments while working with the U.S. on new rules around industrial policy to ensure that incentives spur innovation, rather than becoming a subsidy race to the bottom. We need creative multilateral arrangements to bring partners into our clean energy ecosystem. For example, the Administration should build on the State Department's Minerals Security Partnership, a diplomatic initiative to strengthen critical minerals supply chains, to launch a new critical minerals club to build resilient minerals supply chains for batteries and other clean energy technologies.

Second, we need to continue identifying vulnerabilities in our supply chains and industrial base. Pursuant to Executive Order 14017, and supported by Congress, the Biden Administration has effectively worked to address a known set of supply chain vulnerabilities on products such as semiconductors, rare earth elements and other critical minerals, and clean energy equipment. But there are critical supply chains where we continue to have vulnerabilities, such as ingredients for pharmaceuticals, which are overwhelmingly concentrated in China and India. And there is a set of supply chain vulnerabilities that we don't know even know that we have. Congress should support policies to close known supply chain gaps while I urge the Administration to undertake a comprehensive study of supply chain vulnerabilities, much as Australia and the European Union have, to get a handle on the vulnerabilities we don't yet know we have.

My third recommendation is one squarely in this Committee's jurisdiction: the U.S. should develop a strategy to maintain the preeminent role of the U.S. dollar and the U.S. financial system globally.

The pre-eminence of the U.S. dollar and the U.S. financial system provides the U.S. with economic and national security benefits. It ensures we have access to capital and benefits U.S. companies investing and trading globally. From a national security perspective, it gives us the ability to target our adversaries with financial sanctions that have teeth.

In recent years we have seen growing efforts by countries such as Russia and China to develop alternatives to the existing global financial system—initiatives that have recently borne some success. While the dollar remains preeminent as a reserve currency and in foreign exchange, last year we saw Russia easily shift to Russian payment systems for domestic payments when sanctions forced western payments providers out of the market and cut major Russian banks off from their U.S. relationships. Today Beijing has already built domestic payment rails that are insulated from the U.S. and is increasingly seeking to push Chinese payment rails out to third countries. The Treasury and State Departments need to develop a proactive strategy to maintain the preeminent role of the U.S. dollar and U.S. financial system in the face of these challenges.

Finally, I must make a comment on the ongoing debate here in Congress about our national debt limit. If we fail to raise the debt limit and trigger a default on our obligations, we risk massive harm to both our domestic economy and America's position relative to China. Even aside from the domestic economic ramifications, a default would undermine global confidence in the dollar and speed up the development of effective alternatives. It would undercut the confidence of our allies and partners, who would justifiably question whether, if the U.S. cannot be counted on to pay its debts, it can be counted on as an ally. A default would give the CCP a priceless talking point about the irresponsibility of the United States. Congress must raise the debt limit this spring and ensure that the U.S. never defaults on our national debts.

II. Protecting our strengths and reducing the CCP's leverage

The second pillar of the strategy to address the economic threat from China is to protect our advantages and to reduce the CCP's leverage over the U.S. and our allies.

In recent years the U.S. began to take important steps to protect our economic and technological advantages. 2018 Congress enacted the Foreign Investment Risk Review Modernization Act ("FIRRMA") to modernize the CFIUS process. Congress also enacted the Export Control Reform Act ("ECRA") to update U.S. export controls and put them on a sound statutory basis. The Trump Administration launched a global campaign to reduce the role of Huawei and other untrusted vendors in global telecommunications networks. The Biden Administration has expanded export controls, particularly on semiconductor exports to China. We have begun to build the resilience of key U.S. supply chains so that the CCP cannot weaponize its control of key inputs, like rare earths minerals, to our disadvantage.

I would like to highlight three specific areas for additional action: data, investment, and trade.

Data:

The current debate here in Washington over TikTok, the Chinese-owned social media app, highlights the need for new legislation to better protect U.S. data from exploitation by the PRC and other competitors. The simple reality is that the U.S. does not currently have an effective legal regime to address and mitigate the national security data security risks we face from the PRC. And while the U.S. has taken steps to reduce specific risks, such as the important work begun by the Trump Administration to target the presence of Huawei and other untrusted telecoms vendors in 5G telecoms networks, much more needs to be done.

There are essentially five major vectors through which the PRC can get access to U.S. data. First, the Chinese government can engage in outright hacking or other espionage to steal data from U.S. IT networks. Second, the Chinese government can use its control of pieces of network infrastructure, not just mobile networking equipment but other key pieces of infrastructure like cloud services, to gain access to data. Third, the Chinese government can purchase U.S. companies that hold repositories of sensitive U.S. data, which is one reason the CFIUS process has been focused on data security risks. Fourth, the Chinese government can control apps and software, or other data-collecting tools, that are popular in the U.S. While TikTok is the most prominent Chinese app in the U.S., there are others, including in areas such as genomics, that arguably collect more sensitive data than does TikTok (albeit with far smaller numbers of users). And fifth, Chinese government-aligned entities can purchase data on the open market from the same data brokers that U.S. companies use to enable targeted advertising and market research.

We need a strategy that addresses each of these vectors. We need to continue hardening U.S. IT networks against espionage and cyber attacks. We need a network infrastructure line of work that focuses not only on mobile telecommunications, but on cloud services providers, undersea cables, and other parts of the network. We need CFIUS to continue focusing on data security risks as it evaluates Chinese acquisitions of U.S. companies. While the Biden Administration is working diligently within existing legal structures to creatively address the risks posed by apps and software like TikTok, the reality is that current legal structures are inadequate and we need new legislation to fully address these risks. We need a new domestic data privacy law to crack down on data brokers and to reduce the volume of data collected in the first place. I urge members of Congress to make data security a major area of work.

Investment:

The second area is investment. Following the enactment of FIRRMA in 2018, the Executive Branch stepped up scrutiny of Chinese investment in the U.S., including requiring notifications for all investments in certain U.S. technologies and beginning to actively require the divestment of certain companies that Chinese companies acquired without going through CFIUS review.

However, five years after FIRRMA's enactment the time has come to take another close look at CFIUS. In 2021 and 2022 I participated in the work of the CFIUS committee as a non-voting observer member and saw several continuing vulnerabilities. For example, while FIRRMA gave CFIUS some jurisdiction over certain real estate transactions, and over smaller minority investments, CFIUS continues to lack clear jurisdiction over certain greenfield investments here in the U.S. This creates a risk where, for example, a Chinese company can come into the U.S. to set up a data-intensive subsidiary—even in a sensitive area such as a cloud services--without ever passing through CFIUS jurisdiction. While I strongly believe that the U.S. should be open to capital and attract global investment, we also need adequate, narrowly targeted authorities to review and prohibit national security-sensitive investments from China and other competitors. CFIUS also needs greater authority to review and prohibit investments in U.S. companies that play a critical role in U.S. civilian supply chains, not just military supply chains, given the need to increase U.S. supply chain resilience.

Moreover, the time has come to take a close look at certain U.S. investments in China—not just Chinese investments here in the U.S. I fully recognize that much U.S. investment in China is benign, and I'm happy to see U.S. farmers and consumer companies prosper from sales to Chinese customers. However, U.S. investments in certain sectors in China can foster Chinese technological innovation to our detriment and can undermine our supply chain resilience. By and large, the U.S. government doesn't currently even have a full or detailed understanding of what U.S. investments in China are.

Take semiconductors. The U.S. is currently investing billions of dollars to strengthen semiconductor R&D and manufacturing. New export controls limit China's access to high end chips and chip manufacturing equipment. But there is currently no tool that clearly provides an authority to review investments by U.S. companies in Chinese semiconductor companies—even if a U.S. company is investing, for example, in a Chinese company that is trying to develop Chinese semiconductor tools or chip designs.

Establishing an outbound investment review is a complex undertaking that will raise novel policy, legal, and resourcing issues, and there are risks of unintended consequences. It makes sense to start an outbound investment review regime small and build it over time—much as the U.S. did with CFIUS in the 1980s. However, I strongly recommend that the government establish a narrowly tailored regime with the authority to require disclosures regarding narrow categories of investments in critical Chinese technology and supply chain sectors, and that the government have the authority to limit or block the small number of transactions that are likely to raise serious national security risks.

Trade:

The third area I'd like to discuss is trade. I believe our current trade posture towards China needs to be re-evaluated with a view towards the specific economic threats we face from the CCP and the U.S. needs to better integrate trade tools with our national security needs.

The existing U.S. tariff regime on China established by the Trump Administration was designed to increase U.S. economic leverage over Beijing in pursuit of a trade deal in which the Chinese government would cease IP theft, abandon a host of distortive subsidies, and end other unfair trade practices. The experience of the last several years, however, demonstrates that the PRC is simply not going to agree to such a deal. And despite the tariffs, data out today are likely to show record levels of bilateral trade between the U.S. and China in 2022.

The U.S. should expect that many tariffs on China will remain in place for the foreseeable future and re-evaluate specific tariffs against specific economic and national security threats we face.

For example, the U.S. currently imposes tariffs on a large number of imports from China that are not necessarily strategically important. Tariffs on products like clothing and inexpensive furniture were designed for negotiating leverage, not because imports of the goods themselves necessarily threatened U.S. economic or national security. Yet there are a number of critical goods in our supply chains that are not currently subjected to tariffs—ranging from rare earths and other critical minerals to pharmaceuticals and pharmaceutical ingredients, a situation that risks maintaining our dependencies on China for these critical products. Meanwhile, tariffs on other goods we import, like certain intermediate goods used in U.S. manufacturing, might actually raise costs for U.S. manufacturers and make U.S. manufacturing less competitive vis-à-vis international competitors. The U.S. Trade Representative and Commerce Department should review individual tariffs with an eye towards adjusting them—both up and down—to ensure that each specific tariff on each specific good is in our national interest.

III. Strengthening relations with allies and partners

Finally a strategy to address the economic risks we face from China must include expanding our cooperation with friends. In a world where the U.S. represents 24 percent of global GDP, but the G7, including the European Union, and other allies like South Korea and Australia, represent more than half, it is obvious that we are better positioned to address the economic risks from China collectively. Key U.S. allies also have strong technological and innovation ecosystems that can either complement U.S. expertise—or, if the U.S. doesn't keep our allies and partners on board, can undermine efforts to out-compete Beijing.

Fortunately, the U.S. is well-positioned to expand cooperation internationally. Russia's invasion of Ukraine a year ago has re-unified the trans-Atlantic alliance and raised awareness in Europe and Asia about the risks of autocratic, saber-rattling countries. It has also strengthened U.S. diplomacy regarding key technological and economic tools: the international working groups that coordinated sanctions and export controls on Russia have built relationships and expertise that the U.S. can leverage to improve cooperation regarding China.

The Biden Administration has taken a smart approach to diplomacy by seeking to assemble bespoke groupings of nations focused on specific risks. Bespoke groups for different risks let the U.S. pull together the countries needed to solve a specific risk while minimizing the presence of potential diplomatic spoilers. For example, effective multilateral export controls on high-end semiconductors effectively only require the U.S., the Netherlands, Japan, Taiwan, and South Korea. Adding other countries to discussions of semiconductor export controls would risk including spoilers without bringing additional leverage to the table. On the other hand, an issue such as ensuring a free and open internet in the face of the PRC's authoritarian vision of the internet requires a much broader grouping of countries—which is why the Biden Administration worked with the European Union and more than 60 countries last year to launch the Declaration for the Future of the Internet, a political commitment to maintaining a free, open, secure, and competitive internet ecosystem.

When it comes to trade, current initiatives including the Indo-Pacific Economic Framework and the Americans Partnership for Economic Prosperity create the opportunity to increase economic opportunities for both American citizens and partner countries while helping diversify and build more resilient global supply chains.

The Biden Administration has also been effective at revitalizing the G7 as a core coordinating body of large, technologically savvy, like-minded democratic partners. The G7 and a handful of "adjunct" members such as Australia and South Korea have achieved a remarkable degree of coordination on issues as diverse as Russia sanctions to launching coordinated global infrastructure investment initiatives to provide emerging markets with alternatives to BRI development financing. The Biden Administration should continue to invest in the G7, especially under Japan's leadership this year, as a tool for coordination with close allies to collectively address the risks we face.

Finally, the U.S. must invest in expanded bilateral ties with key emerging partner countries. Last week's announcement of a new technology partnership with India shows the potential for patient diplomacy to bring the U.S. and emerging partner governments closer together on technological issues like space and AI as well as the economy. The Administration's embrace of friendshoring and its economic statecraft and the work of the U.S. Development Finance Corporation to crowd in private capital and support impactful projects in the developing world, have the potential to strengthen economic ties with partners in ways that help us build collective resilience against the risks we face.

In Closing:

I want to close with two final, brief points. The first is that while my testimony today focuses on the risks we face from the PRC, we must keep lines of communication open to both the Chinese government and the billion-plus Chinese citizens who harbor no ill will towards the United States. We have to find ways to cooperate on issues such as global climate change. We will need nuanced diplomacy with China that embraces pressure where we need pressure but keeps lines of communication open to avoid crisis and to ensure that we understand each other.

Finally, I am optimistic about our future. There is a growing consensus here in Washington and across the country about competitive threats we face. We have proved resilient in the face of the shocks of the past several years. We have begun making investments to ensure our competitiveness. The American people remain more innovative and entrepreneurial than people anywhere else on earth. I am confident our future is bright, and that we will succeed in the era of economic and geopolitical competition we now face.

Thank you. I look forward to your questions.