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Committee on Financial Services

"Combatting the Economic Threat from China"

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Chairman McHenry, Ranking Member Waters, and Members of the Committee,

Thank you for the opportunity to discuss the threat that China poses to U.S. national security and economic leadership. The Chinese Communist Party (CCP) seeks to remake the international order to its advantage with priorities and values that differ significantly from our own. Accordingly, the outcome of the U.S. – China strategic competition will profoundly affect the future of our country and the world we live in.

Congress deserves credit for prioritizing the China challenge. The fact that this is the first Financial Services Committee hearing of 2023 underscores your commitment to overcoming this existential threat, as does the creation of the *Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party*.[1]

For its part, the Financial Services Committee will play a pivotal role in developing Congress' legislative approach to China. With jurisdiction over the U.S. financial system, this Committee will shape some of the most consequential policies being considered, such as restrictions on U.S. capital flows to prevent them from strengthening China's military.

In my testimony today, I hope to facilitate the Committee's development of a robust and thoughtful China agenda by outlining principles and actions to improve the odds of success. In particular, the United States should clearly define its objectives with respect to China,[2] fully consider the broader economic and geopolitical consequences of its policies, and coordinate action with allies. Our approach should also be comprehensive and not only defensive in nature. We should crack down on problematic capital and technology flows. But we should also prioritize competitive tax and regulatory policies and double down on our comparative advantages, including our free market economy, democratic values, deep network of partners and allies, and the most vibrant financial system in the world.

To this end, my testimony will cover:

- The <u>defensive measures</u> necessary to protect U.S. national security and prevent our capital and technology from contributing to China's military development;

- The need for <u>multilateral coordination</u> to ensure these measures are effective and do not harm U.S. economic competitiveness, as well as engagement with China in <u>international financial institutions</u> to advance U.S. interests;

- The importance of pairing defensive action with <u>offensive measures</u> to maintain U.S. economic strength and create incentives to reduce supply chain reliance on China; and

- The role and appropriate contours of balanced <u>bilateral</u> engagement with China.

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[1] Congress should be commended for clarifying that the U.S. national security threat to the United States emanates from the Chinese Communist Party (CCP), not the Chinese people, many of whom suffer under the same policies that concern the United States.

[2] Possible objectives include protecting U.S. national security from the CCP and promoting U.S. economic and geopolitical leadership to preserve important values like freedom, democracy, and the respect for human rights.

My ideas are shaped by a career working on China policy in the U.S. Government. This includes serving as the Deputy Director of the National Economic Council (NEC), a member of the National Security Council (NSC), and President Trump's Sherpa to the G7 and G20. In 2019, I joined Akin Gump Strauss Hauer & Feld, where I help companies in the private sector navigate the challenges posed by the complex U.S.-China relationship. Nonetheless, the views in this testimony are entirely my own and do not necessarily align with the firm's many clients.

Part I: Defensive Measures

To win the strategic competition with China, the United States should take all necessary actions to avoid contributing to China's military development with U.S. capital or technology. This necessitates novel actions on outbound investment, sanctions, and export control measures.

At the same time, it is important to realize that these actions can impose a substantial cost on the U.S. economy by cutting off a critical market and are only effective if U.S. allies take similar actions since they can provide much of the same capital and technology that we can. Overly-broad measures also raise questions about our commitment to a market economy, a key source of our strength in contrast to China's industrial policies and a distinction that matters to many of our allies. Therefore, our "defensive" measures should be predicated on national security threats, appropriately targeted, and internationally coordinated to the extent possible.

Outbound Investment Screening

The Biden Administration and Congress are both considering an outbound investment screening mechanism. To date, no action has been taken, likely in part because of conflicting objectives under consideration. Some proponents focus on national security concerns about U.S. capital funding People's Republic of China (PRC) military development while others advocate for broad supply chain and economic objectives, including on-shoring the production of key goods. Many experts have also raised questions about whether such a mechanism would be redundant of existing authorities, where it would be housed in the U.S. Government, and whether it would be overly burdensome for the U.S. Government and U.S. business.[3]

The United States should seriously consider adopting outbound investment restrictions and a corresponding transparency mechanism; however, any restrictions should be targeted to national security concerns and designed to cover gaps in existing tools. For example, if the United States determines that an export control action is warranted to prevent U.S. companies from sending national security sensitive technology to China, the United States should also prohibit U.S. companies from financing China's indigenous development of that same technology. Greater transparency about how U.S. investment in China is being deployed would also help us gain a better sense of the problem and whether additional restrictions are ultimately needed.

This approach has numerous merits. Prohibiting U.S. capital from financing China's indigenous development of sensitive technologies with military implications is a clearly defined (and hard to

[3] See, e.g., Sarah Bauerle Danzman and Emily Kilcrease, "Sand in the Silicon: Designing an Outbound Investment Controls Mechanism", Atlantic Council and Center for New American Security, available at: https://www.atlanticcouncil.org/wp-content/uploads/2022/09/Sand_in_the_Silicon-Designing_an_Outbound_Investment_Controls_Mechanism..pdf.

argue with) national security objective. Because this approach is national security-based, it will be easier to convince U.S. allies to follow along than with a broad supply chain-based approach. This policy would also fill a gap in export control actions that focus on technology flows, not financial flows. And clear prohibitions will be less burdensome for the U.S. Government and business than a bureaucratic review mechanism.

By contrast, we should not address broad supply chain issues with outbound investment screening. This would unduly harm the many U.S. companies that have operations in the Chinese market primarily to sell there.[4] It would also represent an unprecedented type of intervention in U.S. company decision-making and resemble the type of command and control policies associated with Beijing. Finally, there are better ways to reduce supply chain reliance on China, including a proactive trade policy with third countries.

Sanctions on Chinese Military-Industrial Complex (CMIC) Companies

To help ensure U.S. capital is not financing Chinese military development, the United States should also expand existing restrictions on financing for Chinese-Military Industrial Complex (CMIC) companies. Both the Trump and Biden Administrations have taken action to limit U.S. investments in companies that are part of China's military-industrial complex.[5] However, the prohibitions are limited to the "purchase or sale of publicly traded securities" and entities involved in the "defense-material" or "surveillance-technology sectors". This leaves two major gaps: (1) private investment, including private equity and venture capital activity; and (2) PRC companies that pose national security threats but are not technically in one of the named sectors. Therefore, the United States should expand existing CMIC restrictions to cover private investment and a broader set of activities in China that may pose national security concerns.

Relatedly, the United States should consider whether it is possible to reconcile the various types of entity-based restrictions that it applies under CMIC and Commerce's Entity List and Military-End User Lists. There are reasons why this could be difficult, including a different process and different set of interagency actors for each determination. But if the Administration believes that a Chinese company raises enough concerns to apply restrictions on export, it should strongly consider limiting any potential investment in that same company as well.

Export Controls

A robust use of export controls is critical to ensure that U.S. companies are not supplying China with sensitive technology that could enhance the PRC's military capabilities. But it is vital that these measures are targeted, coordinated with U.S. allies, and implemented in a predictable manner to ensure their effectiveness and mitigate harm to U.S. industry.

The Biden Administration has actively deployed new export controls, but its implementation has been mixed. For example, the October 7, 2022 rule targeting China's ability to obtain advanced

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[4] US-China Business Council, "Member Survey", Jun. 2022, available at: https://www.uschina.org/sites/default/files/uscbc_member_survey_2022.pdf.

[5] Executive Order 14032, Addressing the Threat from Securities Investments That Finance Certain Companies of the People's Republic of China, issued Jun. 3, 2021; Executive Order 13959, Addressing the Threat from Securities Investments That Finance Communist Chinese Military Companies, issued Nov. 17, 2020.

computing chips, develop and maintain supercomputers, and manufacture advanced semiconductors has numerous positive elements.[6] The rule highlights the Administration's commitment to addressing the PRC military threat and attempts to avoid impacting legacy semiconductor ecosystems that are important to the global supply chain. Additionally, the rule's country-wide application is better than entity-based approaches, which have allowed China to shift production to unnamed companies to avoid restrictions.

However, it remains unclear why the Biden Administration did not initially coordinate the October 7 rule with U.S. allies. As a result, in the immediate aftermath of the rule's release, Dutch and Japanese companies made statements suggesting it would help their business in China, while U.S. companies reported that their business would be substantially harmed.[7]

Recent reports that the Biden Administration has now convinced the Netherlands and Japan to impose additional export controls on China are welcome, but it may be a Pyrrhic victory. A key open question is whether these allies will include key features of the U.S. rule in their regulations, including controls on persons, the broad end-use catch-all control on semiconductor technology, and prohibitions on re-exportation for those tools outside of the Netherlands and Japan. Nothing short of parity with the U.S. rules will level the playing field or meet the Administration's national security objectives.

If the Dutch and Japanese actions lack key features of the U.S. rule, China will find ways to exploit the gaps. For example, without Dutch and Japanese person controls, Chinese companies can lure talent away from Dutch and Japanese companies to aid in their advancement. Without a catch-all control, the rule will not keep up with an evolution in the tools used for advanced node manufacturing. And without restrictions on re-exportation, Chinese companies can find ways to obtain foreign tools and technology via third countries. In addition, Chinese indigenous equipment makers can today freely obtain critical sub-systems and components from firms in Asia and Europe that can be integrated into indigenous semiconductor manufacturing equipment – all outside the purview of the U.S. export control system.

The Administration also erred in issuing the October 7 action as an interim final rule instead of a proposed rule. This deprived U.S. companies, with their deeper understanding of supply chains, a chance to opine on the rule before it went into effect. It was also unnecessary since Commerce had already imposed licensing requirements on tools and integrated circuits through "is

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[6] Bureau of Industry and Security Interim Final Rule, "Implementation of Additional Export Controls: Certain Advanced Computing and Semiconductor Manufacturing Items; Supercomputer and Semiconductor End Use; Entity List Modification", Oct. 7, 2022.

[7] See, e.g., Financial Times, "US export curbs will have 'limited' impact, chip tool supplier ASML says", Oct. 19, 2022, available at: https://www.ft.com/content/4e5687df-737a-4d62-bb53-b3f316f52e2c; Bloomberg Law, "Chip Industry Braces for 'Heavy Blow' From China Export Curbs", Oct. 12, 2022, available at: https://news.bloomberglaw.com/international-trade/applied-materials-cuts-forecast-blaming-china-export-curbs-1; Reuters, "Lam Research warns of up to $2.5 bln revenue hit from U.S. curbs on China exports", Oct. 19, 2022, available at: https://www.reuters.com/technology/lam-research-warns-up-25-bln-revenue-hit-us-curbs-china-exports-2022-10-19/.

informed" letters.[8] Finally, this decision defies the Export Control Reform Act, which requires BIS to "include a notice and comment period" before publishing unilateral controls.[9]

Due to this unforced error, there were widespread and unnecessary disruptions in production, fraying the already strained semiconductor supply chain. In response, the Administration backpedaled through "interpretations" and "waivers" for certain companies. It was also forced to fine-tune parts of the rule to prevent multinational companies from shutting down manufacturing operations – the ramifications of which would have been felt by downstream consumers.

Moving forward, Congress should pressure the Administration to follow ECRA's clear guidance about coordination with allies and the importance of public comments on export control rules. Rule of law and due process begets predictability and stability, which are hallmarks of the U.S. legal system, and that will ultimately help U.S. businesses and U.S. allies.

Part II: Multilateral Coordination

Multilateral coordination is critical to ensure that U.S. measures on China are effective and do not unduly harm U.S. economic competitiveness. The United States should use all available avenues to facilitate such coordination, including bilateral discussions and multilateral fora. Among the multilateral fora, the G7 is likely the best suited to advance U.S. goals. By contrast, the G20's ability to achieve effective coordination appears limited due to its membership, although the United States should use the G20 to pressure China directly on select issues.

The United States should also be active at the World Bank and International Monetary Fund (IMF) to pressure China to follow through on its lofty rhetoric about being a responsible international stakeholder and defender of the multilateral system. More specifically, the United States should push to change China's status as one of the top recipients of World Bank loans. The United States should also work with allies to prevent China from blocking important reform packages at the IMF through an unwillingness to restructure developing country debt.

G7/G20

The G7 provides a useful forum to work with U.S. allies to coordinate policy on China. Many key U.S. allies are present, including those best positioned to provide financial flows, technology, and know-how to China. The G7's year-round meeting schedule also offers frequent opportunities for engagement on key issues. And in recent years, the G7 has a track record of success, including on geopolitical crises like Ukraine.

Recent G7 actions and statements illustrate progress on aligning approaches on China. For example, the G7's recently enhanced Investment Screening Expert Group helps coordinate on policy approaches in this area.[10] Likewise, the 2022 communique highlights "China's non-

[8] See, e.g., Reuters, "Biden to hit China with broader curbs on U.S. chip and tool exports", Sept. 15, 2022, available at: https://www.reuters.com/business/exclusive-biden-hit-china-with-broader-curbs-us-chip-tool-exports-sources-2022-09-11/.

[9] ECRA, 50 U.S.C. § 4817(a)(2)(C).

[10] White House, "Carbis Bay G7 Summit Communiqué", Jun. 13, 2021", available at https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/13/carbis-bay-g7-summit-communique/.

transparent and market-distorting interventions and other forms of economic and industrial directives" and pledges to "work together to develop coordinated action to ensure a level playing field for our businesses and workers, to foster diversification and resilience to economic coercion, and to reduce strategic dependencies."[11] Japan's G7 host year is likely to offer new opportunities, including collectively developing "effective responses to economic coercion".[12]

To maximize the G7, the United States should push members to build on these statements and turn pledges into tangible action. Two areas of focus should be outbound investment screening and export control coordination. Indeed, with respect to broadening export controls on China, this forum may be more useful than the Wassenaar Arrangement, which has bogged down in recent years. The United States should also consider proposing an expansion of the membership to include other key allies on a permanent basis, such as Australia and Korea, and to invite others on a select basis, such as Taiwan, for export control discussions.

The G20 has recently been less effective than the G7 and the United States needs to be realistic about how much it can achieve through this forum. Although the G20 was essential in managing the 2008 financial crisis, it has since lost its unifying issue and struggled to develop a coherent agenda in light of its diverse range of members with a diverse range of priorities, including China and Russia. The United States should not disengage from this forum entirely since regular engagement with these countries on international economic issues still has some utility. Further, the United States can use G20 meetings to put China on the defensive by pushing issues such as the need for more transparent infrastructure financing and debt restructuring for poorer nations.

World Bank

At the World Bank, the United States should push to substantially limit the loans provided to China. Despite a slight decrease in its position, China remains one of the top five recipients of World Bank loans, with $16 billion currently outstanding.[13] Some of the World Bank's loans to China may serve good purposes, but it is hard to reconcile how a country with China's track record as the world's leading bilateral lender continues to be a major World Bank borrower, preventing other countries in greater need from receiving loans instead.

China's Belt and Road Initiative and its creation of the Asian Infrastructure Investment Bank (AIIB) only serve to underscore the absurdity of the situation. Indeed, recent reports suggest that China's loans to middle and lower-income countries exceed $170 billion and are probably much higher.[14] As a result, there are now more than 40 low and middle-income countries whose debt

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[11] G7 Germany, "G7 Leaders' Communiqué", Jun. 2, 2022, available at: https://www.g7germany.de/resource/blob/974430/2062292/9c213e6b4b36ed1bd687e82480040399/2022-07-14-leaders-communique-data.pdf?download=1.

[12] TIME, "As G7 Head, Japan Wants Member Countries to Team Up Against China's 'Economic Coercion'", Jan. 3, 2023, available at: https://time.com/6245021/japan-g7-economic-coercion-china/.

[13] World Bank, "IBRD Country-wise Loan summary", Jan. 8, 2023, available at: https://finances.worldbank.org/Loans-and-Credits/IBRD-Country-wise-Loan-summary/5xqk-t59j.

[14] Kai Wang, "China: Is it burdening poor countries with unsustainable debt?", Jan 6. 2022, available at: https://www.bbc.com/news/59585507.

exposure to Chinese lenders exceeds 10 percent of their annual economic output (GDP), with Djibouti, Laos, Zambia, and Kyrgyzstan holding debts to China equivalent to at least 20 percent.

Despite the clear policy imperative to curtail Chinese World Bank loans, it is important to recognize that achieving this objective will be difficult. The United States has the largest World Bank voting power but cannot make unilateral changes to the institution's practices. International Bank of Reconstruction and Development (IBRD) graduation is based on the "[b]orrowing countries' decision to graduate from IBRD" and "involves a dialogue between the country and the bank".[15] It also takes place on "a case-by-case basis reflecting country context", which disregards the fact that China has long surpassed the graduation discussion threshold. Thus, the United States can and should continue to object to China receiving loans, but it is unlikely to yield immediate changes.

The United States could seek broader reforms to the rules to address the China situation, but this could also pose risks to the United States. In particular, if the United States pushes for reforms that would prohibit China from receiving loans, it should also expect China and others to push for reforms that could disadvantage U.S. interests, such as more voting power for themselves.[16]

In light of this situation, the United States should continue to work with allies to publicly pressure China to reduce or abandon its World Bank loans, but recognize that actually changing this practice will take time. The Trump Administration made incremental progress and in 2019 was able to persuade the World Bank to reduce China's loans, converting China from a net borrower to a net lender within the institution.[17] More progress is needed, and this Committee could consider working with Administration to devise a broader reform package that includes provisions to wean China off of World Bank loans once and for all, paired with other reforms that might draw support from a broader range of members to minimize any negative trade-offs.

International Monetary Fund (IMF)

At the IMF, the United States should also seek to change the way China does business. In particular, the United States should work with allies to pressure China to restructure faulty loans for countries where it has provided significant amounts of lending, putting China on the spot to finally become the responsible international stakeholder it claims that it wants to be.

As just discussed, China is a major lender to several developing nations in significant need of debt relief. One role of the IMF is to provide such relief in exchange for important economic

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[15] World Bank Group, "Sustainable Financing for Sustainable Development: World Bank Group Capital Package Proposal," April 2018.

[16] Victor Shih, "How China Would Like to Reshape International Economic Institutions", Atlantic Council, Oct. 17, 2022, available at: https://www.atlanticcouncil.org/in-depth-research-reports/report/how-china-would-like-to-reshape-international-economic-institutions/.

[17] World Bank, "New Country Partnership Framework for China Reduces Lending and Focuses on Global Public Goods and Institutional Challenges", Dec. 5, 2019, available at: https://www.worldbank.org/en/news/press-release/2019/12/05/new-country-partnership-framework-for-china-reduces-lending-and-focuses-on-global-public-goods-and-institutional-challenges.

reforms within the country. Oftentimes, however, China is the main obstacle to providing such relief, which prevents the necessary restructuring from occurring.

There are numerous examples in just the last few weeks of China's lack of cooperation in restructuring loans for needy countries. This has been a major highlight of Secretary Yellen's recent trip to Africa, where she criticized China for its refusal to provide debt relief for Zambia.[18] Similar situations appear to be unfolding in Chad, Ethiopia, and Sri Lanka, despite China previously agreeing through the G20 that it would assume its share of the burden in helping restructure debt.[19]

There is no easy solution here either, although Congress should partner with the Administration and ramp up the pressure on China to hold it accountable for its promises. Indeed, the United States should loudly and clearly declare that this is an opportunity for China to demonstrate that it will be a responsible international stakeholder, or it will be called it out for its hypocrisy.

Other International Bodies

Despite these concerns about how China has been operating in multilateral institutions, we should not go so far as to attempt to reject China from these institutions outright. China's economy and lending to other countries are too large to be ignored, and there are no good alternatives to the existing international economic framework. Therefore, we must continue to do the best we can working with allies in these institutions to hold China to account.

Additionally, we should be careful about prohibiting Chinese entities from other global institutions, such as standard-setting bodies. Along these lines, there have been calls to reject Chinese participation from the body that develops specifications and standards to promote secure, global interoperability of payments.[20] It is in the interest of U.S. businesses and consumers that these bodies have global participation to maintain a secure global payments system and to pressure the Chinese government and Chinese actors to adopt global standards.

Part III: Offensive Measures

Enacting "defensive measures" is a necessary part of a successful strategy to counter China, but it is not sufficient. At the same time as the United States is cutting off capital and technology, we must also be creating new opportunities for U.S. companies affected by these measures.

One reason this type of "offensive" strategy is so important is that sales into the Chinese market are a vital source of revenue for many leading U.S. technology companies.[21] Limiting those

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[18] Hans Nichols, "China's first African debt rodeo is playing out in Zambia", Jan. 31, 2023, available at: https://www.axios.com/2023/01/26/china-zambia-africa-debt-restructuring.

[19] Bloomberg, "China's Premier Vows to Work With G-20 on Debt Restructuring", Dec. 8, 2022, available at: https://www.bloomberg.com/news/articles/2022-12-08/china-s-premier-li-vows-to-work-with-g-20-on-debt-restructuring.

[20] E.g., the Merchants Payments Coalition.

[21] See, e.g., Market Watch, "Apple, Nike and 18 other U.S. companies have $158 billion at stake in China trade war", Apr. 4, 2018, available at: https://www.marketwatch.com/story/trade-war-watch-these-are-the-us-companies-with-the-most-at-stake-in-china-2018-03-29.

sales through export controls and other restrictive measures will substantially reduce the revenue available to fund groundbreaking R&D. Therefore, we must help our companies find new markets to make up for lost revenue, allowing them to maintain their position as global innovation leaders ahead of their Chinese competitors. One way to do this is to pursue market access trade agreements that cut down barriers to U.S. exports in third-country markets.

Comprehensive, market access trade agreements are also critical to achieving our supply chain objectives, including reducing our reliance on China for critical goods. In particular, if we want companies to move supply chains out of China, we need to provide them with meaningful incentives to relocate. This is all the more pressing in light of China's aggressive pursuit of trade deals around the world that aim to lower the cost of integrating supply chains with China. If we are serious about resolving our supply chain issues, we need a serious trade policy to match.

The U.S. Export-Import Bank (EXIM) and U.S. Development Finance Corporation (DFC) should also be considered as a part of an offensive strategy. EXIM includes tools that can help U.S. companies access additional markets while the DFC has tools that can assist with a "friend-shoring" strategy by helping to finance trade infrastructure in key third markets.

Trade Agreements

High-standard trade agreements are a vital part of any strategy to counter China. They can help our companies make up lost revenue with new markets, make it easier for companies and countries to link their supply chains with the United States, and help demonstrate to the world that we have a coherent, comprehensive international economic strategy to counter China.

Recent U.S. trade agreements also include numerous provisions that liberalize financial services markets and facilitate a level playing field for U.S. financial institutions. For example, some of the key features of the United States – Mexico – Canada Agreement (USMCA) include:

- Obligations to prevent discrimination against U.S. financial service suppliers and prohibit restrictions that would limit their business;
- Prohibitions on local data storage requirements in the financial services sector;
- Provisions to allow for the cross-border transfer of data;
- Robust transparency provisions to ensure good regulatory practices in licensing and other market access authorizations; and
- Policy and transparency commitments on currency.[22]

[22] United States–Mexico–Canada Agreement ("USMCA"), "Macroeconomic Policies and Exchange Rate Matters", available at: https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/33_Macroeconomic_Policies_and_Exchange_Rate_Matters.pdf; Office of the United States Trade Representative, "UNITED STATES–MEXICO–CANADA TRADE FACT SHEET Modernizing NAFTA into a 21st Century Trade Agreement", available at: https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/fact-sheets/modernizing.

USMCA was a major success, but it was a revision to the North America Free Trade Agreement (NAFTA), not a new trade agreement that yielded new partners. In fact, the United States has not acquired a single new trade agreement partner in the last 10 years.

By contrast, China is collecting new trade partners around the world. Just last year, the Regional Comprehensive Economic Partnership (RCEP), a 15-nation China-led Indo-Pacific pact, entered into effect.[23] This agreement – the world's largest – cuts tariffs and harmonizes standards between China and its 14 other countries, including Australia, Indonesia, Japan, Korea, Malaysia, New Zealand, Thailand, and Vietnam, among others. RCEP raises serious concerns, but it is hardly an outlier. Since the last new U.S. deal in 2012, China has also inked separate deals with Iceland, Switzerland, the ASEAN countries, Georgia, Pakistan, and Mauritius.[24] To add insult to injury, China is now attempting to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the successor agreement to the Trans-Pacific Partnership (TPP).

This situation is entirely unacceptable. The Biden Administration appears to recognize that China is dominating the United States on trade and is pursuing the Indo-Pacific Economic Framework (IPEF). Unfortunately, IPEF lacks many of the most important features of traditional trade deals, including the market access provisions that are critical to change the supply chain cost calculus for companies. Moreover, IPEF does not include meaningful proposals on financial services, among many other sectors left behind.

To address this problem, the Financial Services Committee should work closely with Ways & Means to pressure the Biden Administration to adopt a real trade strategy. Restarting negotiations with the United Kingdom, which also has a strong financial services sector, and Kenya should be no-brainers. Beyond that, we need to be bold if we want to provide a meaningful supply chain alternative to China. In particular, Congress should push the Administration to pursue an agreement with Taiwan and renegotiate the CPTPP.

Taiwan is a particularly attractive trading partner for economic and geopolitical reasons. Our farmers are seeking additional market access,[25] and there are significant benefits to more closely linking supply chains with Taiwan in high-tech goods like semiconductors.[26] Further, nearly 50 percent of Taiwan's trade is with China, which provides the CCP with an undue ability to exert

[23] Regional Comprehensive Economic Partnership ("RCEP"), Nov. 15, 2020, available at: https://rcepsec.org/wp-content/uploads/2020/11/All-Chapters.pdf.

[24] Clete Willems, "TTC, IPEF, and the road to an Indo-Pacific trade deal: A new model", Sept. 27, 2022, available at: https://www.atlanticcouncil.org/in-depth-research-reports/issue-brief/ttc-ipef-and-the-road-to-an-indo-pacific-trade-deal-a-new-model/.

[25] Russell Boening, Testimony before the House Ways & Means Committee, Sept. 14, 2022, available at: https://docs.house.gov/meetings/WM/WM00/20220914/115098/HHRG-117-WM00-Bio-BoeningR-20220914.pdf.

[26] See e.g., Center for Strategic and International Studies, "Why Taiwan Matters - From an Economic Perspective", Oct. 12, 2022, available at: https://www.csis.org/analysis/why-taiwan-matters-economic-perspective; Mark Wu, Testimony before the House Ways & Means Committee, Sept. 14, 2022, available at: https://docs.house.gov/meetings/WM/WM00/20220914/115098/HHRG-117-WM00-Wstate-WuM-20220914.pdf.

economic coercion on the island.[27] A U.S. trade agreement with Taiwan would reduce this vulnerability and signal to other countries that they should expand trade with Taiwan as well.[28]

Moreover, the United States should seek to rejoin CPTPP, subject to renegotiating the agreement to improve it and address U.S. concerns. This could provide an immediate economic boost to U.S. companies by removing thousands of tariff and non-tariff barriers in the fastest-growing region in the world. It would also provide a platform to promote U.S. interests and values in China's backyard. The CPTPP has flaws, such as automotive rules of origin and labor and environmental standards that fall short of the USMCA. But rather than walk away from the agreement, we should seek to improve it in the same way that USMCA improved upon NAFTA.

To try to craft a viable path back to CPTPP, I have spent the past year consulting with a broad bipartisan group of experts to determine what changes would be necessary to ensure the agreement supports U.S. economic and national security interests. The outcome of those consultations is a report entitled *Reimagining the TPP: Revisions That Could Facilitate U.S. Reentry* that I co-authored with Wendy Cutler of the Asia Society.[29] Our report outlines changes to CPTPP to modernize and improve the agreement so it can provide a meaningful alternative to China in the Indo-Pacific. I strongly urge Congress to pressure the Administration on a real trade policy, including a renegotiated CPTPP.

EXIM and DFC

As part of its offensive strategy, the United States should also aggressively use the tools available at EXIM and DFC to facilitate U.S. exports and U.S. participation in infrastructure projects abroad. Such projects will help open up new markets, while also creating additional trade infrastructure to support friend-shoring of critical supply chains and help wean countries off of less secure Chinese technology.

This role for EXIM and DFC is important, especially in light of China's expansive use of its two official export credit agencies, along with a number of other state entities such as state-owned banks, enterprises, and investment funds to expand its influence and gain competitive advantages globally. From 2015 to 2019, China's official Medium- and Long-Term (MLT) export credit activity alone was greater than 90 percent of that provided by all G7 countries combined.[30]

The most recent authorizations of EXIM and DFC were major steps forward in promoting a more strategic role for these agencies in countering China. The 2019 EXIM reauthorization established a "Program on China and Transformational Exports" that charges EXIM to reserve

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[27] Congressional Research Service, "U.S.-Taiwan Trade Relations", Mar. 7 2022, available at: http://sgp.fas.org/crs/row/IF10256.pdf.

[28] POLITICO, "Taiwan sees U.S. trade deal as vital to maintaining its democracy", July. 4, 2022, available at: https://www.politico.com/news/2022/07/04/taiwan-sees-u-s-trade-deal-as-vital-00043556.

[29] Clete Willems & Wendy Cutler, "Reimagining the TPP: Revisions That Could Facilitate U.S. Reentry", Dec. 12, 2022, available at: https://asiasociety.org/sites/default/files/2022-12/ASPI_CPTPP3_rev.pdf.

[30] Export-Import Bank of the United States ("EXIM"), "EXIM Debuts 2019 Competitiveness Report, Finds that China's Predatory Practices are Fundamentally Changing Nature of Export Credit Competition", Jun. 30, 2020, available at: https://www.exim.gov/news/exim-debuts-2019-competitiveness-report-finds-chinas-predatory-practices-are-fundamentally.

not less than 20 percent of the agency's total financing authority to directly neutralize China's export subsidies for competing Chinese goods and services.[31] This program focuses on 10 transformational export industries, including 5G, artificial intelligence, and semiconductors, by relaxing overly burdensome requirements that have made it difficult for EXIM to counter China in the past. EXIM recently took a major step forward in promoting U.S. 5G exports abroad by clarifying its rules under this program.[32]

The BUILD Act was also a major achievement in improving DFC's ability to counter China by modernizing its tools, expanding the capital available for investments abroad, and providing a strategic vision.[33] However, DFC's effectiveness has been hampered in a few ways, including a decision by the Office of Management and Budget (OMB) to limit the capital available for equity investments.[34] Congress should act to ensure that DFC can counter China with all available tools, including equity, and should also consider whether some version of the Transformational Exports program tailored for DFC tools could help cut through DFC red tape in strategic areas.

Part IV: Bilateral Engagement

Any winning China strategy requires bilateral engagement. This is important to prevent the kinds of miscommunication and miscalculation that can lead to conflict and to strengthen our economy by seeking opportunities in the second-largest economy in the world. China is the top export market for U.S. agriculture products and has massive, untapped potential in energy and financial services, among other sectors.[35] In this context, it is worth noting that many financial services firms cannot do business on a cross-border basis due to prudential requirements and thus have a need to be in the Chinese market to compete in China and to remain competitive globally. Accordingly, the United States needs to engage with China directly to ensure these companies are being treated fairly and able to access over one billion potential customers.

As we engage bilaterally, we should be careful to avoid falling back into old habits of engaging in mere "process" dialogues, like those of the mid-2010s that had limited effectiveness.[36] But we

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[31] Further Consolidated Appropriations Act 2020, P.L. 116-94, 116th Congress, Dec. 20, 2019; EXIM, "EXIM's Chairman's Council on China Competition Meets to Discuss Implementation of Program on China and Transformational Exports", May. 20, 2021, available at: https://www.exim.gov/news/readout-exims-chairmans-council-china-competition-meets-discuss-implementation-program-china.

[32] "Export-Import Bank of the United States' Board of Directors Approves Clarified Policy for 5G Transactions", Jan. 20, 2023, available at: https://www.exim.gov/news/export-import-bank-united-states-board-directors-approves-clarified-policy-for-5g.

[33] Better Utilization of Investments Leading to Development Act of 201 ("BUILD"), P.L. 115-254, 115th Congress, Oct. 5, 2018.

[34] See, e.g., Center for Global Development, "Current Budget Rules Stand in the Way of a Reasonable Path for US DFC to Realize Ambition on Climate and Pandemic Response", Apr. 19, 2021, available at: https://www.cgdev.org/blog/current-budget-rules-stand-way-reasonable-path-us-dfc-realize-ambition-climate-and-pandemic.

[35] See, e.g., U.S. Department of Agriculture, "Record U.S. FY 2022 Agricultural Exports to China", Jan. 6, 2023, available at: https://www.fas.usda.gov/data/record-us-fy-2022-agricultural-exports-china; Council on Foreign Relations, "The Contentious U.S.-China Trade Relationship", Dec. 2, 2022, available at: https://www.cfr.org/backgrounder/contentious-us-china-trade-relationship.

[36] This includes the U.S. – China Strategic and Economic Dialogue (S&ED) and the U.S. – China Joint Commission on Commerce and Trade (JCCT).

can and should engage China in a clear-eyed fashion to achieve market access for U.S. goods and services and to hold China accountable for unfair behavior.

Enforcing the Phase One Deal

One mechanism that the United States should use to engage bilaterally with China is the *Economic and Trade Agreement Between the United States of America and the Government of the People's Republic of China*, also known as the "Phase One Deal".[37] This agreement included a robust chapter on Financial Services that addressed barriers that had plagued U.S. financial firms for years, including commitments from China to:

- Eliminate foreign equity caps for U.S. securities companies and ensure that U.S. suppliers can access China's market on a non-discriminatory basis;

- Eliminate foreign equity caps for U.S. suppliers of life, health, and pension insurance services, remove discriminatory requirements for market access, and approve licenses;

- Improve the licensing process for U.S. suppliers of electronic payment services so as to facilitate access to China's market in a timely fashion;

- Eliminate foreign equity caps for U.S. fund management companies, ensuring market access on a non-discriminatory basis, including in regard to the review and approval of qualified license applications;

- Expand opportunities for U.S. financial institutions, including bank branches, to supply securities investment fund custody services;

- Remove barriers facing U.S. suppliers of credit rating services, including approving applications for service and majority ownership, as well as allowing these suppliers to expand their rating activities;

- Eliminate foreign equity caps for U.S. futures companies and ensure non-discriminatory treatment; and

- Expand the services provided by U.S. financial services suppliers with expertise in handling distressed debt.[38]

Unfortunately, it has been very difficult to determine China's Phase One implementation track record to date. There have been at least some periodic reports that indicate China is following

[37] Economic And Trade Agreement Between The Government Of The United States Of America And The Government Of The People's Republic Of China ("Phase One Deal"), Jan. 15, 2020, available at: https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf.

[38] Economic And Trade Agreement Between The Government Of The United States Of America And The Government Of The People's Republic Of China ("Phase One Deal"), Jan. 15, 2020, available at: https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf.

through in certain areas,[39] but the Office of the U.S. Trade Representative (USTR) has not provided Congress or the public with a thorough accounting of China's progress in implementing the agreement, including the Financial Services chapter.

In light of this situation, this Committee should work with Ways & Means to pass legislation requiring USTR to provide a Phase One report card and demand that USTR enforce the agreement in areas where China is falling short. This will help ensure that the U.S. financial services sector can expand in China, underpinning its overall strength. Deal follow through is also essential to building trust, a necessary precursor to any future U.S. – China bilateral economic agenda. If China is unwilling to follow through on the deal we already have and the United States is unwilling to hold China accountable, it is difficult to see meaningful value in a broader set of commitments.

The Holding Foreign Companies Accountable Act (HFCAA)

A second area where the United States should continue to engage China bilaterally – and where this Committee can play an important oversight role – is on the implementation of the Holding Foreign Companies Accountable Act (HFCAA).[40] The Public Company Accounting Oversight Board's (PCAOB) announcement on December 15, 2022, that it had for the first time secured the ability to inspect and investigate firms in mainland China and Hong Kong completely was a major achievement.[41] And it almost certainly would not have happened without Congress' intervention, which sent a powerful signal to China that it could no longer play by its own set of rules without consequence.

Congress should be mindful of this lesson moving forward and continue its rigorous oversight of the law. In particular, Congress should ensure that U.S. regulators remain vigilant and routinely check their access to Chinese firms, dispelling any concerns that this was a one-time act by the Chinese government to avoid mass de-listings. Recent Congressional passage of the Accelerating HFCAA was a step in the right direction.[42] Consistent with this law, we should do

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[39] See, e.g., CNBC, "U.S. financial firms like Citi and BlackRock make inroads into the Chinese market", Sept. 2, 2020, available at: https://www.cnbc.com/2020/09/02/us-financial-firms-make-inroads-into-the-chinese-market.html; Nikkei Asia, "China steps up approvals for foreign financial companies", Jan. 25, 2023, available at: https://asia.nikkei.com/Business/Finance/China-steps-up-approvals-for-foreign-financial-companies?utm_campaign=Marketing_Cloud&utm_medium=email&utm_source=USCBC+News+Overview+1.25.23&%20utm_content=https%3a%2f%2fasia.nikkei.com%2fBusiness%2fFinance%2fChina-steps-up-approvals-for-foreign-financial-companies.

[40] Holding Foreign Companies Accountable Act ("HFCAA"), P.L. 116-22, 116th Congress, Dec. 18, 2020.

[41] Public Company Accounting Oversight Board ("PCAOB"), "PCAOB Signs Agreement with Chinese Authorities, Taking First Step Toward Complete Access for PCAOB to Select, Inspect and Investigate in China", Aug. 26, 2022, available at: https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-signs-agreement-with-chinese-authorities-taking-first-step-toward-complete-access-for-pcaob-to-select-inspect-and-investigate-in-china; PCAOB, "PCAOB Secures Complete Access to Inspect, Investigate Chinese Firms for First Time in History", Dec. 15, 2022, available at: https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-secures-complete-access-to-inspect-investigate-chinese-firms-for-first-time-in-history.

[42] Accelerating Holding Foreign Companies Accountable Act, S. 2184, 117th Congress, as passed by the Senate, Jun. 22, 2021.

everything we can to ensure our markets remain the most attractive place in the world to raise capital, and one way to do this is to protect their sanctity.

Conclusion

I appreciate the opportunity to detail these ideas for the Committee and hope they can help provide a bipartisan roadmap for addressing the challenge posed by the Chinese Communist Party. I look forward to continuing to work with members of the Committee of both parties on these critical issues.