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OUTCOMPETING BEIJING: A ROADMAP FOR MEETING CHINA'S COMMERCIAL CHALLENGES

By Clark Packard

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INTRODUCTION

The relationship between the United States and China is one of the most important geopolitical relationships in the world—and will be for the foreseeable future. How Washington and Beijing manage their relationship will have far-ranging consequences for global peace, prosperity and stability for decades to come.

With a global pandemic ravaging the world on the heels of a temporary détente in a protracted and intense trade war, the relationship between Washington and Beijing is souring. The media, politicians and pundits now routinely refer to the deteriorating relationship between the United States and China as a new "cold war."[1] However, the analogy is flawed. The United States and the Soviet Union were never economically integrated the way the United States and China are today, which makes the Washington-Beijing relationship much more complicated and challenging to manage.[2] Though the United States' and China's economic integration began in the 1970s, Beijing's place in the rules-based economic system was guaranteed by its admission into the World Trade Organization (WTO). Much of the current discourse today revolves around Beijing's membership in the WTO, which ostensibly prevents the United States from discriminating against Chinese trade and investment.

One of the bedrock principles that governs international trade is the most-favored-nation (MFN) status. With some exceptions, such as bilateral or regional free trade agreements, MFN status requires WTO members to treat other WTO members equally when applying tariffs or other trade barriers to their goods. When Beijing began negotiations

1. See, e.g., Rick Gladstone, "How the Cold War Between China and U.S. Is Intensifying," *The New York Times*, July 22, 2020. https://www.nytimes.com/2020/07/22/world/asia/us-china-cold-war.html; Rick Scott, "Communist China's Mission for Global Domination is the New Cold War," The Hudson Institute: The China Challenge: A Conversation with Senator Rick Scott, Feb. 28, 2020. https://www.rickscott.senate.gov/sen-rick-scott-hudson-institute-communist-chinas-mission-global-domination-new-cold-war; Robin Wright, "Why Trump Will Never Win His New Cold War With China," *The New Yorker*, July 29, 2020. https://www.newyorker.com/news/our-columnists/why-trump-will-never-win-his-new-cold-war-with-china.

2. Richard Fontaine and Ely Ratner, "The U.S.-China confrontation is not another Cold War. It's something new," *The Washington Post*, July 2, 2020. https://www.washingtonpost.com/opinions/2020/07/02/us-china-confrontation-is-not-another-cold-war-its-something-new.

to join the WTO, U.S. law prohibited permanently granting communist countries like China MFN. However, after a lengthy negotiation between Washington and Beijing, and a vigorous debate in Congress, President Clinton signed legislation granting China permanent normal trade relations (PNTR) in October 2000.[3] A year later, China formally joined the WTO.[4] Though increasingly controversial today, the decision to grant China PNTR and welcome Beijing into the WTO enjoyed wide bipartisan support in Congress at the time—and was broadly supported by foreign policy analysts and the U.S. business and agricultural communities.[5]

Today, critics contend that rather than moving China in a democratic, capitalist direction, admitting Beijing into the WTO simply empowered a brutal regime and decimated U.S. manufacturing through a surge of imports.[6] Yet policies must be judged by the calculus facing lawmakers at the time the decision was made, not based on information available to policymakers nearly two decades *ex post*. Under that framework, the decision to admit China into the WTO was the right one at the time.[7] Likewise, even with the benefit of hindsight, the decision still makes sense today even if some of the more Panglossian predictions about the nature of the government in Beijing did not come to fruition.[8]

To be sure, all is not well with the U.S.-China relationship. From the trade war and investment restrictions to tensions over Hong Kong, Taiwan and the treatment of Uighur Muslims, the Biden administration inherited an increasingly toxic relationship with Beijing.[9] Opportunities to de-escalate the tensions exist, but it will be a fraught task. This paper will briefly detail the recent history of the U.S.-China commercial relationship, diagnose the current problems, explain the failures of the current approach and provide policymakers with concrete policy ideas to outcompete China in the 21st century.

HISTORY

To understand the current economic clash between Washington and Beijing, it is imperative to understand a brief post-World War II history of Sino-American relations, though a full accounting is beyond the scope of this paper.

Between the establishment of the People's Republic of China in 1949 and the early 1970s, the United States and China had little interaction, including virtually no international trade or investment.[10] After Secretary of State Henry Kissinger's secret visit to Beijing in 1971 and President Richard Nixon's subsequent trip in 1972, relations between the United States and China began to thaw.[11] These meetings would eventually lead to the normalization of diplomatic and economic relations between the two countries as the United States sought a new ally in its Cold War with the Soviet Union.

In the late 1970s, China made internal reforms to its economic model that continue to have a profound impact on the global economy. As one economist notes in his comprehensive history of U.S. trade policy:

> In the 1970s, China was one of the poorest countries in the world…and it had virtually no presence in world markets. In 1978, China's premier, Deng Xioping, began to open what had been a closed economy, moving it away from rigid state control and central planning toward a market-oriented system with limited private enterprise. Agricultural collectives were phased out, and private farming was introduced; the state monopoly on foreign trade was abolished; foreign investment was gradually permitted; and trade barriers were reduced in stages.
>
> These policy reforms led to a dramatic acceleration in China's economic growth and sparked a rapid expansion in its foreign trade…Within two decades, China made an enormous impact on world markets and trade flows. China's share of world exports rose from miniscule proportions in 1980 to 5 percent in 2000, reaching 12 percent in 2014.[12]

Indeed, Beijing's own internal reforms are much more important to its status today as an economic superpower than Washington's decision to grant China PNTR—or the rest of the world's decision to admit the country into the WTO. In many ways, the "main explanation for the rapid growth in imports from China in the 1990s and 2000s was the large size and rapid growth of the Chinese economy."[13]

3. Bob Davis and Lingling Wei, *Superpower Showdown: How the Battle Between Trump and Xi Threatens a New Cold War* (HarperCollins, 2020), p. 94.

4. Douglas A. Irwin, *Clashing Over Commerce: A History of US Trade Policy* (University of Chicago Press, 2017), p. 666.

5. Ibid; Davis and Wei, pp. 53-97.

6. See, e.g., Josh Hawley, "The WTO Should Be Abolished," *The New York Times*, May 5, 2020. https://www.nytimes.com/2020/05/05/opinion/hawley-abolish-wto-china.html; W. Bradford Wilcox and Samuel Hammond, "What Tucker Carlson Gets Right," *The Atlantic*, Jan. 9, 2019. https://www.theatlantic.com/ideas/archive/2019/01/tucker-carlson-was-right-about-working-class-family/579754.

7. Philip Levy, "Was Letting China Into the WTO a Mistake?", *Foreign Affairs*, April 2, 2018. https://www.foreignaffairs.com/articles/china/2018-04-02/was-letting-china-wto-mistake.

8. Scott Lincicome, "Testing the 'China Shock': Was Normalizing Trade with China a Mistake?", The Cato Institute, July 8, 2020. https://www.cato.org/publications/policy-analysis/testing-china-shock-was-normalizing-trade-china-mistake.

9. Ana Swanson, "Biden's China Policy? A Balancing Act for a Toxic Relationship," *The New York Times*, Nov. 16, 2020. https://www.nytimes.com/2020/11/16/business/economy/biden-china-trade-policy.html.

10. Irwin, p. 663.

11. Ibid.

12. Ibid.

13. Ibid., p. 664.

Under the terms of the Trade Act of 1974, the president has the authority to grant communist countries temporary most-favored-nation (MFN) status on a yearly basis.[14] Congress can vote to disapprove of the president's decision.[15] Between 1980 and 2001, Beijing was granted MFN status every year. During this time, China's MFN status was only in question once "when a presidential veto was needed to sustain it."[16] Even after the massacre at Tiananmen Square, China continued to enjoy MFN status. However, if China had lost its MFN status at any point the consequences would have been significant: "[T]he average tariff on its goods would have risen from 4 percent to 37 percent, and as high as 70 percent on some items."[17]

Beginning in the 1990s, the United States, China and other world powers undertook serious negotiations about Beijing joining the General Agreement on Tariffs and Trade (GATT), which morphed into the WTO in 1995. For Beijing, the stakes were high; membership in the WTO "would banish any remaining fears that China would backslide," to previous eras "where private property was expropriated and businessmen were persecuted."[18] In short, with WTO admission, China would become a more attractive destination for foreign investment. Indeed, between 2001 and 2010, foreign investment in China more than doubled.[19]

As part of the agreement to admit China into the WTO, Beijing agreed to a number of changes, including significant tariff reductions, as well protections for intellectual property, international investment, opening up the services industry to foreign competition and certain quota phaseouts.[20] For example, China's average tariff dropped from 25 percent to 9 percent.[21] This type of market access represented a massive opportunity for businesses hoping to reach the billion-plus potential customers in China. For its part, the United States had to grant China permanent normal trade relations (PNTR)—and stop the practice of giving Beijing temporary MFN status on a yearly basis.

Between Beijing's entry into the WTO and the 2008 financial crisis, China's economy grew at a rapid clip.[22] Imports from China surged into the United States between 2001-2011, known in economic circles as the "China Shock."[23] In the midst of the China Shock, the global economy faced a major financial crisis. At the height of the crisis, Washington and Beijing closely cooperated on the economic response.[24] China agreed not to sell its massive portfolio of U.S. government bonds, which would have spiked interest rates in the United States and driven down the value of the dollar.[25] And both governments agreed to enact large-scale fiscal stimulus measures in response. At the time, there was growing concern about a number of Chinese trade practices, including currency manipulation designed to encourage exports by making them cheaper.

In order to bolster U.S. competitiveness in the Asia-Pacific region and pressure Beijing to raise its commercial standards, the United States and a number of allies began negotiating an ambitious trade pact known as the Trans-Pacific Partnership (TPP). The Obama administration tried to cajole Congress to pass the TPP during the height of the 2016 presidential campaign, but by then it was too late.

After promising to reverse the tide of globalization and alter the trajectory of U.S. trade policy, Donald Trump won the presidency in a close race in 2016. Once in office, he began to make good on his campaign promises. At the heart would be a trade war with China.

PROBLEMS WITH CHINA'S COMMERCIAL PRACTICES

In August 2017, President Trump directed the Office of the United States Trade Representative (USTR) to begin investigating China's trade practices.[26] In his memorandum, the president stated:

> China has implemented laws, policies, and practices and has taken actions related to intellectual property, innovation, and technology that may encourage or require the transfer of American technology and intellectual property to enterprises in China or that may otherwise negatively affect American economic interests. These laws, policies, practices, and actions may inhibit United States exports, deprive United States citizens of fair remuneration for their innovations, divert American jobs to workers in China, contribute to our trade deficit with China, and otherwise

14. Ibid., p. 664.

15. Ibid.

16. Lincicome, p. 10. https://www.cato.org/publications/policy-analysis/testing-china-shock-was-normalizing-trade-china-mistake.

17. Irwin, p. 667.

18. Davis and Wei, p. 65.

19. Ibid., p. 104.

20. Irwin, p. 664.

21. Ibid.

22. Davis and Wei, p. 99.

23. David H. Autor et al., "The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade," *Annual Review of Economics*, 8 (October 2016), pp. 205-240. https://chinashock.info/wp-content/uploads/2016/06/ChinaShockARE.pdf.

24. Davis and Wei, pp. 99-100.

25. Ibid.

26. Donald J. Trump, "Presidential Memorandum for the United States Trade Representative," The Office of the President of the United States, Aug. 14, 2017. https://trumpwhitehouse.archives.gov/presidential-actions/presidential-memorandum-united-states-trade-representative.

undermine American manufacturing, services, and innovation.[27]

Over the course of the next seven months, through oral testimony and written submissions, the USTR compiled a lengthy report pursuant to Section 301 of the Trade Act of 1974 (301 Report).[28] The underlying theme of the 301 Report is that China is using a number of unfair and pernicious methods to acquire American technology in service of Beijing's indigenous industrial policy goals to dominate the commanding heights of 21st century technology. This policy is known as "Made in China 2025," which seeks to lessen significantly the country's dependence on foreign technology.[29]

The core allegations contained in the 301 Report are as follows. First, "the Chinese government uses foreign ownership restrictions…to require or pressure technology transfer from U.S. companies to Chinese entities."[30] For example, the 301 Report highlights requirements that foreign new energy vehicle manufacturers are barred from Chinese markets unless they have a domestic Chinese company as their joint venture partner with foreign ownership capped at 50 percent.[31] Pressure is then exerted on the foreign manufacturers to turn over cutting-edge and core technologies to their Chinese joint venture partner.[32]

Second, Beijing uses opaque and uncertain licensing requirements to discriminate against American firms seeking to operate in China.[33] An example highlighted in the report describes how the Chinese government often requires a foreign firm or company to turn over sensitive technical information to secure approval to operate in the country in addition to other requirements that do not apply to domestic Chinese firms.[34] These practices disadvantage foreign technology importers "relative to Chinese companies and [impose] additional restrictions on the use and enjoyment of technology and intellectual property rights simply because the technology is of foreign origin."[35]

Third, with "pervasive" state support, the "Chinese government directs and unfairly facilitates the systemic investment in, and acquisition of, U.S. companies and assets by Chinese companies."[36] Such investments and acquisitions have explicit economic and military goals.[37] These transactions are often undertaken by China's numerous state-owned enterprises (SOEs) and state-supported banks and investment funds, which are obviously not subject to market discipline.[38]

Fourth, the 301 Report notes that over the last decade, China has engaged in widespread, unauthorized state-sponsored cyber intrusions into U.S. commercial networks.[39] These intrusions have allowed the Chinese government and state-backed firms to steal and access "trade secrets, technical data, negotiating positions, and sensitive and proprietary internal communications."[40] The Report continues: "[In] recent years, cyber theft became one of China's preferred methods of collecting commercial information because of its logistical advantages and plausible deniability."[41] Much of the state-backed cyber intrusions are focused on those American firms operating in markets and industries deemed strategic by the Chinese government, including those with a national security nexus like military modernization.[42] These practices continue despite a 2015 agreement reached between the Obama administration and the Chinese government that:

> neither country's government will conduct or knowingly support cyber-enabled theft of intellectual property, including trade secrets or other confidential business information, with the intent of providing competitive advantages to companies or commercial sectors.[43]

Though not thoroughly covered by the 301 Report, there is an emerging awareness that China's industrial subsidies, partic-

27. Ibid.

28. Office of the United States Trade Representative, "Findings of the Investigation Into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation Under Section 301 of the Trade Act of 1974," Executive Office of the President, March 22, 2018. https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF.

29. James McBride and Andrew Chatzky, "Is 'Made in 2025' a Threat to Global Trade?", Council on Foreign Relations, May 13, 2019. https://www.cfr.org/backgrounder/made-china-2025-threat-global-trade.

30. Office of the United States Trade Representative, p. 19. https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF.

31. Ibid., pp. 29-32.

32. Ibid., p. 32.

33. Ibid., p. 48.

34. Ibid., pp. 41-43.

35. Testimony of Jennifer Hillman, U.S.-China Economic and Review Security Commission, "The Best Way to Address China's Unfair Policies and Practices Is Through a Big, Bold Multilateral Case At The WTO," 115th Congress, June, 2018, p. 4. https://www.uscc.gov/sites/default/files/Hillman%20Testimony%20US%20China%20Comm%20w%20Appendix%20A.pdf.

36. Office of the United States Trade Representative, p. 65. https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF.

37. Ibid., p. 147.

38. Ibid.

39. Ibid., p. 153.

40. Ibid.

41. Ibid.

42. Ibid., p. 168.

43. Office of the Press Secretary, "FACTSHEET: President Xi Jinping's State Visit to the United States," The White House, Sept. 25, 2015. https://obamawhitehouse.archives.gov/the-press-office/2015/09/25/fact-sheet-president-xi-jinpings-state-visit-united-states.

ularly for SOEs and well-connected firms, and the resulting overcapacity issues are a growing problem for market-oriented economies.[44] Likewise, trade lawyers and economists are increasingly bearish about the ability of existing WTO anti-subsidy to adequately discipline China's state-driven capitalist model and its massive use of unique industrial subsidies.[45] Regrettably, Washington and Beijing left out anti-subsidy rules from the Phase One agreement, signed in January 2020.[46]

Taken together, Beijing's unique economic model presents very real challenges for the United States and other market-oriented economies around the world. Even if the Trump administration correctly diagnosed the problem, its proposed remedies have so far failed to induce significant changes to China's economy.

SCORING THE TRADE WAR

Before delving into concrete policy recommendations that may actually change China's troublesome commercial practices, it is important to understand exactly why the Trump administration's aggressive, unilateral trade war has failed.

After the USTR released its Section 301 Report in March 2018, Washington and Beijing began a lengthy back and forth, tit-for-tat of increasing tariffs and retaliation.[47] In January 2020, Washington and Beijing signed a détente colloquially known as the "Phase One" agreement.[48] As part of the Phase One agreement, the two sides agreed to forgo additional tariff reprisals, but the existing tariffs largely remain in place. Likewise, China agreed to purchase large quantities of American products, including about $80 billion worth of agricultural products over the next two years, and make a number of changes to their economic practices.

Even after the truce between Washington and Beijing, tariffs cover about two-thirds of all U.S. imports from China—or about $350 billion worth of imports—and the average tariff is "19.3 percent, as compared to 3.0 percent before the trade war started."[49] The costs of the tariffs have been enormous.

Countless studies have confirmed that Americans, not the Chinese, pay the tariffs.[50] The New York Federal Reserve estimates that the average cost for a typical household is about $830 per year, accounting for direct costs and efficiency losses.[51] Likewise, research shows that American firms lost approximately $1.7 trillion in market capitalization and "investment growth will be reduced by 1.9 percent by the end of 2020" as a result of the trade war with China.[52] Moody's Analytics estimates that the trade war cost 300,000 jobs.[53] Further, researchers estimate that after accounting for the jobs protected from import competition by tariffs, the trade wars—including the Trump administration's "national security tariffs" and the China tariffs—cost more than 175,000 manufacturing jobs through higher production costs and retaliatory tariffs.[54] Indeed, even amidst an otherwise strong economy in 2019, manufacturing slipped into a recession in large part because of the Trump administration's trade war with China.[55]

America's farmers and ranchers also paid a steep price for the trade war with Beijing as retaliatory tariffs cut exports to China and put downward pressure on commodity prices.[56] To manage the fallout of the trade wars, the Trump administration dusted off a New Deal-era program to pay billions of dollars to farmers for lost market access abroad.[57] However,

44. Chad P. Bown and Jennifer A. Hillman, "WTO'ing a Resolution to the China Subsidy Problem," The Peterson Institute for International Economics, October 2019. https://www.piie.com/sites/default/files/documents/wp19-17.pdf.

45. Ibid.

46. David J. Lynch, "Initial U.S.-China trade deal has major hole: Beijing's massive business subsidies," *The Washington Post*, Dec. 31, 2019. https://www.washingtonpost.com/business/economy/initial-us-china-trade-deal-has-major-hole-beijings-massive-business-subsidies/2019/12/30/f4de4d14-22a3-11ea-86f3-3b5019d451db_story.html.

47. Chad P. Bown and Melina Kolb, "Trump's Trade War Timeline: An Up-to-Date Guide," The Peterson Institute for International Economics, updated Sept. 28, 2020. https://www.piie.com/blogs/trade-investment-policy-watch/trump-trade-war-china-date-guide.

48. Office of the United States Trade Representative, "Economic and Trade Agreement Between the United States of America and the People's Republic of China: Phase One," Executive Office of the President, Jan. 15, 2020. https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf.

49. Chad P. Bown, "Phase One China Deal: Steep Tariffs Are the New Normal," The Peterson Institute for International Economics, Dec. 19, 2019. https://www.piie.com/blogs/trade-and-investment-policy-watch/phase-one-china-deal-steep-tariffs-are-new-normal.

50. Jeanna Smialek and Ana Swanson, "American Consumers, Not China, Are Paying for Trump's Tariffs," *The New York Times,* Jan. 6, 2020. https://www.nytimes.com/2020/01/06/business/economy/trade-war-tariffs.html.

51. Mary Amiti et. al., "New China Tariffs Increase Costs to U.S. Households," Federal Reserve Bank of New York, May 23, 2019. https://libertystreeteconomics.newyorkfed.org/2019/05/new-china-tariffs-increase-costs-to-us-households.html?mod=article_inline.

52. Mary Amiti et. al., "The Investment Cost of the U.S.-China Trade War," The Federal Reserve Bank of New York, May 28, 2020. https://libertystreeteconomics.newyorkfed.org/2020/05/the-investment-cost-of-the-us-china-trade-war.html.

53. Rachel Layne, "Trump trade war with China has cost 300,000 jobs, Moody's estimates," CBS News, Sept. 12, 2019. https://www.cbsnews.com/news/trumps-trade-war-squashed-an-estimated-300000-jobs-so-far-moodys-estimates.

54. Lydia Cox and Kadee Russ, "The Trade War Has Cost 175,000 Manufacturing Jobs and Counting," Econbrowser, Sept. 19, 2020. https://econbrowser.com/archives/2020/09/guest-contribution-the-trade-war-has-cost-175000-manufacturing-jobs-and-counting.

55. Heather Long and Andrew Van Dam, "U.S. manufacturing was in a mild recession during 2019, a sore spot for the economy," *The Washington Post*, Jan. 17, 2020. https://www.washingtonpost.com/business/2020/01/17/us-manufacturing-was-mild-recession-during-2019-sore-spot-economy/.

56. Amita Regmi, *Retaliatory Tariffs and U.S. Agriculture*, Congressional Research Service, Sept. 13, 2019, p. 11. https://fas.org/sgp/crs/misc/R45903.pdf.

57. See, e.g., Clark Packard, "The Fallouts of Bailouts," R Street Policy Study No. 176, July 2019. https://www.rstreet.org/wp-content/uploads/2019/07/RSTREET176.pdf; Clark Packard, "U.S.-China Trade War: Farmers Caught in the Crossfire," *R Street Shorts* No. 73, July 2019. https://www.rstreet.org/wp-content/uploads/2019/07/Short-No.-73.pdf.

farm bankruptcies skyrocketed as a result of the trade wars[58] and there is speculation that the financial stress of the trade wars is increasing suicide rates among farmers.[59]

Perhaps all this damage to the American economy might have been justified if it forced China to make market-oriented changes to its economic model, but early indications show that not much has changed. For starters, China is not meeting its purchase commitments:

> Through December 2020, China's total imports of covered products from the United States were $100.0 billion, compared with the target of $173.1 billion. In the first year of the agreement, China's purchases of all covered products only reached 59 percent of their target.[60]

China committed to purchasing target amounts of covered agricultural, manufactured products and energy products, all of which are below prorated targets as of December 2020.[61] For example, about 30 percent of U.S. exports were not covered by the Phase One agreement; of that 30 percent, purchase amounts were "23 percent lower than in 2017," the last year before the trade war began.[62]

Moreover, in its attempt to meet some of the purchase requirements under Phase One, Beijing is relying on state-owned enterprises, which is the opposite of Washington's stated demands that China operate on more market-oriented terms.[63] At the same time, Beijing's forced technology transfer requirements, a major basis of the USTR's complaints about China's economic model, may be getting worse. A recent survey from the U.S.-China Business Council found that 13 percent of the companies surveyed were asked to transfer technology to their Chinese-based joint venture partners—up from 5 percent the previous year.[64]

58. Mike Dorning, "U.S. Farm Bankruptcies Surge 24% on Strain from Trump Trade War," *Bloomberg*, Oct. 30, 2019. https://www.bloomberg.com/news/articles/2019-10-30/u-s-farm-bankruptcies-surge-24-on-strain-from-trump-trade-war.

59. Mary Papenfuss, "Another Possible Toll of Donald Trump's Trade War: Farmer Suicides," *The Huffington Post*, Sept. 8, 2019. https://www.huffpost.com/entry/farm-suicides-rural-trump-trade-war-national-farmers-union_n_5d74a976e4b07521022dcd0c.

60. Chad P. Bown, "US-China phase one tracker: China's purchases of US goods," The Peterson Institute for International Economics, Feb. 8, 2021. https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods.

61. Ibid.

62. Ibid.

63. Chad P. Bown and Mary E. Lovely, "Trump's phase one deal relies on China's state-owned enterprises," The Peterson Institute for International Economics, March 3, 2020. https://www.piie.com/blogs/trade-and-investment-policy-watch/trumps-phase-onedeal-relies-chinas-state-owned-enterprises.

64. "Member Survey," US-China Business Council, 2020, p. 13. https://www.uschina.org/sites/default/files/uscbc_member_survey_2020.pdf.

All told, the Trump administration's unilateral tariffs are causing an enormous amount of economic pain for Americans while early indications suggest that China's economic model has not changed. It simply belies common sense that the way to confront Beijing's legitimately concerning commercial practices is by weakening ourselves with sclerotic protectionism. There is a better way.

RECOMMENDATIONS

Accept Hard Truths

Policymakers in Washington hoping to change China's commercial practices must recognize a few hard truths. First, given the United States' status as an incumbent superpower and China's status as a rising superpower, a certain amount of friction between Washington and Beijing is probably inevitable. As the COVID-19 outbreak has demonstrated, there are serious, transnational problems facing the globe that will require the world's two superpowers to cooperate in order to avoid catastrophe. For example, along with public health, as the world's largest emitters of fossil fuels, the United States and China will need to work together to address climate change. Constant engagement and a flexible posture will be much more effective than erecting a new Iron Curtain and trying to completely isolate China under an outdated Cold War framework. Such a policy would make it impossible to tackle global collective action problems.

Next, patience is required. China has the world's largest population with an extensive bureaucracy. Changing course will take time; it is not a short-term proposition. Likewise, change will largely be driven by Beijing, not Washington. That is not to say that Washington is helpless, but it is important to recognize the limits of economic statecraft. Simply put, there will be no silver bullet to resolve the multidimensional problems that exist in our trade and investment relationship with Beijing.

Finally, reverting to a Cold War posture of complete economic disengagement—"decoupling" the world's two largest economies—would be devastating for two reasons. First, countries with high degrees of economic interdependence tend to fight fewer wars.[65] A war between the United States and China is not imminent, but there are flashpoints that exist, including Taiwan's sovereignty. Cutting off economic ties between the two superpowers could make conflict more likely. Second, China is the world's most populous country and it has a growing middle class. Writing off 1.4 billion people would be a blow for American firms—losing Chinese market access and investment—and families who would see higher prices for a number of products and services or lose

65. Jong-Wha Lee and Ju Hyun Pyun, "Does Trade Integration Contribute to Peace?", *Review of Developmental Economics* 20:1 (2016), pp. 327-344. https://onlinelibrary.wiley.com/doi/abs/10.1111/rode.12222.

access to such products and services entirely. Likewise, by depriving the United States of Chinese talent, it would damage our long-term competitiveness in key sectors. Nevertheless, there are some tools and policies that policymakers can utilize to influence China's commercial behaviors and outcompete Beijing.

Defeat COVID-19 and Jumpstart the Economy

The single most important thing policymakers can do right now is get the pandemic under control, which will jumpstart the economy. As long as COVID-19 is ravaging the country, the economy will remain depressed. To date, more than 500,000 Americans have lost their lives due to COVID-19 and the economic toll has been equally devastating.[66]

While it is a positive sign that vaccines have been developed and recently approved by appropriate regulators, the administration of vaccines has been far too slow. In January 2021, the Council of Economic Advisers estimated that every day the vaccine can be accelerated is worth approximately $10 billion to the U.S. economy.[67] Congress has passed two large relief packages, but more is needed, particularly with respect to state and local government aid and bolstering the rollout of vaccine administration.

Aside from the direct economic and human toll, Washington's mismanaged response to the pandemic is beginning to have significant, long-term, geoeconomic implications. According to recently released data from the United Nations Conference on Trade and Development, China overtook the United States as the leading destination for inward foreign direct investment (FDI) in 2020.[68] Indeed, FDI into the United States fell by 49 percent during 2020 and rose by 4 percent in China in 2020.[69] Inward FDI has fallen every year since 2017 while China has seen increases in FDI over the same span, largely as a result of misguided U.S. policies including the trade wars, proliferation of investment restrictions and the poor public health response to COVID-19.[70] Over the long run, declining inward FDI will lead to lower economic development, fewer jobs created, lower output and higher budget deficits. This problem is especially acute if China continues to attract FDI at a higher rate than the United States.

BETTER UTILIZATION OF TRADE TOOLS

Enforcement

As established earlier, President Trump's tariffs have been costly to American families, firms, farmers and ranchers. They have raised costs for consumers, sewn investment uncertainty, triggered retaliation and bred political dysfunction in Washington as firms scramble for tariff reprieves. While tariffs have been ineffective, there are other trade tools at the disposal of Washington's policymakers.

First, the United States should drop its national security tariffs on imported steel and aluminum from virtually every country in the world. These tariffs were expensive and hurt the United States' economy, but they also alienated our closest allies—the very allies the United States needs to effectively confront China's abusive trade practices. Many of our allies share the United States' concerns about Beijing's abusive practices; removing the national security tariffs would go a long way toward regaining the trust of our allies and forming a large coalition to tackle the legitimate problems posed by China.

Next, the United States should stop blocking the appointment of Appellate Body jurists at the WTO.[71] The Trump administration's war of attrition on the Appellate Body has crippled the functioning of the dispute settlement system. This breakdown of the binding litigation system will hinder the United States' ability to hold foreign countries like China accountable for their discriminatory and protectionist trade policies.

With a fully functioning Appellate Body restored, the United States should form a large coalition of allies to pursue a dispute against China at the WTO. There are a few reasons why the WTO is the appropriate venue to challenge some of China's abusive trade practices.

First, it is the legally required venue under the terms of both domestic and international law. Under the Uruguay Round Agreements Act—which Congress passed in 1994 to implement WTO agreements domestically—and the binding Statement of Administrative Action, the United States is required to resolve all disputes over alleged violations of WTO rules within the WTO system and not take unilateral

66. Pien Huang, "'A Loss to the Whole Society': U.S. COVID-19 Death Toll Reaches 500,000," NPR, Feb. 22, 2021. https://www.npr.org/sections/health-shots/2021/02/22/969494791/a-loss-to-the-whole-society-u-s-covid-19-death-toll-reaches-500-000.

67. The Council of Economic Advisers, "Economic Report of the President," The White House, January 2021, p. 121. https://trumpwhitehouse.archives.gov/wp-content/uploads/2021/01/Economic-Report-of-the-President-Jan2021.pdf.

68. Paul Hannon and Eun-Young Jeong, "China Overtakes U.S. as World's Leading Destination for Foreign Direct Investment," *The Wall Street Journal*, Jan. 24, 2021. https://www.wsj.com/articles/china-overtakes-u-s-as-worlds-leading-destination-for-foreign-direct-investment-11611511200?mod=djemalertNEWS.

69. Ibid.

70. Ibid; "The alarming decline in foreign direct investment," *World Finance*, Feb. 28, 2019. https://www.worldfinance.com/strategy/the-alarming-decline-in-foreign-direct-investment.

71. Clark Packard, "Trump's Real Trade War Is Being Waged on the WTO," *Foreign Policy*, Jan. 9, 2020. https://foreignpolicy.com/2020/01/09/trumps-real-trade-war-is-being-waged-on-the-wto.

action.[72] In other words, Congress allows the executive branch to take unilateral action—such as imposing tariffs "for only those foreign trade barriers that fall outside of the WTO Agreements."[73] Many of the alleged policies and practices that burden U.S. commerce are prohibited under WTO agreements.

Likewise, under Article XXIII of the WTO's Dispute Settlement Understanding, the United States, like all WTO members, is prohibited from taking unilateral actions against alleged practices and policies covered by WTO agreements without the authorization of the dispute settlement body.[74]

Second, it is only through collective action that the United States can create market power large enough to discipline China's economic practices.[75] Simply put, the United States alone does not have the economic heft to force changes to Beijing's model. Though the Trump administration's antipathy for the WTO is well-known, our closest allies and the countries most likely to agree with the United States' substantive concerns about China's practices are still committed to the WTO as the bulwark of the rules-based trading system.

The third reason to form a large coalition of like-minded countries and pursue a dispute against China at the WTO is that it could reestablish the Geneva-based institution as the indispensable venue to solve trade and investment disputes—where adherence to rules, not economic might, controls outcomes. As a former member of the WTO's Appellate Body has written:

> If the WTO can be seen to be able to either bend or amend its rules to take on the challenges presented by China's 'socialist market economy' framework, then faith in the institution and its rules-based system can be enhanced, for the good of the United States and the world.[76]

Fourth, there is a strong case to be made that some of the acts, policies and practices alleged in the 301 Report violate China's WTO commitments. When China joined the WTO, Beijing agreed to abide by the same rules every other WTO member abides by, but also took on extra obligations known as "WTO-plus" obligations in their Accession Protocol.

Under the terms of Article 7.3 of the Accession Protocol prohibits China from conditioning investment approval on the transfer of technology.[77] Likewise, the 301 Report alleges that China uses licensing practices to discriminate against American firms; under the terms of the Accession Protocol and the Trade-Related Aspects of Intellectual Property Rights Agreement (TRIPS Agreement), China promised not to discriminate against foreign holders of intellectual property rights.[78] Additionally, the 301 Report documents widespread theft of trade secrets and intellectual property abuse, yet such practices violate China's WTO commitments under the TRIPS Agreement. Article 39.2 of the TRIPS Agreement states that "[n]atural and legal persons shall have the possibility of preventing information lawfully within their control from being disclosed to, acquired by, or used by others without their consent."[79] Article 41.1 of the TRIPS Agreement requires all WTO members to provide adequate enforcement and potential remedies for violations of intellectual property rights.[80]

After releasing the 301 Report, the United States brought a case against China at the WTO over their discriminatory licensing practices, but chose to forgo potential claims over technology transfer and intellectual property abuse and trade secrets theft.[81] This is regrettable because China has a decent, though not perfect, record of complying with adverse WTO decisions by taking steps to remove inconsistent measures and open markets.[82]

Largely shunning the WTO dispute settlement system has been a terrible mistake. Policymakers should rectify this by lifting the blockade on new WTO Appellate Body Jurists, partnering with like-minded allies and bringing a more comprehensive case against China at the WTO. A larger case will not solve all of China's trade and investment transgressions, but it would be more helpful than sclerotic tariffs. Enforcement, though, has its limits.

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72. Scott Lincicome, "Chinese Intellectual Property Policies Demand a Smart U.S. Trade Policy Response—One President Trump Doesn't Appear to be Considering," The Cato Institute, Jan. 2, 2018. https://www.cato.org/blog/chinese-intellectual-property-policies-demand-smart-us-trade-policy-response-one-president.

73. Ibid.

74. Julia Qin, "The Elephant in the Room: the Missing Claim in DS543," International Economic Law and Policy Blog, Sept. 18, 2020. https://ielp.worldtradelaw.net/2020/09/the-elephant-in-the-room-the-missing-claim-in-ds543.html.

75. Chad P. Bown, "Why the U.S. Needs Allies in a Trade War Against China," *Harvard Business Review*, Dec. 11, 2018. https://hbr.org/2018/12/why-the-u-s-needs-allies-in-a-trade-war-against-china.

76. Hillman testimony.

77. "Accession of the People's Republic of China," The World Trade Organization, Nov. 23, 2001. https://www.worldtradelaw.net/misc/ChinaAccessionProtocol.pdf.download.

78. Ibid.

79. "Section 7: protection of undisclosed information," in *Agreement on Trade-Related Intellectual Property*, The World Trade Organization, Article 39.2. https://www.wto.org/english/docs_e/legal_e/27-trips_04d_e.htm.

80. "Section 1: general obligations," in *Agreement on Trade-Related Intellectual Property*, Article 41.1. https://www.wto.org/english/docs_e/legal_e/27-trips_05_e.htm.

81. Office of the United States Trade Representative, "Following President Trump's Section 301 Decisions, USTR Launches New WTO Challenge Against China," Press Release, March 23, 2018. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/march/following-president-trump%E2%80%99s-section.

82. James Bacchus et. al., "Disciplining China's Trade Practices at the WTO: How WTO Complaints Can Help Make China More Market Oriented," The Cato Institute, Nov. 15, 2018. https://www.cato.org/publications/policy-analysis/disciplining-chinas-trade-practices-wto-how-wto-complaints-can-help.

Regional and Bilateral Liberalization

Beyond trade enforcement action at the WTO, Washington should be negotiating more trade liberalization in order to pressure Beijing to raise its commercial standards and enhance U.S. competitiveness.

For starters, the United States should quickly rejoin and expand the TPP, which the Trump administration unwisely abandoned as one of its first official actions in January 2017.[83] Negotiated by the Obama administration, the TPP was an ambitious trade agreement with Pacific Rim nations that sought to establish high-quality commercial standards in a growing and increasingly vital region of the world. The 12 original members of the TPP accounted for 40 percent of the global economy.[84] The agreement cut tariffs and non-tariff barriers to trade and investment among member countries with an eye toward strengthening supply chains. The geopolitical logic of the TPP was straightforward: to provide Asian allies in China's orbit with an alternative market structure of similar size and adherence to enforceable rules—rather than the sheer economic might offered by Beijing.[85] Eventually the United States hoped to entice China to raise its commercial standards in order to join the TPP.[86]

Once the United States withdrew from the agreement, the remaining countries moved forward and renamed it the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). Now on the outside of the CPTPP, American consumers face higher tariffs on imports from CPTPP countries and American exporters face discriminatory barriers in CPTPP countries. Over the long term, this will damage U.S. competitiveness and weaken the United States' ability to shape commercial practices in Asia.

The need to reengage with Asian Pacific countries is especially acute, given that 15 countries, including China, Japan and South Korea recently moved forward with their own trade bloc known as the Regional Comprehensive Economic Partnership (RCEP).[87] In December 2020, China and the European Union completed negotiations on the Comprehensive Agreement on Investment (CAI), a bilateral investment treaty.[88] The CAI will liberalize investment rules and further integrate the Chinese and European Union economies. These moves should serve as a wake-up call to policymakers in Washington.

As one scholar recently remarked:

> By reinforcing its security role while allowing the other pillar of its leadership to atrophy, Washington risks becoming the 'Hessians' of Asia—a military force that all except Beijing rely upon but whose economic involvement grows in absolute terms while markedly receding in relative terms.[89]

Indeed, a stagnant trade and investment agenda is a recipe for falling behind the rest of the world, which will have geostrategic ramifications.

In short, withdrawing from the TPP was a catastrophic strategic mistake, but policymakers can rectify it by rejoining the agreement. In addition to rejoining the CPTPP, policymakers should encourage regional countries like Thailand and Taiwan, a high-tech manufacturing hub, to accede to the agreement.

Europe, too, presents opportunities for commercial reengagement. During the Obama administration, the United States and the European Union (EU) were negotiating the Transatlantic Trade and Investment Partnership (TTIP). However, negotiations were abandoned after Trump's election and the United Kingdom's decision to leave the EU. Despite the absence of a free trade agreement, before Brexit, the EU was the largest two-way (exports plus imports) trading partner of the United States.[90] There are warning signs, though; recent data shows that China overtook the United States as the EU's largest trading partner in 2020.[91]

To be sure, there were a number of hang-ups and political sensitivities on both sides of the Atlantic, but the potential gains—economic and strategic—are too large to ignore. Strategically, the TTIP would re-emphasize the value of the transatlantic relationship after years of neglect and hostility from the Trump administration, including its dubious claims that imported steel and aluminum from the EU jeopardizes the national security of the United States, questioning the

83. Peter Baker, "Trump Abandons Trans-Pacific Partnership, Obama's Signature Trade Deal," *The New York Times*, Jan. 23, 2017. https://www.nytimes.com/2017/01/23/us/politics/tpp-trump-trade-nafta.html.

84. Wendy Cutler, "Reengaging the Asia-Pacific on Trade: A TPP Roadmap for the Next U.S. Administration," The Asia Society, September 2020, p. 11. https://asiasociety.org/sites/default/files/2020-09/A%20TPP%20Roadmap%20for%20the%20Next%20U.S.%20Administration.pdf.

85. Clark Packard, et al., "How to Make America's Next Trade Policy," *The Bulwark*, March 2, 2020. https://thebulwark.com/how-to-make-a-americas-next-trade-policy/#.

86. Daniel J. Ikenson, "Scrapping TPP Harms US Economic Interests, Strengthens China's," The Cato Institute, Dec. 12, 2016. https://www.cato.org/publications/commentary/scrapping-tpp-harms-us-economic-interests-strengthens-chinas.

87. Amy Gunia, "Why the U.S. Could Be the Big Loser in the Huge RCEP Trade Deal Between China and 14 Other Countries," *Time*, Nov. 17, 2020. https://time.com/5912325/rcep-china-trade-deal-us.

88. Laurence Norman, "EU, China Agree on Terms of Investment Pact Despite U.S. Wariness," *The Wall Street Journal*, Dec. 30, 2020. https://www.wsj.com/articles/eu-china-agree-on-terms-of-investment-pact-despite-u-s-wariness-11609334398.

89. Evan A. Feigenbaum, "Meeting the Challenge in Asia," *The National Interest*, Dec. 22, 2020. https://nationalinterest.org/feature/meeting-challenge-asia-174917.

90. Andres B. Schwarzenberg, *U.S. Trade With Major Trading Partners*, Congressional Research Service, Dec. 18, 2018, p. 3. https://fas.org/sgp/crs/row/R45434.pdf.

91. Giorgio Leali, "China topples US as EU's top trade partner over 2020," *Politico*, Feb. 15, 2021. https://www.politico.eu/article/china-topples-us-as-eus-top-trade-partner-over-2020/.

value of the North Atlantic Treaty Organization and acting outside the confines of the WTO to prosecute a unilateral trade war against China. Likewise, strengthening the relationship between Washington and Brussels could improve the West's position vis-à-vis Russia and firmly establish another trading bloc committed to high-quality commercial rules that can be leveraged to discipline China's trade and investment transgressions.

Likewise, the United States has willing negotiating partners in the United Kingdom and Switzerland. Solidified trade and investment arrangements with these wealthy, non-EU, European countries could be leveraged to extract concessions from the EU in TTIP negotiations and further strengthen the United States' position with respect to China—in addition to increased trade and investment domestically.

Unilateral Trade Liberalization of Intermediate and Capital Goods

As President Trump's trade wars have demonstrated, tariffs are taxes paid by American importers—families and firms. At the same time, World Bank data show that in 2018, about 60 percent of the value of imports were capital goods, raw materials or intermediate inputs such as those that American firms use to make products in the United States.[92] Tariffs on these goods raise production costs for American firms and make American-made products less competitive in global markets.

Policymakers should unilaterally eliminate tariffs on capital goods, raw materials and intermediate inputs. Doing so would improve American competitiveness and give a jolt to the beleaguered manufacturing industry that bore much of the brunt of President Trump's ill-advised trade wars.

WTO Liberalization and New Subsidy Rules

The GATT and then the WTO have been indispensable forums for the negotiations of trade liberalization. Yet today, multilateral negotiations are on life support since the collapse of the Doha Development Round, which was formally canceled at the WTO's ministerial meeting in December 2015.[93] However, there are signs of life for otherwise stalled negotiations.

For nearly 20 years, WTO members have been negotiating new rules on fishing subsidies to prevent overfishing. Negotiations have slowed in recent years, but an agreement is within striking distance. Though fishing subsidies may seem like a minor issue in the grand scheme of global trade, these negotiations get to a core difference of opinion between Washington and Beijing: the role of "special and differential treatment," which is essentially two sets of rules for developed and developing countries.[94] Policymakers in Washington should prioritize completion of these negotiations in the near future.

If multilateral negotiations with all WTO members prove to be too challenging, there are ongoing negotiations with some, but not all, WTO members. Known as "plurilateral negotiations," these negotiations offer the most realistic option for revitalizing the WTO as a negotiating forum.[95] Three areas are ripe for plurilateral negotiations: trade in environmentally-friendly goods to mitigate the effects of climate change; digital trade and e-commerce, the new frontier for commerce in the 21st century; and finally trade in services, in which the United States has an enormous comparative advantage. Finalizing new rules and liberalization in these areas would be a tremendous boon for the United States and revitalize the WTO as a forum to negotiate new rules and not just as a venue to bring complaints against trading partners. These negotiations should be priorities for the Biden administration.

Ultimately, the issue of China's mercantilist economic model is the most important issue facing the global rules-based trading system. New rules are desperately needed to discipline Beijing's commercial practices. With that in mind, the United States should prioritize its negotiations with Japan and the European Union on enacting new WTO rules concerning state capitalism and a level playing field. Such rules should focus on addressing the core complaints about China's economic model: state-owned enterprises, technology transfer and industrial subsidies. Proposals to address China's subsidies through new WTO rules have been proposed, including expanding the list of prohibited subsidies and changing definitions of "government or public bodies" to capture Beijing's state-directed economic model.[96] These are good ideas; the United States and its allies in Tokyo and Brussels should draw on these suggestions as they work toward crafting new rules to help discipline Chinese commercial practices.

92. The World Bank, "United States Capital Goods Imports," World Integrated Trade Solution, last accessed Feb. 10, 2021. https://wits.worldbank.org/CountryProfile/en/Country/USA/Year/2018/TradeFlow/Import/Partner/all/Product/UNCTAD-SoP4; The World Bank, "United States Raw Materials Imports," World Integrated Trade Solution, last accessed Feb. 10, 2021. https://wits.worldbank.org/CountryProfile/en/Country/USA/Year/2018/TradeFlow/Import/Partner/all/Product/UNCTAD-SoP1; The World Bank, "United States Intermediate Goods Imports," World Integrated Trade Solution, last accessed Feb. 10, 2021. https://wits.worldbank.org/CountryProfile/en/Country/USA/Year/2018/TradeFlow/Import/Partner/all/Product/UNCTAD-SoP2.

93. Simon Lester, "Is the Doha Round Over? The WTO's Negotiating Agenda for 2016 and Beyond," The Cato Institute, Feb. 11, 2016. https://www.cato.org/publications/free-trade-bulletin/doha-round-over-wtos-negotiating-agenda-2016-beyond.

94. James Bacchus and Inu Manak, "The Fate of the WTO and Global Trade Hangs on Fish," *Foreign Policy*, May 5, 2020. https://foreignpolicy.com/2020/05/05/wto-global-trade-fisheries-fishing-subsidies.

95. James Bacchus, "Was Buenos Aires the Beginning of the End or the End of the Beginning?", The Cato Institute, May 8, 2018. https://www.cato.org/sites/cato.org/files/pubs/pdf/pa-841-updated.pdf.

96. Bown and Hillman. https://www.piie.com/publications/working-papers/wtoing-resolution-china-subsidy-problem.

REAUTHORIZE TRADE PROMOTION AUTHORITY

Article I, Section VIII of the United States Constitution gives Congress the authority to "regulate Commerce with foreign Nations," and "lay and collect Taxes, Duties, Imposts and Excises." Article II of the Constitution gives the president the authority to negotiate foreign treaties subject to the advice and consent of the United States Senate. At various points since the 1930s, Congress has delegated authority to the executive branch to negotiate trade agreements with foreign trading partners within the parameters set by Congress and has delegated certain tariff authorities to the executive branch.[97]

The most recent iteration of such authority was passed in 2015 when Congress passed the Bipartisan Congressional Trade Priorities Act, known as "Trade Promotion Authority" (TPA).[98] The authority under the 2015 legislation is six years and expires on July 31, 2021.[99] Under the law, once an agreement is reached between the executive branch and our trading partners, TPA provides for expedited congressional consideration of the agreement if certain notifications are provided and the agreement reached is consistent with the priorities established by Congress. Without TPA, negotiating trade agreements "would be virtually impossible if foreign nations had to bargain with 535 members of Congress, rather than one agency."[100]

Given President Trump's abuse of various tariff authorities (e.g., Section 232 of the Trade Expansion Act of 1962 and Section 301 of the Trade Act of 1974), which have wreaked havoc economically and diplomatically as noted in this this paper, it is clear that Congress needs to reassert itself in the trade policy making process. By the same token, given the legislative logrolling process that produced the disastrous Smoot-Hawley tariffs in 1930, Congress needs to be careful in any attempt at clawing back trade authorities—a proper rebalancing is needed.[101]

In order to ensure the United States can continue negotiating much-needed trade agreements while at the same time reasserting its authority over the imposition of tariffs, Congress should renew TPA and establish an expedited process to consider tariffs proposed by the Executive Branch under a number of trade statutes, including Sections 232 of the Trade Expansion Act of 1962; Sections 122, 201, 301 and 406 of the Trade Act of 1974; the International Emergency Economic Powers Act; and the Trading with the Enemy Act. In other words, Congress can rebalance trade authority by establishing that the Executive Branch cannot unilaterally impose tariffs under these statutes; Congress should establish that it is the final arbiter of whether tariffs can be imposed by the Executive Branch.

OUTCOMPETE CHINA ON THE CUTTING-EDGE OF TECHNOLOGY

As the 301 Report makes clear, the trade war between Washington and Beijing over the last several years is in large measure the manifestation of a broader battle for technological supremacy in the 21st century. Much of this is driven by Beijing's pursuit of indigenous innovation through its "Made in China 2025" industrial policies.[102] These policies are a 10-year "plan to update China's manufacturing base by rapidly developing ten high-tech industries." [103] Those industries include alternative energy vehicles, information technology, telecommunications, robotics, artificial intelligence and aerospace engineering.

Take the Chinese telecom giant Huawei, for example. Huawei is privately run, but it is heavily supported by the Chinese government. Huawei's products used component parts made in the United States, such as semiconductors.[104] Huawei has about a 20 percent share of the global market in mobile phones making it the largest manufacturer in the world—ahead of noteworthy brands such as Apple and Samsung.[105] Likewise, it is a major supplier of the telecommunications equipment used by a number of countries in their fifth generation (5G) network infrastructure.[106]

For policymakers and analysts in Washington, Huawei is a national security risk to the United States. They believe the company is a "tool of the Chinese military, which could tap Huawei's equipment and spy on the company's customers around the world."[107] Likewise, the United States has accused Huawei of violating U.S. sanctions by shipping products containing American-made components to Iran.[108] For Xi Jinping and the Chinese government, Huawei is a cutting-edge technology firm that could dominate future telecommunica-

97. Ian F. Ferguson and Christopher M. Davis, *Trade Promotion Authority (TPA): Frequently Asked Questions*, Congressional Research Service, July 21, 2019, p.2. https://fas.org/sgp/crs/misc/R43491.pdf.

98. P.L. 114-26, Defending Public Safety Employees' Retirement Act, 114th Congress.

99. Ibid.

100. Clark Packard and Philip Wallach, "Restraining the President: Congress and Trade Policy," *R Street Policy Study* No. 158, November 2018, p. 6. https://www.rstreet.org/wp-content/uploads/2018/11/Final-158.pdf.

101. Irwin, pp. 371-410.

102. McBride and Chatzky.

103. Ibid.

104. Davis and Wei, p. 26.

105. Chad P. Bown, "How Trump's export curbs on semiconductors and equipment hurt the US technology sector," The Peterson Institute for International Economics, Sept. 28, 2020. https://www.piie.com/blogs/trade-and-investment-policy-watch/how-trumps-export-curbs-semiconductors-and-equipment-hurt-us.

106. Ibid.

107. Davis and Wei, p. 25.

108. Ibid., p. 26.

tions networks, particularly 5G networks.[109]

Over the last several years, policymakers in Washington have attempted to curb Huawei's growth. In 2020, the State Department launched its Clean Network Initiative, which "seeks to keep telecom gear made by Huawei Technologies and other Chinese companies out of communications networks in democratic nations."[110] Still in its infancy, the initiative has shown some progress in slowing the spread of Huawei into 5G networks around the world, though certain countries have resisted Washington's lobbying for a complete ban on Chinese gear.[111] It is worth noting that Washington's efforts probably would have been more successful had the Trump administration not declared steel and aluminum imports from allied countries to be national security threats to the United States.

Careful and Transparent Use of Export Controls

In theory, restricting exports of certain American products can be a powerful tool to protect national security and innovation.[112] In an extreme example, policymakers would prohibit the sale of missiles to North Korea. In other cases, restricting exports is more complicated, particularly in situations in which the product in question has both potential civilian and national security applications.

Yet in a globalized world with various suppliers for particular products, unilateral export controls can lose their efficacy. If a foreign adversary can acquire the product from a non-U.S. source, the export control would not protect national security. Congress explicitly acknowledged this problem when it passed the Export Control Reform Act of 2018, which states in part: "Export controls that are multilateral are most effective…controls applied unilaterally to items widely available from foreign sources generally are less effective in preventing end-users from acquiring those items."[113] Likewise, overbroad classifications may prevent the export of products that pose no national security risk.

An overly restrictive export control regime poses significant risks to the United States' economy. Leading American technology firms could lose vital access in major markets with growing consumer demand. Moreover, foreign countries could retaliate by restricting the export of products that American consumers and firms rely on—similar to the Trump administration's tariff war with China. Likewise, if policymakers are too restrictive, it could dissuade foreign companies from setting up operations in the United States lest they lose access to foreign markets, or it could cause existing U.S. firms to move operations abroad to avoid being subject to the export restrictions. All told, scattershot export control policymaking adds uncertainty to the economy and could make the United States a less reliable commercial partner by fostering mistrust.

With that said, there are legitimate national security concerns with respect to exporting certain cutting-edge technologies with military and national security applications to non-allied nations or adversaries. Establishing a proper balance between the competing demands is imperative.

First, policymakers should be more judicious in the invocation of "national security" in the context of international trade and commerce. As mentioned, the Trump administration has abused this term by classifying imported steel, aluminum and automobiles as a national security threat to the United States, even products originating in allied countries. Export controls should be invoked carefully—and only when there is a genuine national security concern.

Next, in light of the globalized economy, policymakers should avoid applying export controls where the product in question is available from third party countries. Such controls would simply deny sales to American firms and do nothing to mitigate any potential national security risks to the United States.

Policymakers should improve the export control process by creating more checks and enhancing transparency where possible. The Commerce Department should solicit more feedback from the business community to understand the full economic impact of export controls and consider if there are ways to mitigate the national security risks without barring the export of the product(s) in question. Likewise, there should be an easy judicial review of export control restrictions that allows appeals to be heard quickly. Automatic reviews of imposed controls would also be beneficial so that the burden on exporters can be lifted if the national security concern is eliminated or changes.

Do Not Undercut America's Most Innovative Firms

In October 2020, the United States Department of Justice (DOJ) and a large number of state attorneys general brought an antitrust suit against Google alleging that the tech giant uses its dominance in internet searches to illegally harm its

109. Ibid.

110. Peter Coy, "U.S. Policy on China May Move from 'America First' to America & Co.," Bloomberg, Dec. 9, 2020. https://www.bloomberg.com/news/articles/2020-12-09/u-s-policy-against-china-america-first-is-becoming-america-and-others.

111. Ibid.

112. Martin Chorzempa, "Excessive export controls to protect US national security and innovation could compel firms to move overseas," The Peterson Institute for International Economics, Oct. 20, 2020. https://www.piie.com/blogs/realtime-economic-issues-watch/excessive-export-controls-protect-us-national-security-and.

113. Bown. https://www.piie.com/blogs/trade-and-investment-policy-watch/how-trumps-export-curbs-semiconductors-and-equipment-hurt-us.

competitors and consumers.[114] Likewise, in December 2020, the Federal Trade Commission and dozens of state attorneys general brought an antitrust suit against Facebook for allegedly engaging in anti-competitive behavior by buying potential rivals.[115] A full antitrust analysis of these cases is beyond the scope of this paper, but it is worth considering the geopolitical ramifications of the broader debate about breaking up America's most globally competitive and innovative technology firms in light of the overarching competition between Washington and Beijing for technological supremacy. Such firms are driving investment and cutting-edge research on future technologies, including robotics and artificial intelligence, both of which are centerpieces of Made in China 2025.

Indeed, breaking up tech companies may satiate the demands of populists on the left and the right, but it could hamper the long-term competitiveness of the United States vis-à-vis its foreign competitors, including those based in China which receive heavy government support. If the United States is going to continue to lead the world in high tech innovation and research and development, policymakers should be circumspect about unnecessarily hamstringing those firms pushing the envelope.

INCREASE IMMIGRATION

If the United States is going to outcompete China in the 21st century, Washington needs to welcome a lot more immigrants into the country. Unique among the most powerful nations in the world, the United States is a nation of immigrants. In short, immigration is one of our greatest assets. Yet the last several years, policymakers in the Trump administration have unwisely moved to restrict immigration. Between 2016 and 2020, it is estimated that legal immigration was down by about 50 percent as a result of the Trump administration's immigration restrictionism.[116] Such zero-sum thinking is antithetical to American values and will hamper our long-term competitiveness unless it is reversed.

First, the academic literature is crystal clear that immigrants are net job creators because they tend to be more entrepreneurial than non-immigrants.[117] Indeed, some of America's most innovative and competitive firms were founded by immigrants including Google, Uber, Qualcomm, Tesla, eBay and Yahoo.[118] Pfizer, which submitted its COVID-19 vaccine to the Food and Drug Administration for review in November 2020,[119] was also founded by two German immigrants.[120]

Immigration is especially important if the United States is going to dominate the commanding heights of technology, which is at the epicenter of the economic competition underway between the United States and China. As one economist notes:

> As of 2014, 46 percent of Silicon Valley's workforce was foreign-born. The share is even larger for workers between the ages of 25 and 44, and it rises to a whopping 74 percent of workers hired for their math and computer expertise in that age bracket.[121]

It is estimated that between 1990 and 2010, "inflows of foreign [science, technology, engineering and math] workers explain between 30 [percent] and 50 [percent] of the aggregate productivity growth" in the United States.[122] Likewise, a 2010 study found that skilled immigrants are about twice as likely to be granted patents and as non-immigrants because they disproportionately have degrees in science and engineering.[123] That same study found positive innovation spillover effects from skilled immigration; it notes: "A 1 percentage point rise in the share of immigrant college graduates in the population increases patents per capita by 9-18 percent."[124] In other words, skilled immigrants provide a direct benefit to the United States, but they also spur innovation among non-immigrants.

The pipeline of academic talent has also been restricted in recent years. Long incubators of research and development, universities have seen international enrollment decline between 63 percent and 98 percent from 2018-2019 academic year levels.[125] This is troubling for long term competitive-

114. *United States, et al. v. Google LLC*, U.S. District Court for the District of Columbia, Oct. 20, 2020. https://www.justice.gov/opa/press-release/file/1328941/download.

115. Cecilia Kang and Mike Isaac, "U.S. and States Fay Facebook Illegally Crushed Competition," The New York Times, Dec. 9, 2020. https://www.nytimes.com/2020/12/09/technology/facebook-antitrust-monopoly.html.

116. Stuart Anderson, "Immigrants and America's Comeback from the COVID-19 Crisis," National Foundation for American Policy, July 2020. https://nfap.com/wp-content/uploads/2020/07/Immigrants-and-Americas-Comeback-From-The-Covid-19-Crisis.NFAP-Policy-Brief.July-2020.pdf.

117. See, e.g., Pierre Azoulay et al., "Immigration and Entrepreneurship in the United States," National Bureau of Economic Research, Sept. 2, 2020. https://www.kellogg.northwestern.edu/faculty/jones-ben/htm/Immigration_and_Entrepreneurship_in_the_United_States.pdf; Sari Pekkala Kerr and William R. Kerr, "Immigrant Entrepreneurship," *Harvard Business School Working Paper* No. 17-011, 2016, https://www.hbs.edu/faculty/Publication%20Files/17-011_da2c1cf4-a999-4159-ab95-457c783e3fff.pdf.

118. Chris Morris, "10 iconic US companies started by immigrants," CNBC, June 13, 2017. https://www.cnbc.com/2017/06/13/spacex-ebay-and-other-iconic-us-companies-started-by-immigrants.html.

119. Thomas M. Burton and Joseph Walker, "Next Stop for Covid-19 Vaccines: FDA Review," *The Wall Street Journal*, Nov. 19, 2020. https://www.wsj.com/articles/next-stop-for-covid-19-vaccines-fda-review-11605792716.

120. Morris.

121. Kimberly Clausing, *Open: The Progressive Case for Free Trade, Immigration and Global Capital* (Harvard University Press, 2019—ARC Edition), p.181.

122. Giovanni Peri et al., "STEM Workers, H-1B Visas, and Productivity in US Cities," *Journal of Labor Economics* 33:51 (Summer 2015), p. S277. http://giovanniperi.ucdavis.edu/uploads/5/6/8/2/56826033/stem-workers.pdf.

123. Jennifer Hunt and Marjolaine Gauthier-Loiselle, "How Much Does Immigration Boost Innovation?", *American Economic Journal: Macroeconomics* 2:2 (April 2010), pp. 31-56. https://www.jstor.org/stable/25760296?seq=1.

124. Ibid., p. 33.

125. Anderson, pp. 1-2.

ness; visa-holding students make up large portions of graduate degree-seeking students in science, computer science and engineering.[126] David Bier of the Cato Institute recently found that the Trump administration oversaw an enrollment decline of about 700,000 international students in U.S. colleges and universities.[127] Some of the decline is the result of COVID-19, but much of it was driven by the Trump administration's antipathy toward immigrants.

The same study also highlighted other aspects of the Trump administration's shameful record on immigration.[128] By using a 2016 baseline—the last year of the Obama administration—the study finds that the Trump administration issued about 740,000 fewer visas than would have been granted had the Trump administration kept pace with the Obama administration's rate of issuance; the administration resettled about 290,000 fewer refugees than would have been resettled if rates from the Obama administration continued; the Trump administration issued 287,000 fewer nonimmigrant work and cultural visas; denied about 100,000 more requests for asylum; issued about nine million fewer tourist and business visas compared to the Obama administration, a decline of 92 percent; and there are currently seven million pending immigration applications.[129]

Over the long run, sclerotic immigration restrictionism will dampen growth and competitiveness, particularly in technology, and hasten the fiscal reckoning of popular entitlement programs. The Biden administration has signaled that it will reverse much of the Trump administration's deleterious, unilateral actions to restrict immigration. While that is a welcome development, there is only so much that can be done by executive order. In January 2021, President Biden proposed sensible reforms to our nation's opaque and complex immigration laws, including a pathway to citizenship for approximately 11 million immigrants in the United States without a legal status.[130] On top of that, immigration is increasingly popular: "According to a Gallup poll, for the first time in that poll's 55-year history, more Americans support increasing immigration than decreasing it."[131]

126. Clausing, p. 182.

127. David J. Bier, "Visualizing a 4-Year Assault on Legal Immigration: Trends Biden Must Reverse," The Cato Institute, Dec. 11, 2020. https://www.cato.org/blog/visualizing-4-year-assault-legal-immigration-trends-biden-must-reverse-0.

128. Ibid.

129. Ibid.

130. Elliot Spagat, "Biden to prioritize legal status for millions of immigrants," *Associated Press,* Jan. 16, 2021. https://apnews.com/article/joe-biden-politics-legislation-immigration-barack-obama-5274d5912b062989cc4f2856f3741cd6.

131. Alex Norwasteh and David J. Bier, "A Pro-Immigration Agenda for the Biden Administration," The Cato Institute, November 2020. https://www.cato.org/policy-report/november/december-2020/pro-immigration-agenda-biden-administration.

Policymakers should seize this opportunity to simplify the immigration process and dramatically expand legal immigration.

MAKE SMARTER DOMESTIC INVESTMENTS AND REFORMS

Policymakers can, and should, make better use of the tools of economic statecraft, but smarter domestic investments will make it easier to outcompete China in the 21st century. There are a plethora of domestic policy options to boost U.S. competitiveness.

Bolster STEM Education

The battle for technological supremacy is a major driver of the economic frictions that currently exist between the United States and China. The United States' system of higher education is one of the best in the world, yet our K-12 education system is falling behind. We are not preparing students for the workforce of the 21st century.

The Organization for Economic Co-operation and Development's (OECD) Programme for International Student Assessment (PISA) measures international educational outcomes by administering a cross-national exam every three years to 15-year-old students from 79 high- and middle-income countries, including OECD members and non-members.[132] Participating countries select a representative sample of between 4,000 and 8,000 students to take the exam.[133]

Based on the 2018 results of the PISA exam, the most recent exam administered, the United States ranked 13th in reading while China ranked first; in mathematics, the United States ranked 37th and China ranked first; science, the United States ranked 18th, while China ranked first.[134] Improving educational achievement is a complex subject largely beyond the scope of this paper, and no individual study can fully assess the current state of U.S. educational achievement, but the PISA study is consistent with other findings that show the United States is lagging behind our competitors when it comes to K-12 education—particularly in the fields that will drive future innovation and productivity growth.[135]

Policymakers in state capitals and Washington should prioritize improving science, technology, engineering and mathematics (STEM) education. This is by no means a

132. Andreas Schleicher, "PISA 2018: Insights and Interpretations," Programme for International Student Assessment, 2019, p. 4. http://www.oecd.org/pisa/PISA%202018%20Insights%20and%20Interpretations%20FINAL%20PDF.pdf.

133. Ibid.

134. Ibid., pp. 6-8.

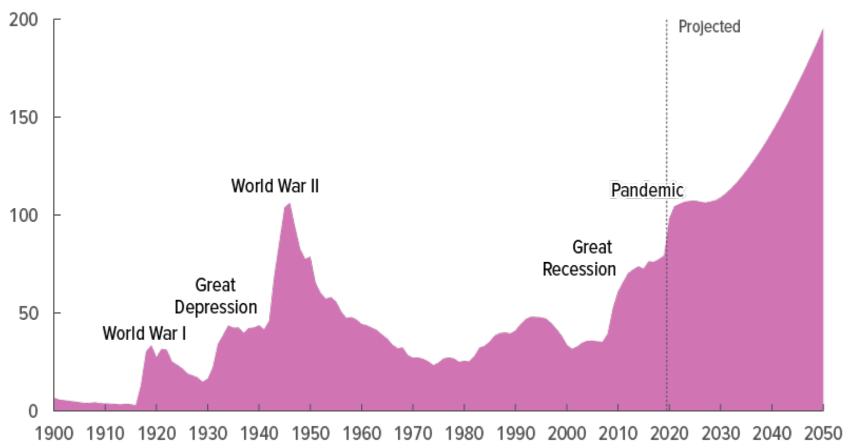
135. Institute for Education Science, *Highlights from the TIMMS and TIMMS Advanced 2015*, United States Department of Education, November 2016. https://nces.ed.gov/pubs2017/2017002.pdf.

comprehensive list, but ideas to consider include expanding STEM education in the elementary school curriculum in order to stimulate long term interest in the subjects, providing more financial support for STEM education, expanding STEM-based charter school options, and expanding hands-on learning and apprenticeships.

Responsibly Address the National Debt Over the Long Term

The national debt is on an unsustainable trajectory. The Congressional Budget Office (CBO) estimates that under current law: "The projected budget deficits would boost federal debt to 104 percent of GDP in 2021, to 107 of GDP (the highest amount in the nation's history) in 2023 and to 195 percent of GDP by 2050."[136] Figure 1 illustrates the dramatically accelerating debt-to-GDP trajectory.[137]

FIGURE 1: FEDERAL AND PROJECTED DEBT OWNED BY THE PUBLIC FROM 1900 TO 2050



Source: Image used with permission from the Congressional Budget Office.

In recent years, the debt has increased as a result of the Tax Cuts and Jobs Act (TCJA) and the Coronavirus Aid, Relief and Economic Security Act (CARES Act). The TCJA's merits are debatable, but the CARES Act was essential to stemming the tide of recession as a result of the pandemic. Now is not the time for fiscal austerity, but it will eventually become essential. Indeed, policymakers should be doing more to jumpstart the economy in the short run, but over the long term, controlling the debt will become essential.

A dramatically increasing debt-to-GDP ratio poses significant problems for the United States. First, rising debt could crowd out private investment. As the CBO explains: "[W]hen the government borrows in financial markets, it does so from people and businesses whose savings would otherwise finance private investment, such as factories and computers."[138] The consequences of this would be devastating to standards of living:

> If investment in capital goods declined, workers would, on average, have less capital to use in their jobs. As a result, they would be less productive, they would receive lower compensation, and they would thus be less inclined to work. Those effects would increase over time as federal borrowing grew.[139]

This is an especially acute problem if policymakers are concerned about maintaining the United States' position as the leading economy in the world.

Next, interest payments required to service the debt would increase, which would reduce the amount of money that could be used to cut taxes or expand government services.[140] Finally, increasing federal debt threatens a fiscal crisis. The CBO states succinctly:

> Such a crisis can occur as investors' confidence in the U.S. government's fiscal position erodes, undermining the value of Treasury securities and driving up interest rates on federal debt because investors would demand higher yields to purchase those securities. Concerns about the government's fiscal position could lead to a sudden and potentially spiraling increase in people's expectations of inflation, a large drop in the value of the dollar, or a loss of confidence in the government's ability or commitment to repay its debt in full.[141]

Ultimately, if unaddressed, the United States would have to dramatically increase taxes, sharply reduce spending on major programs like Medicare, Social Security and national defense, or some combination of the two. That would significantly damage the standard of living for average Americans and weaken our position vis-à-vis China. With the pandemic raging and the economy still soft, now is not the time to worry about the national debt. But as the United States emerges from this period, policymakers should begin making sensible tax and spending changes to alter the trajectory of the long-term debt projections.

136. Congressional Budget Office, "The 2020 Long-Term Budget Outlook," United States Congress, September 2020. https://www.cbo.gov/publication/56598.

137. Ibid.

138. Ibid.

139. Ibid.

140. Ibid.

141. Ibid.

Responsibly Address Climate Change

The United States and China are the world's two largest emitters of carbon dioxide.[142] Even though the United States withdrew from the Paris Climate Accord and then subsequently rejoined the agreement, net emissions in the United States have been declining in recent years.[143] At the same time, while still a member of the Paris Accord, Beijing is building hundreds of new coal-fired power plants in China and around the world as part of its global development goals.[144] Indeed, China plans to continue expanding coal capacity through 2035.[145]

Given the collective action problem associated with climate change, Washington and Beijing will have to cooperate on reducing carbon emissions in order to spare the world from the worst effects of a warming planet. Even though recent years have seen a slight reduction in carbon emissions in the United States, they are still much too high. Aggressive action to curb carbon emissions would be beneficial to the earth, but also re-establish U.S. international leadership on a pressing matter, especially if Beijing continues to pursue dirty energy policies.

Improve Tax Treatment of Research and Development Costs

Currently, when an American firm makes investments into research and development (R&D), it can deduct those costs from its tax liability during the year in which they occur. This is the right idea.

As part of the TCJA, Congress mandated that beginning in 2022, firms making R&D investments must amortize those expenses over a five-year period. As the National Taxpayers Union Foundation has noted:

> At first this might not seem like a big deal, but it's actually quite a backslide...The policy will raise the cost of investments in research and development, meaning companies will be less likely to do R&D. That means less innovation and new technologies for the U.S. economy, leading to lower levels of productivity, lower wages, and a smaller economy.[146]

The tax code is full of misaligned incentives, but surely a top priority for policymakers should be to ensure continued investment in research and development. Any policy that could hamper the United States' status as the world's R&D lab should be addressed as soon as possible. Congress should make this permanent.

Expand Effective Anti-Poverty Programs

Globalization has produced tremendous benefits for the United States—and the world. At the same time, the United States needs to expand its safety net, which complements a dynamic, entrepreneurial economy.[147] Aligning incentives is a paramount concern here.

Expanding the safety net through programs with properly aligned incentives serves several functions. First, it helps ameliorate poverty without discouraging work. Second, and in the context of a global competition between the United States and China, such programs soften the downside risks associated with increased import competition from globalization and rapid technological innovation needed to grow the economy. Related, by softening the blow of failure, which is inevitable in a competitive, market-oriented economy, a more robust safety net can encourage innovation and risk-taking.[148] Finally, a more robust safety net would help expand political support for the open and dynamic economy the United States will need to outcompete China in the coming decades.

One of the most successful anti-poverty programs in the United States is the Earned Income Tax Credit (EITC), which has proper incentives. The EITC provides families with children that have incomes of up to about $57,000 in 2020 with up to $6,660 a year in a refundable tax credit (meaning it reduces the tax liability of the filer, and if it exceeds the liability, the Internal Revenue Service will refund the difference).[149] The value of the EITC depends on income, marital status and

142. Thomas C. Frohlich and Liz Blossom, "These countries produce the most CO2 emissions," *USA Today*, July 14, 2019. https://www.usatoday.com/story/money/2019/07/14/china-us-countries-that-produce-the-most-co-2-emissions/39548763.

143. Joe Lo, "Where are US emissions after four years of President Trump?", Climate Home News, June 6, 2020. https://www.climatechangenews.com/2020/10/06/us-emissions-four-years-president-trump.

144. Gerry Shih, "Years after freezing new projects, China is back to building coal power plants," *The Washington Post*, Nov. 20, 2019. https://www.washingtonpost.com/world/asia-pacific/years-after-freezing-new-projects-china-is-back-to-building-coal-power-plants/2019/11/20/b9075baa-0b38-11ea-8054-289aef6e38a3_story.html.

145. Ibid.

146. Nicole Kaeding, "Correcting the TCJA's Mistreatment of R&D Costs," National Taxpayers Union Foundation, Oct. 8, 2019. https://www.ntu.org/foundation/detail/correcting-the-tcjas-mistreatment-of-rd-costs.

147. Samuel Hammond, "The Free-Market Welfare State: Preserving dynamism in a volatile world," The Niskanen Center, May 2018. https://www.niskanencenter.org/wp-content/uploads/old_uploads/2018/04/Final_Free-Market-Welfare-State.pdf.

148. Hammond, p.4.

149. Internal Revenue Service, "Income Limits and Range of EITC," The United States Department of the Treasury, Dec. 30, 2020. https://www.eitc.irs.gov/eitc-central/about-eitc/income-limits-and-range-of-eitc/income-limits-and-range-of-eitc.

children.[150] With no children, the value of the EITC drops considerably.[151] As one economist notes:

> [F]for low wage workers, [EITC] increases the incentive to work, and for firms, it provides a stronger inducement to hire such workers. At low incomes, the credit provides additional rewards for working, as a worker with two children receives forty cents for every dollar earned. Past a certain income level, however, the credit is phased out.[152]

As the Center on Budget and Policy Priorities notes: "During the 2017 tax year, the average ETIC was $3,191 for a family with children (boosting wages by about $266 a month), compared with just $298 for a family without children."[153] They also note that the program is mostly used to "pay for necessities, repair homes, maintain vehicles that are needed to commute to work, and in some cases, obtain education or training to boost their employability and earning power."[154]

Likewise, R Street has produced research establishing that significant cost-of-living differences "create vast differences in the real value" of the EITC.[155] In essence, the EITC's benefits are more generous to the working poor in low-cost areas. As a result, the incentive to find and maintain a job diminishes in high-cost areas. Additionally, "it also means that the policy extends the least to help those most in need—the working poor who live in high-cost areas."[156]

Policymakers should expand and reform the EITC in a number of ways. Economists suggest a number of thoughtful reforms including "increasing the credit percentage for workers without children…increasing the thresholds up to which [EITC] can be earned for all taxpayers, and by limiting the phase-out of the tax credit."[157] Likewise, the EITC's value should be adjusted for cost-of-living differences to ensure its real benefits incentivize labor force participation equitably across the country.

CONCLUSION

China's rise does pose significant geopolitical and economic challenges to the United States. It is imperative that policymakers assess those challenges in a sober manner—without hysterics or Sinophobia. Ultimately, even the most carefully deployed tools of economic statecraft are no match for simply outcompeting China. Rather than mimicking Chinese industrial policy and mercantilism, policymakers in the United States should trust America's traditional strengths: openness to international trade and immigration and support for dynamic, market-based innovation.

ABOUT THE AUTHOR

Clark Packard is a resident fellow and trade policy counsel in the Finance, Insurance and Trade Policy division at the R Street Institute, where he researches international trade and investment policy.

150. Ibid.

151. "Policy Basics: The Earned Income Tax Credit," Center on Budget and Policy Priorities, Dec. 10, 2019. https://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit.

152. Clausing, p. 244.

153. "Policy Basics." https://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit.

154. Ibid.

155. Andrew Hanson and Zackary Hawley, "Local Labor Markets and the Federal Earned Income Tax Credit," *R Street Policy Study* No. 53, March 2016. https://www.rstreet.org/wp-content/uploads/2018/04/RSTREET53-1.pdf.

156. Ibid., p. 7.

157. Clausing, p. 244.