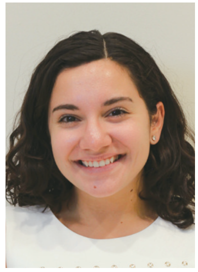
Deepening Economic Confrontation Between the United States & China

By Megan Hogan & Gary Clyde Hufbauer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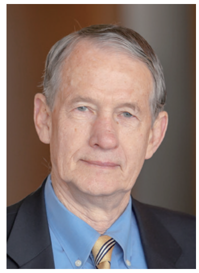
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Introduction

China has become a most important trading partner for the United States. Ever since China joined the World Trade Organization (WTO) on Dec. 11, 2001, trade between the two countries has exploded, rising from $122 billion in 2001 to $691 billion in 2022. The US imports more goods from China than from any other country, and China is the third-largest export market for US goods.

Yet the US-China trade relationship has worsened considerably under the administrations of both President Joe Biden and President Donald Trump. Starting in July 2018, the Trump administration launched a trade war with China, partly as payback for China's unfair trade practices and partly to pressure Beijing into respecting American intellectual property rights and ending forced technology transfers. Trump imposed 25% tariffs on $34 billion worth of US imports from China in July 2018, 25% tariffs on $16 billion of imports in August 2018, and 10% tariffs on $200 billion of imports in September 2018, later increasing the rate of those duties to 25% in June 2019. In September 2019, Trump imposed 15% tariffs on an additional $102 billion of imports, later reducing the rate of those duties to 7.5% in February 2020 under the US-China Phase One agreement. The Biden administration has largely kept these tariffs intact – tariffs on China still average 19% and remain on two-thirds of US imports from China. As a result, only 18% of total US goods imports now come from China, down from 22% at the start of the trade war.

While Biden has reversed Trump in many arenas, ranging from health to labor to environment, he has doubled down on trade protection and remained just as tough, if not tougher, on China. On Dec. 23, 2021, Biden signed the Uyghur Forced Labor Prevention Act, a law that presumes that all goods produced in or sourced from China's Xinjiang Uyghur Autonomous Region (XUAR) are made with forced labor. The law was intended to punish China for its arbitrary detention of over one million Uyghurs in Xinjiang since 2017. Under the law, American companies can still import goods from the XUAR if they can prove that their imports are not linked to forced labor. But because granular information on hiring contracts can be virtually impossible to track down, the law essentially forces American companies to cut Xinjiang – and China more broadly – completely out of their supply chains.

Less than 10 months later on Oct. 7, 2022, the Biden administration announced its most damaging measures against China so far – comprehensive export controls prohibiting the sale of cutting-edge semiconductor chips, advanced equipment needed to manufacture them, and semiconductor expertise from the US. By targeting chips, an input critical to the defense industry and to technologies of the future, the controls represent a far-reaching effort to inhibit China's military modernization and isolate China from advanced industrial supply chains. They foreshadow sanctions across a wider range of high technology sectors, such as artificial intelligence (AI) and surveillance technology.

US-China trade relations are unlikely to improve anytime soon. China-bashing is both popular and bipartisan in the newly elected, Republican-controlled House of Representatives, and Republican presidential candidates will outdo one another in hawkishness during the run up to the 2024 presidential election. Revoking China's permanent normal trade relations (PNTR) status, imposing controls on AI and surveillance technology, and preserving Section 301 tariffs on China are all front-burner issues for the coming year.

Changing US Perspective on Trade

Under the past two presidential administrations, the US has taken a protectionist and unilateralist approach to trade policy, abandoning the traditional liberal multilateral approach of the past 75 years. The Biden administration is not committed to free trade; no priority has been placed on negotiating new trade deals and there is little US support for the WTO. In fact, the Biden administration has asserted that the WTO has no authority to review "issues of national security" (referring to the Section 232 tariffs on steel and aluminum imposed under Trump) and refuses to fill the seven vacant WTO Appellate Body seats, rendering the WTO's dispute settlement system inoperable. The goal of US trade policy is no longer freer trade, but rather a myriad of national security, labor, and other nontrade priorities, especially against China.

Since assuming office on March 18, 2021, US Trade Representative (USTR) Katherine Tai has promoted a "worker-centric" trade policy, using trade to achieve the Biden administration's labor goals. Tai argues that by prizing efficiency above all else, traditional US trade policy brought excessive profits to multinational corporations at the expense of workers, who in turn have suffered lost jobs and low wages. To make up for these alleged failures, Tai wants to place workers' interests at the center of trade policy, promoting worker rights rather than pursuing efficient production. The Uyghur Forced

Labor Prevention Act is one of Tai's worker-centric policies, banning all XUAR imports from entering the US until poor working conditions improve and forced labor ends in Xinjiang. Another is the Rapid Response Labor Mechanism in the US-Mexico-Canada Agreement (USMCA), a provision that allows the US to take action against individual factories in Canada and Mexico that fail to protect workers' rights to freely associate and collectively bargain. Tai, and by extension Biden, believes that the political benefits of a worker-centric policy will outweigh the economic costs.

The US also sees trade policy as a way to confront China. The October 2022 semiconductor export controls are an obvious example, using trade policy to freeze China's semiconductor suite at 2022 levels and severely impede its military development in the short-term. Trump's Section 301 trade war tariffs on China are another. Tai has still not removed the tariffs despite pleas from US firms, viewing them as "a significant piece of leverage" against China for future trade negotiations and a way to pressure China to reform its unfair trade practices. The Indo-Pacific Economic Framework for Prosperity (IPEF) – the Biden administration's proposed regional economic agreement with Asia-Pacific countries – is meant to counter China's growing influence among South and Southeast Asian countries. As the US increasingly uses trade policy to achieve nontrade objectives, when it comes to China, Biden and his administration are clearly wielding trade policy to reshape the bilateral relationship. Recent Congressional activity indicates that US policymakers are just as eager as Biden to continue down the path of economic escalation.

Hardening US Position on China

Despite a divided Congress, there is bipartisan consensus amongst American lawmakers on remaining tough on China. In a major win for the newly minted Speaker of the House Kevin McCarthy, on Jan. 10, 2023, both Democrat and Republican members voted overwhelmingly in favor to establish a new select committee to investigate the various threats China poses to the US. Dubbed the "House Select Committee on the Strategic Competition Between the US and the Chinese Communist Party", the committee is also bipartisan, composed of nine Republicans and seven Democrats. During the committee's first hearing on Feb. 28, 2023, lawmakers raised numerous concerns over China's behavior and policies, including many issues already the subject of legislation (such as limiting or prohibiting Chinese investment in US firms and agricultural land and restricting US outbound investment in China's technology sector).[1] China's unfair trade practices were also raised, with both Democrat and Republican members suggesting that the US should revoke China's Permanent Normal Trade Relations (PNTR) status.

Bipartisan antagonism towards Beijing culminated in a flurry of committee action in late February 2023. On Feb. 28, 2023, the House Foreign Affairs Committee approved legislation that would require the Biden administration to seek revocation of China's status as a developing country in all international organizations, agreements, and treaties, and restrict Biden's ability to waive the measure.[2] While the legislation does not name specific international organizations, it takes aim at the WTO, where the US has long complained about China's developing country status.

On the same day as the House Foreign Affairs Committee approved its China bill, the House Financial Services Committee passed a slew of seven China-focused bipartisan bills. The bills include the "Taiwan Conflict Deterrence Act of 2023" (a bill that would cut select Chinese leaders and their families off from financial services and publish their assets if Beijing acts against Taiwan); the "Preventing the Financing of Illegal Synthetic Drugs Act" (a bill that would study illicit financing in drug trafficking to stop Chinese-origin fentanyl from entering the US); the "Taiwan Non-Discrimination Act of 2023" (a bill that would require the US to advocate for Taiwanese membership of the International Monetary Fund (IMF)); the "Chinese Currency Accountability Act of 2023" (a bill that would require the Treasury Secretary to oppose an increase in the weight of China's renminbi in the basket of currencies influencing the value of Special Drawing Rights); the "China Exchange Rate Transparency Act of 2023" (a bill that would require the US director at the IMF to advocate greater transparency in China's exchange rate policies); the "PROTECT Taiwan Act" (a bill that would require the Federal Reserve, Treasury Secretary, and the Securities and Exchange Commission to exclude Chinese representatives from various international financial groups and organizations if China invaded Taiwan); and the "China Financial Threat Mitigation Act of 2023" (a bill that would require the Treasury Secretary to report on the global economic risks the Chinese financial sector poses). While these committee bills still need to pass the full House of Representatives and the Senate to become law, the speed with which they are moving through the House reflects the pervasiveness of anti-China sentiment in Congress today.

As the chasm between Washington and Beijing continues to grow, a good indication of what future US trade policy towards China will look like comes from the US-China Economic and Security Review Commission's 2022 Annual Report to Congress. Created by Congress in October 2000 to monitor, investigate, and submit an annual report outlining the national security implications of bilateral trade between the US and China, the Commission considers the following 10 of its 39 recommendations in its 2022 report to be "of particular significance":

1. Congress should direct the Biden administration to produce a report assessing China's compliance with provisions agreed to for its accession to the WTO, and if it finds that China failed to comply, Congress should consider suspending China's PNTR treatment.
2. Congress should direct the Biden administration to establish an Economic and Security Preparedness and Resilience Office within the executive branch to "ensure resilient US supply chains and robust domestic capabilities".
3. Congress should create a permanent interagency committee in the executive branch charged with developing plans to impose sanctions and other economic measures on China in the event Beijing acts against Taiwan.
4. Congress should direct the US Food and Drug Administration to identify pharmaceuticals that contain ingredients and inputs that are sourced directly or indirectly from China and develop

1 See *Washington Trade Daily*, Vol. 32, No. 41 (March 1, 2023).
2 Ibid.

alternative sourcing plans.

5. Congress should direct the Biden administration as part of IPEF to prohibit the use of China's National Transportation and Logistics Public Information Platform (LOGINK) within IPEF member ports.
6. Congress should direct the US Department of the Treasury to require US corporations to publicly disclose all holdings in firms linked to the Chinese military on an annual basis.
7. Congress should create an authority under which the president can require specific US entities to divest their operations, assets, and investments in China in the event of China using or threatening imminent military force against the US or one of its allies.
8. Congress should direct the US Department of Defense to produce a classified report on requirements needed to bolster the US's "capacity to resist force" in the event of a Chinese invasion of Taiwan in all scenarios.
9. Congress should commit "significant additional multiyear defense funds" in conjunction with (1) Taiwan legislatively committing significant additional defense funds and (2) a joint planning mechanism between Taiwanese and US defense officials.
10. Congress should remove Hong Kong Economic and Trade Offices as a covered organization, reversing this amendment only if China either negotiates an agreement with the US to have Hong Kong Economic Trade Offices considered an official part of China's mission to the US or if China sufficiently abides by One Country, Two Systems as enumerated by the Hong Kong Policy Act.

The new House Select Committee on China is likely to embrace many of the Commission's recommendations. Several members from both sides of the political aisle have already suggested revoking China's PNTR status – the Commission's leading recommendation – at the Select Committee's first hearing.

Future Trade Policy Issues

Rhetoric from the USTR and current proposed legislation in Congress clearly indicate that the US will maintain an antagonistic approach towards trade with China. The Biden administration will extend rather than roll back many of the trade policies developed by the Trump administration, including Section 301 tariffs on Chinese imports. Trade will continue to be a means for achieving nontrade objectives – in the case of China, geopolitical and national security objectives.

Permanent Normal Trade Relations for China in the WTO

On Jan. 26, 2023, one month before the new House Select Committee on China's first hearing, four Republican senators proposed the China Trade Relations Act, a bill that would strip China of its PNTR status and make both human rights and trade abuses disqualifying factors for future most favored nation status. Then, on Feb. 24, 2023, four days before the Select Committee's first hearing, USTR Tai lambasted China's compliance with WTO rules in her statement on the USTR's 2022 Report to Congress on China's WTO Compliance, saying "More than 20 years after it acceded to the World Trade Organization, China still embraces a state-led economic and trade approach that runs counter to the open, market-oriented principles endorsed by all members of the organization." Tai labeled China's approach "an outlier" that causes "serious harm to workers and businesses in the United States and around the world", while the 2022 USTR report accused China of continuing "to use numerous and constantly evolving unfair, nonmarket and distortive trade policies and practices in pursuit of harmful and anticompetitive industrial policy objectives". Most importantly, the report recommends holding China accountable for existing commitments as a "new strategy" needed to deal with the challenges that China presents. Stripping China of its PNTR status as punishment for disregarding WTO norms is the leading example of this new strategy. Adding together the proposed Senate bill and negative USTR assessment with both the US-China Economic and Security Review Commission's recommendation and bipartisan support for revoking China's PNTR status in the Select Committee on China hearing suggests that Congress is likely to withdraw normal trade relations treatment from China during the coming year.

Artificial Intelligence

Following the October 2022 export controls on semiconductors to China, lawmakers are currently trying to determine which technology sectors should be the subject of future controls. In separate letters to Treasury Secretary Janet Yellen and Commerce Secretary Gina Raimondo, the heads of the Senate Select Committee on Intelligence, Chairman Mark Warner and Vice Chairman Marco Rubio, called upon the Biden administration to employ existing tools and authorities to prevent China's military from "benefitting from US technology, talent, and investment".[3] To Yellen, the senators warned about the vulnerabilities China's Military-Civil Fusion (MCF) program creates for US security and directed attention to the Treasury's Specially Designated Nationals and Blocked Persons lists, which do not currently include a number of individuals and organizations identified by the US government as national security threats. To Raimondo, the senators urged Commerce to impose export controls more broadly and questioned Commerce's ability "to evaluate companies' reliance on China and assess the flow of US innovation to Chinese entities".[4]

The US has long wished to prevent China from developing advanced AI computing and supercomputing facilities. Indeed, the primary motivation behind the 2022 US semiconductor export controls was to choke off China's access to the future of AI by blocking China's ability to purchase, design, and manufacture the most advanced AI chips. Future US controls on AI will most likely take the form of regulations on US outbound investment in AI, but such regulations will be very difficult to draft because AI is so much broader than semiconductors. While semiconductors represent a specific type of computing hardware with varying degrees of sophistication, AI encompasses everything from search and recommendation algorithms to facial recognition, navigation apps, and answering queries and writing essays. Despite the argument that all AI investments in China can technically be considered dual use because of China's MCF program, a

3 See *Washington Trade Daily*, Vol. 32, No. 36 (Feb. 22, 2023).
4 Ibid.

blanket ban on US outbound investment in Chinese AI companies seems implausible.

Moreover, such a ban would likely hurt the US more than it would hurt China. Recent analysis from Georgetown's Center for Security and Emerging Technology (CSET) suggests that the vast majority of investors in Chinese AI companies are Chinese (not American), US venture capital investment mainly brings intangible benefits (e.g., name recognition rather than cash), and the US government is not currently in a position to effectively monitor outbound investment flows to Chinese AI companies. "Turning off the tap" via a blanket AI outbound investment ban would cut off what little information the US has about China's AI sector. Instead, CSET recommends the US create a program specifically to collect data before determining whether to impose restrictions.

The Biden administration appears to be taking that recommendations to heart. Reporting from Politico indicates that Biden's forthcoming executive order on AI outbound investment is now expected to focus on transparency. US firms will be required to notify the government when doing deals in AI and quantum computing, while new investments in Chinese semiconductor firms will likely be prohibited. This goes against previous expectations, where House Foreign Affairs Chair Michael McCaul revealed the Biden administration was considering a full investment blockade on Chinese AI and other sectors of the economy.

Surveillance Equipment

On Feb. 4, 2023, a Chinese spy balloon floated across the US, infuriating lawmakers on Capitol Hill and resulting in the cancellation of Secretary of State Antony Blinken's planned trip to China. On Feb. 10, 2023, the Commerce Department added six Chinese aerospace companies to the Entity List – a trade blacklist – for supporting Beijing's surveillance programs. Companies placed on the Entity List are restricted from obtaining US technologies and goods without US government authorization, which protects national security by imposing another layer of government oversight.[5] Specifically, the Feb. 10, 2023 controls apply to goods related to aerospace programs, including airships and balloons as well as related materials and components, that are used by the Chinese military for intelligence.[6] In a press statement, Bureau of Industry and Security chief Alan Estevez said the decision to blacklist the six Chinese firms "makes clear that entities that seek to harm US national security and sovereignty will be cut off from accessing US technologies". While the spy balloon incident may blow over, the Biden administration could choose to include surveillance equipment in its forthcoming executive order limiting outbound investment in China.

Section 301 Tariffs

The Biden administration is unlikely to roll back the Section 301 tariffs on Chinese imports, despite hearing direct pleas from some American business owners to ease them. During a tour of a Chicago eyewear manufacturer as part of USTR's required four-year review of the tariffs on Feb. 10, 2023, USTR Tai was unsympathetic to the company's struggles to pay increased prices on intermediate goods imports from China. The real problem, Tai argued, is not the tariffs, but rather that the US has "an incredible vulnerability" that needs to be addressed. Though Tai's tariff review remains ongoing, her position – and by extension, the Biden administration's position – appears set.

There is also support for maintaining the tariffs in Congress. On Feb. 1, 2023, 14 Senate Republicans urged the Biden administration to continue to retain the Section 301 tariffs on Chinese goods in a joint letter to Blinken and Yellen ahead of their visits to China (which were later cancelled).[7] Unlike Tai, who views the tariffs as leverage against China, the senators see maintaining the tariffs as a way to punish China for its long history of industrial espionage, unfair trade practices, and human rights violations. As the Biden administration has already extended two other sets of tariffs imposed under Trump – solar tariffs and Section 232 tariffs on aluminum and steel – it is highly unlikely the administration will fully or even partially remove the Section 301 tariffs.

Conclusion

Despite record bilateral trade in 2022, US-China trade relations will worsen for the foreseeable future. Strong bipartisan support exists in Congress for confronting China, with a raft of anti-China bills currently making their way through both the House and the Senate. The Biden administration has grown accustomed to deploying trade policy for national security and labor objectives, and this sentiment will continue.

Over the coming year, the US will probably revoke China's PNTR status, impose outbound investment controls on AI, add more stringent export controls on surveillance technology, and maintain Section 301 tariffs on Chinese imports. China is sure to retaliate against some, if not all, of these measures. Since Biden shows no signs of seeking détente with China, and since President Xi Jinping has amplified his rhetoric against the US, the most likely outcome is a new "Cold War". JS

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5 See *Washington Trade Daily*, Vol. 32, No. 29 (Feb. 13, 2023).
6 Ibid.
7 See *Washington Trade Daily*, Vol. 32, No. 22 (Feb. 2, 2023).