A China Strategy for Working Americans

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Craig Allen

President of U.S.-China Business Council

Thank you for this opportunity. I would like to make some observations about US-China relations and the impact of bilateral tension on employment in the United States.

US-China relations at the dawn of the Biden Administration present us with a difficult conundrum.

In his speech at the State Department on February 4, the President said that "Every action we take in our conduct abroad, we must take with American working famili**es** in mind." Full employment is a key goal of the Administration.

In the same speech, the President said, "We will confront China's economic abuses; counter its aggressive, coercive action; to push back on China's attack on human rights, intellectual property and global governance."

There is an in-built tension between these two sets of foreign policy objectives. How is it that we confront China where we must; but still work to maximize economic employment for Americans? It will take deft diplomacy to accomplish both goals. Another way to approach the question is how do we bridge the economic and security divide in a manner that does not prejudice employment for American working families?

Today, I would like to offer some 10 specific policy suggestions on how to maximize employment in the US, by leveraging China's growth, without compromising on any of our geopolitical or diplomatic objectives.

But before proceeding, I have to offer a few big caveats.

The first caveat is that the correlation of trade policies to specific outcomes in the labor market is weak. President Trump, for example, pursued a protectionist trade policy and yet employment in the pre-COVID period was strong. President Trump was on track to add some 9 million jobs, mostly due to a combination of loose fiscal and monetary policy, as well as de-regulation. Trade policy does have an impact on employment – which we shall discuss - but it is relatively small, the tail being wagged by the dog.

The second caveat is that future technological change will impact the US labor market in ways that are impossible to predict. The future of autonomous driving, for example, will have a far larger effect on employment than trade policy.

But, technological competition is also a key element of US-China relations. I will say more about China's technology policies of "self-reliance and self-strengthening" in a bit, but let's park that subject for the time being.

The third caveat is that we cannot talk about US trade policy toward China in the abstract, without taking into account distortions in China's domestic macro-economy.

As Wen Jiabao said in 2007 that China's economic growth was "unstable, unbalanced, uncoordinated and unsustainable ". Premier Wen's observation is probably as true now as it was when he said this – and that there are profound implications for policy makers around the world.

In summary, China's household consumption is far too low, less than 40 percent of total GDP in 2020. This is in contrast to between 60 and 70 percent in the OECD countries. From a comparative perspective, China hugely over-saves and over invests in often uneconomic infrastructure, at the expense of family consumption. This drives over-capacity, overt-investment and (implicitly) subsidized exports – at the expense of both Chinese workers, consumers and China's foreign trade partners.

The good news is that the Chinese government recognizes the imbalance and has articulated an intention to address the underlying issues.

We should all watch the National People's Congress in March when I expect we will learn more about the "dual circulation" policies and the State's plan to expand consumption as a percentage of GDP. Will these policies be effective in growing the middle class and raising consumption as a percentage of GDP? Will they be WTO compatible? What will the impact of the "dual circulation" policy be on China's trading partners?

The transition from an economy based on capital investment and net exports to one based on domestic consumption will be a difficult and longer-term process for China. China needs to move as much as 2 or 3 percentage points of GDP from investment to consumption each year for 10 years if it is to escape from Wen Jiabao's "unstable, unbalanced, uncoordinated and unsustainable" paradigm.

So, having recognized the primacy of macroeconomic adjustments in China and the United States, let me move to trade policy. Notwithstanding the importance of macro-economic adjustment and changing technology, trade policy will also continue to have a large impact on employment in the United States.

Future economic historians will look back at the Trump Administration with great interest for its many innovations in trade policy. The last four years will provide a cornucopia of evidence on the costs and benefits of tariffs and other protectionist policies.

While we do not yet have the benefit of sufficient hindsight, I think that the evidence suggests that – despite what may have been best of intentions – the tariffs and other trade wars of the Trump era had a very negative net impact on American employment.

Yes, it is true that some jobs may have been created. But we can be certain that many more jobs were lost as a result of the tariffs.

If Ambassador Robert Lighthizer or Professor Peter Navarro were in the room they discuss the jobs in aluminum smelters and steel mills that they saved. What they might not say is that each of the jobs in those industries were saved at the cost of USD 900,00 per job, according to Chad Braun of the Peterson Institute.

In manufacturing, the hit to US employment has been direct, through decreased exports and indirect through declines in total factor productivity and competitiveness. Let me give you a very specific example of a company that lost sales and market share due to the tariffs.

> A tool maker imported parts for tools from China, assembled them in the US and then sold the tools around the world. When tariffs went up, many of their components hit by 25 percent tariffs and they could not find alternative suppliers at a good price. Because they were manufacturing in the US with Chinese components, they had to raise prices and subsequently lost market share in the US market and abroad to competitors. .
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> This story is repeated ten thousand times over across the US manufacturing sector.

USCBC recently commissioned a study on this subject from Oxford Economics and the bottom line that we come up with is that, at its peak, approximately 245,000 American jobs were lost.

So let me go through a few charts here to try to describe the industries and geographies where jobs have been lost due to Mr. Trump's trade war. The first chart is just a level set. (SLIDE) It shows total US exports by category to China. You will notice that services are a very important part of the export mix to China, making up as much as 40 percent of our total exports – and they were growing rapidly.

My second chart focuses on the manufacturing sector in both China and the United States and it shows the impact of the trade war on those various sectors in terms of Gross Value Added. (SLIDE) I think that this chart demonstrates very well that Mr. Trump's tariffs had their intended effect in China. Chinese GVA in all of these industries declined. But, in all cases, US GAV in the same industries also declined … sometimes more and sometimes less. Both sides lost.

My third chart shows the impact of the trade wars on employment from a regional perspective. (Slide) It is not equal. The underlying data is ONLY job losses or gains from US exports to China – and does not include total factor productivity. Nonetheless, it is instructive that those states that rely mostly on commodity production and manufacturing have been most badly hit by the trade policies.

It is important to note that the excessive reliance on bilateral tariffs on our trading partners almost always will rebound on American farmers. When other countries retaliate against the WTO-illegal use of tariffs by the United States, they retaliate by hitting American farm exports – as this is where they will get the biggest political bang for the buck.

While President Trump spent some USD 28 billion to compensate American farmers for their losses, the compensation has been unevenly distributed and could not nearly make up for the loss hard-earned market share and long-term prospects in China and elsewhere.

> Because of these subsidies, the unemployment effect of the tariffs on American farmers is very hard to calculate. I heard of a small American dairy family in Wisconsin that had to sell his 80 cows to a neighbor who had 800 cows. The farmer then took a job as a long-distance truck driver. While he was not technically unemployed, the composition of the labor market had changed.

And then finally, to introduce the next part of my talk, I would share here data from Oxford Economics on the economic and employment impact of trade war de-escalation from 2022 to 2025. (OEp19) The assumption underlying this graph is not total removal of tariffs – but rather a reduction of bilateral tariffs from the current average rate of 20 percent to a more moderate 12 percent. This would lead to 145,000 new jobs by 2025.

So, with this data as background, let me move on to policy prescriptions.

First, the US and China must reinstitute a forum to discuss the important macro-economic issues that will impact the well-being of the other. There is an urgent need to establish a dialogue to understand – and perhaps shape – the macroeconomic decisions that will be made in China which will impact employment in the US. Something like the S&ED should be re-established to provide technical support to assist China to adjust its economic model toward greater consumption as a percentage of GDP. Alternatively, we may consider more narrow technical dialogues around resolving specific problems. There are many difficult issues to discuss, including:

- How to address the overcapacity
- Improving the social safety net
- Preparing for a rapidly aging society
- The misallocation of capital to state owned enterprises and corporate governance.
- Greater transparency for government subsidies
- Abolishing the Huko system

Another reason why we should have this discussion with the government of China is that we need to change the bilateral conversation from the protectionism and containment of the Trump Administration. We should move on to a more realistic and pragmatic conversation about ensuring that China's rise is peaceful and not deleterious to China's neighbors and trading partners. How do we square a state and party run economic system within global system as envisioned by the WTO?

These are big questions and there are no easy answers. But talking is better than not talking.

Second, we should maintain and fully implement the Phase One Deal. Phase One has many critics. They note that the Chinese have met only approximately 60 percent of their purchase obligations under the deal in the first year. (SLIDES)

The Chinese government has said that they fully intend to meet their commitments under the deal, and I think that we should encourage them to do so. USTR, DOC, DOE and DOA should initiate negotiations to understand when and how the Chinese will meet this obligation. If successful, this would lead to a significant increase in US exports and much-needed jobs over the 2021 calendar year.

Perhaps even more important in the longer-term, the Chinese government has met its commitments under the deal to change Chinese market access policies to improve market access for American agriculture, and financial service firms as well as increase protections for intellectual property. Much progress has been made in these areas and this progress should be protected.

The Phase One deal is in place only for another 12 months. This leads me to my third recommendation.

Third, we should urgently begin negotiations on the Phase Two Agreement, to be completed prior to the expiration of Phase One. A target date for completion would be when President Biden and President Xi meet on the margins of the APEC meeting in New Zealand which will be held November 10 - 13.

The issues that were not resolved in 2019 are state owned enterprises, subsidies, industrial technology policy and cyber. While all of these issues are very difficult, the Chinese side has indicated that it is willing to discuss the problems. The recent China- EU Comprehensive Agreement on Investment led to modest commitments on SOEs and Subsidies.

We could build on these and reach back to the Bilateral Investment Treaty negotiations and ask the Chinese to bring forward the commitments made at that time. One could also reach back to the Obama-Xi cyber agreement and pick up those negotiations again. While the negotiations will be difficult, it is possible to make incremental progress on all of these issues.

The new Administration might now wish to call this a Phase Two agreement. Moreover, it could be succession of smaller agreements on specific topics. But, we need to get some momentum in bilateral trade negotiations and, I believe that this is most likely, if we use the agreed-upon road map.

Fourth, we should complete a Phase Two agreement by APEC in November and then get rid of the tariffs on both sides, but possibly retaining 2022 and 2023 purchase taregets

We must recall that tariffs on goods going both ways across the Pacific are currently at an average of about 20 percent – and unless these are addressed – there is a danger that they may become permanent. Tariffs tend to be easy to put up and sticky to come down. The longer they are up, the harder they are to bring down.

Tariffs are both job killers and they have impoverished consumers in both China and the United States. The leverage that they have created should be used as quickly as possible to achieve the ends to which they were directed and then removed. If these tariffs become permanent, they will distort US-China trade and investment – possibly in perpetuity, condemning us to an unstable bilateral relationship which can not ever be fully normalized.

Our research suggests that if the tariffs were lowered to 12 percent – there would be a net gain of about 145,000 jobs by 2025. If the tariffs were fully removed – especially in concert with incremental improvement on the outstanding issues – these job gains would be much higher.

Fifth, following completion of the Phase Two Negotiations and elimination of tariffs we should continue negotiations with the Chinese using the CPTPP as a discussion framework.

Let's step back for one second. It should be clear that the economic architecture of Asia is starkly different now compared to the situation four years ago. The Chinese and their partners have successfully concluded the 15 country RCEP agreement. The Chinese and the Europeans have successfully concluded a Comprehensive Agreement on Investment. Belt and Road investments have further strengthened regional economic integration. China's trade negotiators have been extremely busy.

And, finally, Premier Li and President Xi have both stated that China will consider entering the CPTPP. We should take them at their word. As Chinese economists told me, it is the next logical step in China's reform and opening program. While China's entry into CPTPP will certainly take time, one should not doubt their determination or ability to do so.

While it is not politically feasible for USTR-designate Catherine Tai to consider joining the CPTPP in the near term, perceptions will change if the Chinese appear to be moving to join the group without us, particularly as we would be locked out of Asia - the world's fastest growing markets - by our absence.

To hedge against this risk, it makes sense for the world's two largest economies to talk with each other in terms of the rules associated with an agreement that they may both – one day – join. The CPTPP is largely based on US trade law and it closely complements the USMCA.

I admit that this recommendation is longer-term. I admit that we cannot clearly know the employment effects of joining CPTPP. However, one needs a strategy to move forward and, in my view, talking with the Chinese in discussions structured around the CPTPP is in America's long term economic interest.

My next three recommendations are much more short term – and they lie outside the traditional bounds of trade diplomacy – but they will have immediate quantifiable benefits for American workers.

Sixth, in preparation for the post COVID world, we should immediately remove offensive visa restrictions and facilitate Chinese tourism to the United States.

As you may recall from a previous slide, travel and tourism is the United States single largest export to China, worth as much as USD 30 billion a year prior to COVID 19. The Trump Administration put into place restrictions on 92 million CCP members and their families visiting the United States. These regulations are offensive, but completely unenforceable, and they should be abolished immediately.

Travel and tourism is a very labor-intensive industry and continued expansion of our exports of these services to China would be especially beneficial to lower income Americans.

There is no doubt that there is demand for these services and that continued expansion of this market is likely in the post-COVID era – if the US government will get out of the way. Abolishing the visa restrictions on CCP members and their families would be a great start.

Seventh, the Biden Administration should be clear that civilian Chinese students are welcome at American universities in all fields that are not directly related to national security.

Education is roughly a USD 15 billion-dollar export market and Chinese students remain committed to studying in the United States, provided that they know that they are safe and welcome. There are many competitors that wish to supplant us in this market and we must not be complacent.

There have been excesses and inappropriate behavior by Chinese researchers at American institutions. It is also clear that China's Thousand Talents campaign is insufficiently transparent and induces researchers into relationships that may be improper. But it is also true that our response to these excesses has led to unfair treatment of individual Chinese and Chinese American academics.

Eighth, we should welcome Chinese investment in the United States in all industries and localities that do not have clear national security implications.

When you look at US economic history, going back centuries, countries with a large trade surplus eventually invest in our markets to make products here. This industrial migration is a good thing. It helped to mitigate tensions with Japan in the 70s and Taiwan and Korea in the 80s and 90s.

Today, we need more Chinese investment in the United States, particularly in areas that have high unemployment and suffer from chronic underdevelopment. There is a huge demand in China to invest in the US mostly in industries that have no national security implications. The US government should welcome such investment. While Mayors and Governors want Chinese investment in their jurisdiction, the Federal Government clearly does not. (SLIDE)

CFIUS and FIRRMA, our in-bound investment regulatory regimes, are necessary. However, they have been applied in a manner that made it clear that the Federal Government wanted to reduce investment from China to as little as possible. This is counterproductive. It hurts American workers.

To be balanced, I have to note that the Chinese government also has been regulating outbound investment to the United States, and thus US policies are not the only impediment.

Nonetheless, if we do not allow Chinese investment into the United States, we condemn ourselves to long-term economic imbalances with China and this is not a future to which we should aspire.

Ninth, we need to address supply chain resiliency issues with incentives rather than trade distorting tariffs or other government-mandated barriers.

As a result of COVID and a concern for potential shocks to our supply chain, it is reasonable to aspire to greater resilience and flexibility – to ensure the continued flow of critical goods in times of emergency. However, the government should be extremely careful before using coercive tactics to re-shore manufacturing or force companies to produce in a particular place.

Tariffs are an incredibly blunt instrument. There are precious few cases that I am aware of where tariffs have incentivized manufacturing investment in the United States. Yes, the tariffs have moved manufacturing from China to ASEAN countries. But does that really help resilience? Does it help employment in the United States?

If the government wishes to induce companies to invest domestically, it should provide WTO compliant incentives toward this end and allow companies to make the decision on what to buy where.

Finally, it is imperative that we address the challenges of data, export controls and technology policy in a more comprehensive manner – preferably in alignment with Europe and Japan.

In my view, technology is the most difficult and important element of the bilateral relationship, especially over the longer-term.

There should be zero doubt that the Chinese also believe that technology self-reliance and self-strengthening is a key national objective. It is unfortunate that the policies associated with technology self-reliance and self-strengthening are so often WTO illegal and outside of OECD norms. In addition, the Chinese R&D establishment is too often plagued by waste, fraud and abuse.

In addition to the trade policy problems associated tech in China, there is also the specter of Civil Military Fusion and the Chinese Intelligence Law, both of which cast a chilling light on any civilian technology cooperation with Chinese universities, institutions, and academics. China should reconsider these laws – which are complete outliers and not found in any other country of which I am aware.

Without being naïve, I think that there is some degree to which international negotiations and better bureaucratic hygiene could lead to China transitioning from playing a predatory role in the global economic ecosystem to playing an integrated and trusted partnership role along with the world's other great research countries. It is in the interest of Chinese civilian institution to better integrate with global R&D norms, values and procedures.

As this issue is so critical and multi-dimensional, I believe that the establishment of a new office in the White House to coordinate global technology and data policy is necessary. The office could coordinate with allies. Further, the office could negotiate with the Chinese and others on the rules of the road for technology cooperation, the rules of the road for technology competition and most importantly, mechanisms to enforce those rules.

Technology is the most difficult issue in US-China relations and we need a focused, coordinated approach to this subject within the US government.

Equally important, we need to work with our partners, friends and allies on these issues. We should aspire to common standards on export controls, common standards on in-bound investment and, if possible, a common research and development agenda and budget.

I highly commend the work done by UC San Diego and the Asia Society on this subject and I am sorry that I cannot do it justice after an already long talk. But it is the central question of the bilateral relationship and we need more study.

Conclusion

In conclusion, I have tried to outline here ten ideas that would help to grow employment in the United States over the short, medium and longer terms, without prejudicing our overall geopolitical and diplomatic challenges with China.

In an ideal world, one would be able to enumerate exactly the employment impact of each of these items in a complex and dynamic American labor market.

While I think it is impossible to be precise about these numbers, I am confident that the ten policy recommendations I have made will lead to a much healthier American economy and job opportunities for American citizens.

The United States and China have a complex security and economic relationship. We must change the overall dynamic of the relationship to be more competitive and less confrontational – mindful of **both** our security and economic needs, bridging these two worlds whenever possible.

Thank you.