U.S. Trade Policy *at a* Turning Point

How America can better protect itself against China's predatory policies.

By Robert D. Atkinson

Trade policy in the United States has reached a turning point as a rising China seeks absolute advantage across a broad range of vital industries. If the United States rejects both free trade and protectionism, and going forward adopts power trade as a strategy, what needs to be done to implement that strategy? This is the third of three articles which examine power trade as practiced by Germany before World War II, and by China today.

The practice of U.S. power trade from 1945 to 2016, focused as it was on ensuring global market integration (outside of the Soviet Union and then Russia)—even at the expense of U.S. industrial competitiveness—has run its course. America's adversary today is not a sclerotic but militarily powerful foe that could inflict little or no economic damage outside of its bloc. China today is a dynamic, militarily and technologically powerful foe that can and does inflict considerable economic damage around the world, including to the U.S. economy.

As such, the United States needs to shift from an approach to power trade based on advancing U.S. foreign policy interests to an approach that focuses on advancing U.S. competitive advantage against China, especially in critical advanced technology sectors. Doing so necessitates a new approach to trade strategy, including a more sophisticated and analytical role for the federal government.

U.S. trade negotiation has long been premised on the notion that nations do best when they align their trade policies with market forces based on

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THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
202-861-0791
www.international-economy.com
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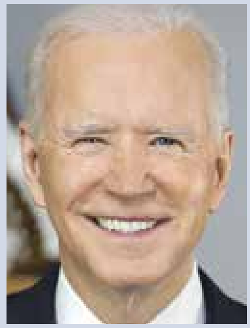
An Agenda for Joe Biden



U.S. President
Joe Biden

With regard to China directly, the Biden administration needs to replace the Trump administration's shotgun style of confrontation with more carefully aimed rifle shots to advance America's strategic economic interests while constraining China's. Unless Europe fully joins the United States, or the World Trade Organization undergoes significant reform so it can take effective action against non-rule-of-law nations like China, it is unlikely that outside forces will be able to roll back China's rampant unfair and predatory economic and trade practices.

What the United States can and should do is better protect itself against China's predatory policies. This will entail stepping up commercial counterintelligence efforts and cybersecurity to limit Chinese access to key intellectual property. It will require using the powers the Foreign Investment Risk Review Modernization Act gave the Committee on Foreign Investment in the United States (CFIUS) to largely stop Chinese investment in U.S. technology-related firms, including venture capital investments. It will mean effectively tracking Chinese companies that benefit from U.S. intellectual property theft or unfair subsidies, and limiting their access to U.S. markets.

The risk now is that the Biden administration's "middle-class" trade doctrine will make redistribution the key focus, continuing long-term decline in American economic and technology competitiveness and power.

—R. Atkinson

comparative advantage. In this sense, U.S. trade negotiators have often seen their role, at least in part, as helping other nations identify and advance their own comparative advantages. The endless dialogues with China under the George W. Bush and Obama administrations were a reflection of this: U.S. negotiators worked to get China to open its markets to certain U.S. industries because they believed the United States and China both would benefit.

Under a new power trade doctrine that focuses on U.S. competitiveness, the assumption should be that nations know their strategic industrial interests and negotiate to achieve them. As such, trade negotiations with China should not be about achieving enlightenment or changing minds; they should be about compelling change from a position of superior power. In this sense, Trump assumed that China was not going to negotiate in good faith, so persuasion was futile and only threats backed up by action would work. While this was a better reflection of the reality of power trade negotiations, it accomplished little, in part because acting alone is no longer enough to compel China to change.

Power trade also has implications for how trade strategy is developed. If the optimal domestic industrial structure and trading relationships reflect a nation's natural comparative advantage—Britain as good at textiles, Portugal at wine, and so forth—then there is no need for the state to have strong analytical capabilities. Ricardo's theory of comparative advantage was developed at a time when well more than half of nations' GDPs was a product of agricultural sectors (with 60 percent of Britain's labor force still in the fields). Today, agriculture contributes less than 1 percent of U.S. GDP, and the vast majority of economic impact derives from knowledge- and technology-driven manufacturing and services industries, where comparative advantage is created, not naturally given.

The United States needs to shift from an approach to power trade based on advancing U.S. foreign policy interests to an approach that focuses on advancing U.S. competitive advantage against China, especially in critical advanced technology sectors.

Moreover, in China, the United States faces a competitor who rejects even the notion of comparative advantage and instead seeks absolute advantage across all high-value–added, advanced technology industries, from airplanes and biotechnology to clean energy to critical information and communications technologies from semiconductors to 5G equipment. When the intentional actions of nation-states are capable of creating and shifting advantage in these sectors, then the United States had better have strong analytical capabilities to understand this dynamic.

But the longstanding view has been that as long as trade policy is focused on removing barriers and distortions, market forces do the rest and produce the optimal economic structure. This belief explains the lack of strong analytical capabilities in the federal government to evaluate industrial capabilities and trade interests. The United States Trade Representative's Office is not an analytical agency; it is a legalistic one, staffed principally with lawyers who deal with trade law arcana. While the U.S. Department of Commerce engages in some modest collection of trade statistics coupled with equally modest export promotion programs, it lacks analytical capabilities to understand U.S. industrial structure or domestic and international competitive forces in key industries. And while the Bureau of Industry and Security and the International Trade Commission engage in analysis, the former's is limited to narrow national security issues, and the latter's relates to trade adjudication issues and ad hoc requests for industrial and trade analysis.

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By contrast, trade and industrial policy focused on boosting U.S. competitive advantage requires deep analysis, both of how to generate the optimal industrial structure, and also of adversaries' industries and strategies. This is why, in his 1945 book *National Power and the Structure of Foreign Trade,* noted development economist Albert O. Hirschman wrote with respect to Germany, "the amazing coherence of German policies was due … in part to detailed planning springing from economic analysis." This also explains the advantage China has developed in its vast bureaucratic apparatus governing and analyzing trade, from the National Development and Reform Commission to the Ministry of Industry and Information Technology to the Ministry of Commerce, and it highlights the nature of the shift that has occurred under Xi Jinping from a "China, Inc." regime to a "CCP, Inc." regime, as analyst Jude Blanchette at the Center for Strategic and International Studies has articulated.

This recognition explains the recent widespread calls for the Biden administration to step up its analytical capabilities when it comes to trade and industrial competitiveness in order to at least close the gap between the country's economically oriented analytical capabilities and its national security–oriented

Jack Ma *is founder of the Chinese multinational technology company Alibaba.*

The Advantages of Dictatorship

Power trade has been easier to implement in nondemocratic regimes where the state more easily imposes its will on industry.

With its CCP dictatorship, especially now with the cult of President Xi, the Chinese state can largely ignore vested domestic interests that are a casualty of a trade war. It can force CCP members onto the boards or executive teams of all enterprises operating in China, whether these are domestic or foreign companies. It can even force Jack Ma, the richest person in China, to lay low for several months.

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Some Policy Proposals

Smart industrial and technology policies should include a much more robust research and development tax credit and a new investment tax credit, establishment of well-funded, pre-competitive R&D institutes, major investment incentive programs like the CHIPs Act focused on semiconductors, and major federal government moonshots—involving funding and massive procurement—for key areas like smart cities, robotics, curing cancer and other chronic diseases, and clean energy.

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The Shadow robot hand system.

analytical capabilities. Indeed, the closest America has to that now is in the Defense Department's Office of Industrial Policy, but the focus, as expected, is defense-oriented. What the country needs is an economy-wide equivalent to the Defense Department's "net assessment" structure and process, which is a "framework for strategic analysis" involving quantitative and qualitative information, to assess the current and future military power of the United States and its adversaries. The United States needs the same in-depth practice to assess the commercial power and capabilities of itself and its adversaries.

In addition, while the domestic politics of trade are real regardless of the regime—free, limited, or power—they are considerably more difficult in a power trade regime. Indeed, one core challenge with implementing a competitiveness-based power trade policy is that it generates considerable domestic policy conflicts, because it requires actively promoting certain industries while "sacrificing" others. While such conflicts might exist in the free trade regime, the expectation is that the role of the state in adjudicating these conflicts is minimal; the government promotes free trade and reduced market barriers for all. In this world, there is a general direction of opening up, and while some negatively affected domestic interests might complain, it is in the context of a broader liberalization and opening, so their complaints have less weight.

But in competitiveness-based power trade, it is clear that the state can and does play a decisive role and must choose. As Hirschman writes, "conflicts between the policies implementing the different principles of a power policy with foreign trade as an instrument are conceivable and do occur." For example, a power trade-based trade negotiation would not put the chicken industry on par with the semiconductor industry for the simple reason that the latter is much more important to national security and growth and much harder to replicate later if trade were to harm it. Nor would it shrink from a fight for strong intellectual property rights in trade agreements for industries like biopharmaceuticals because of their strategic importance *vis-à-vis* China.

This explains why power trade has been easier to implement in nondemocratic regimes where the state more easily imposes its will on industry. With its CCP dictatorship, especially now with the cult of President Xi, the Chinese state can largely ignore vested domestic interests that are a casualty of a trade war. It can even force Jack Ma, the richest person in China, to lay low for several months. It can force CCP members onto the boards or executive teams of all enterprises operating in China, whether these are domestic or foreign companies. But this doesn't mean that in America's pluralist and contentious system more cannot be done to prioritize strategic industries in trade policy.

In addition, countering China's power trade can be difficult for any nation, because so many of those countries' domestic economic interests are now dependent on China. And that is precisely what China has sought. For example, when in response to Trump's initial rounds of tariffs China erected tariffs on U.S. agricultural products, particularly from politically important midwestern

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states, China was doing what Germany had done in the first part of the twentieth century. As Hirschman points out, "In the social pattern of each country there exist certain powerful groups, the support of which is particularly valuable to a foreign country in its power policy; the foreign country will therefore try to establish commercial relations with these groups, in order that their voices will be raised in its favor." Given the U.S. reflexive embrace of free trade, this kind of trade reorientation obviously will be much more difficult, especially given the extent to which Beijing has now leveraged its domestic market to create dependency for certain U.S. exporters such as farming interests. Consequently, even the Trump administration asked for concessions from China to import more U.S. agricultural products.

STRATEGIC IMPLICATIONS FOR THE DIRECTION OF U.S. TRADE POLICY

So what should be done at a policy level?

First, policymakers should abandon, at least while China is controlled by the CCP, any hope that the world can be remade in the Ricardian image of free-trading nations pursuing comparative advantage through fair, rules-based trade. The high-water mark for that was in 2001, just after China joined the World Trade Organization, when the Doha round commenced. It has largely been downhill ever since, at least in terms of fulfilling the idealized global free trade vision.

Achieving that vision was never going to be easy, because, as Hirschman writes:

> *[I]nternational trade remains a political act whether it takes places under a system of free trade or protection… Still, the belief is widespread that it is possible somehow to escape this intimate connection between international trade and "power politics" and to restore trade to its "normal and beneficial economic functions."*

And if getting to deeper global integration and free trade was harder before China ramped up its power trade, it is virtually impossible now.

If trying to force open the stuck free trade door is not possible, at least on a global, multilateral basis, then what should the United States do? In short, it must trade where it can, protect what it must, and embrace industrial policy as much as possible.

In other words, the Biden administration should continue to seek trade liberalization with nations that are not power traders, either on a bilateral basis (such as in a U.S.-UK agreement), on a multilateral basis (such as in a U.S.-Commonwealth agreement), or in particular sectors, such through an expanded Information Technology Agreement, a new e-commerce and digital trade agreement, or an environmental goods and services agreement. But these sorts of agreements should be negotiated without China's involvement to ensure U.S. interests are reflected as fully as possible. The administration should also work for robust World Trade Organization reforms to better deal with China violations, as a Center

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for Strategic and International Studies commission has recommended. It should also form a new allied-nation trade compact that would operate outside and in parallel to the World Trade Organization.

Shifting to a new form of power trading will also entail altering the meaning of President Biden's commitment to a trade policy for the middle class, which appears an amalgam of protectionism (for example, strengthened "Buy America" provisions), limited defense of U.S. economic interests (such as weakening intellectual property protection in trade agreements), and domestic spending to help those hurt by trade, all the while paring back the ambition of the prevailing U.S. power trade doctrine. While ensuring that American workers benefit more from trade is critical, the best way to accomplish that is to bolster U.S. advanced industrial competitiveness *vis-à-vis* China. America's middle class is not in a "precarious state" principally because of imbalances of distribution; it is in a precarious state because the overall U.S. economy is in a shaky competitive position. Any new trade doctrine to help the middle class should be first and foremost focused on helping enterprises, large and small, in advanced industries compete globally, especially against China. Among other steps, this means abandoning the misguided notion that certain U.S. business interests, such as intellectual property protection overseas, are not also the interest of U.S. workers.

President Biden is right to focus on domestic investment and boosting competitiveness as part of any new approach to trade. For too long, policymakers believed that America did not need a competitiveness strategy to compete—partly because the country was in a superior position, and partly because of the prevailing belief that competitiveness strategies were not effective. China has largely changed that. As such, a core component of a China-focused power trade doctrine must be a domestic competitiveness agenda.

The United States needs to do a better job of supporting its own advanced and critical industries through smart industrial and technology policies. But the conventional wisdom generally stops at advocating for better generic factor inputs, such as supporting high-skill immigration and increased science funding. These are necessary but woefully insufficient in confronting the China challenge. A real strategy should focus on policies and programs that change corporate strategy and decision-making in sectors key to the United States' future, in part to align these firms' interests with the long-term interests of the United States. These policies should include a much more robust research and development tax credit and a new investment tax credit, establishment of well-funded, pre-competitive R&D institutes, major investment incentive programs like the CHIPs Act focused on semiconductors, and major federal government moonshots—involving funding and massive procurement—for key areas like smart cities, robotics, curing cancer and other chronic diseases, and clean energy.

On the trade front, a new China-focused doctrine will entail closer collaboration between allied nations to push back against China's predatory power trade practices, including by increasing foreign aid to help developing nations avoid crippling dependency on China, by better coordinating export controls and inward investment reviews, and by collaborating on technology policy. But U.S. policymakers should have modest and realistic expectations here. Europe seems to have little stomach for anything other than exporting a few more cars to China. While South Korea and Japan are more willing to be on America's side against China, ultimately they will likely have to choose neutrality.

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Finally, with regard to China directly, the Biden administration needs to replace the Trump administration's shotgun style of confrontation with more carefully aimed rifle shots to advance America's strategic economic interests while constraining China's. Unless Europe fully joins the United States, or the World Trade Organization undergoes significant reform so it can take effective action against non-rule-of-law nations like China, it is unlikely that outside forces will be able to roll back China's rampant unfair and predatory economic and trade practices.

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U.S. trade policy is at a turning point, between one regime and another. The old, post-war regime has exhausted itself. The Trumpian alternative was a backward-looking dead end. However, the risk now is that the Biden administration's "middle-class" trade doctrine will make redistribution the key focus, continuing long-term decline in American economic and technology competitiveness and power. To avert that, it is time for a new China-containing power trade doctrine and regime focused on developing a sizeable and sustainable lead in the key advanced technology industries central to America's future prosperity and defense. ◆