

**SAFEGUARDING THE HOMELAND: EXAMINING
CONFLICTS OF INTEREST IN FEDERAL
CONTRACTING TO PROTECT AMERICA'S FUTURE**

HEARING

BEFORE THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ONE HUNDRED EIGHTEENTH CONGRESS

SECOND SESSION

SEPTEMBER 24, 2024

Available via the World Wide Web: <http://www.govinfo.gov>

Printed for the use of the
Committee on Homeland Security and Governmental Affairs



U.S. GOVERNMENT PUBLISHING OFFICE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

GARY C. PETERS, Michigan, *Chair*

| | |
|---------------------------------|--------------------------|
| THOMAS R. CARPER, Delaware | RAND PAUL, Kentucky |
| MAGGIE HASSAN, New Hampshire | RON JOHNSON, Wisconsin |
| KYRSTEN SINEMA, Arizona | JAMES LANKFORD, Oklahoma |
| JACKY ROSEN, Nevada | MITT ROMNEY, Utah |
| JON OSSOFF, Georgia | RICK SCOTT, Florida |
| RICHARD BLUMENTHAL, Connecticut | JOSH HAWLEY, Missouri |
| LAPHONZA BUTLER, California | ROGER MARSHALL, Kansas |

DAVID M. WEINBERG, *Staff Director*

ALAN S. KAHN, *Chief Counsel*

MICHELLE M. BENECKE, *Senior Counsel*

STEPHANIE T. ROSENBERG, *Investigative Counsel*

DANIEL M. LABONTE, *Professional Staff Member*

TIFFANY ANN SHUJATH, *U.S. Department of Homeland Security Detailee*

WILLIAM E. HENDERSON III, *Minority Staff Director*

CHRISTINA N. SALAZAR, *Minority Chief Counsel*

PHILLIP A. TODD, *Minority Chief Economist*

LAURA W. KILBRIDE, *Chief Clerk*

ASHLEY A. GONZALEZ, *Hearing Clerk*

CONTENTS

| | |
|----------------------|------|
| Opening statements: | Page |
| Senator Peters | 1 |
| Senator Paul | 3 |
| Senator Hawley | 17 |
| Senator Hassan | 20 |
| Prepared statements: | |
| Senator Peters | 29 |

WITNESSES

TUESDAY, SEPTEMBER 24 2024

| | |
|--|----|
| Jessica Tillipman, Associate Dean for Government Procurement Law Studies, and Government Contracts Advisory Council, Distinguished Professional Lecturer in Government Contracts Law, Practice, and Policy, George Wash- ington University Law School | 5 |
| Rush Doshi, Ph.D., C.V. Starr Senior Fellow for Asia Studies, Council on Foreign Relations and Assistant Professor, Georgetown University | 7 |
| Clark Packard, Research Fellow, Herbert A. Stiefel Center for Trade Policy Studies, Cato Institute | 9 |
| Bryan Riley, Director, Free Trade Initiative, National Taxpayers Union | 11 |

ALPHABETICAL LIST OF WITNESSES

| | |
|--------------------------|----|
| Doshi, Rush Ph.D.: | |
| Testimony | 7 |
| Prepared statement | 42 |
| Packard, Clark: | |
| Testimony | 9 |
| Prepared statement | 56 |
| Riley, Bryan: | |
| Testimony | 11 |
| Prepared statement | 92 |
| Tillipman, Jessica: | |
| Testimony | 5 |
| Prepared statement | 32 |

APPENDIX

| | |
|------------------------------|----|
| Senator Hawley's chart | 96 |
| USAF FOIA Request | 97 |

**SAFEGUARDING THE HOMELAND:
EXAMINING CONFLICTS OF INTEREST IN
FEDERAL CONTRACTING TO PROTECT
AMERICA'S FUTURE**

TUESDAY, SEPTEMBER 24, 2024

U.S. SENATE,
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Gary Peters, Chair of the Committee, presiding.

Present: Senators Peters [presiding], Hassan, Blumenthal, Ossoff, Paul, Scott, and Hawley.

OPENING STATEMENT OF SENATOR PETERS¹

Chairman PETERS. The Committee will now come to order.

Federal contractors are a key part of our government's operations. The services and products they provide play a critical role in delivering services to the American people, as well as keeping our nation safe. From advanced defense systems to cutting-edge cybersecurity, contractors are entrusted with information and responsibilities that can impact the national and economic security of our Nation.

From modernizing and enhancing the safety of our infrastructure and power grid to providing critical intelligence that safeguards our nation from foreign and domestic threats, the scope of government contractors' support is immeasurable.

To ensure that government contractors are working in the best interests of Americans, we must ensure they are meeting the highest standards of integrity, impartiality and transparency, by removing conflicts of interest from their work. Conflicts of interest are not minor infractions. They pose threats that undermine our national security and economic competitiveness and can dangerously erode the American people's trust in their government.

Over the past decade, there have been alarming reports of Federal contractors who are simultaneously promoting competing interests, including those of foreign adversaries, interests that directly contradict our national security needs and hurt our economic competitiveness.

¹The prepared statement of Senator Peters appears in the Appendix on page 29.

For example, in the summer of 2023, in one of the largest intrusions of U.S. Government (USG) cloud services, Chinese state-backed hackers gained access to the emails of high-level officials, compromising the information security of U.S. officials who work on national and economic security matters. This attack has raised serious concerns that China-backed hackers were able to steal this information because of the service provider's partnership with a Chinese entity while they were providing services to the U.S. Government at exactly the same time.

In 2015, a consulting firm responsible for advising the U.S. Government on national security strategy, cybersecurity, and cutting-edge technology was simultaneously advising Chinese state-run enterprises. This consulting work for Chinese enterprises involved China's naval fleet and Chinese government efforts to raise its profile and strengthen its position and power globally, a goal in direct competition with American interests.

In another example, the same firm's research and recommendations allegedly assisted in the creation of the Chinese government's Made in China 2025 industrial plan in opposition to U.S. foreign policy objectives and our national and economic security.

These examples demonstrate the need to strengthen our laws, specifically around disclosure of foreign ties, particularly where Federal contractors are providing services to authoritarian governments who seek to bolster their economic and geographic assets in competition with our Nation.

In sectors like defense and cybersecurity, the stakes are incredibly high. Just last week, the Federal Bureau of Investigation (FBI) Director Wray announced the FBI had successfully disrupted a malware attack targeting over 200,000 devices in the United States and worldwide by a Chinese-backed hacking group called the Flax Typhoon.

The Chinese cyber actor exploited known vulnerabilities, including in a major U.S. cloud service provider that receives billions in U.S. taxpayer dollars each year, to support the Federal Government's information technology (IT) services. It goes without saying that major U.S.-based technology service providers working for foreign adversaries while performing multibillion-dollar contracts for the U.S. Government risk exposing vulnerabilities that can be exploited by our adversaries.

We can and must stop this.

In 2022, my bipartisan bill, the Preventing Organizational Conflicts of Interest in Federal Acquisition Act, was signed into law. The bill seeks to end conflicts of interest from Federal contracts that provide critical services to the American people. It directed the Federal Acquisition Regulatory (FAR) Council, to provide clear guidance to agencies and Federal contractors on ways to identify, mitigate, and even avoid conflicts of interest.

Despite being signed into law nearly two years ago, the FAR Council is late on issuing guidance required by my law, which is why yesterday I led the cosponsors of this legislation in a letter pressing for quick action to issue this desperately needed guidance.

I continue to call on the FAR Council, which includes the General Services Administration (GSA), National Aeronautics and Space Administration (NASA), the Department of Defense (DOD),

and the Office of Federal Procurement Policy (OFPP) to provide better guidance to agencies on how to handle conflicts of interest.

Earlier this year, I also worked with Senator Hawley on his bill, the Time to Choose Act of 2024, which would add guardrails to prevent consulting firms that are under contract with foreign adversaries from simultaneously providing services to the Department of Defense and other Federal agencies. I joined the bill, along with Senators Rick Scott and Marco Rubio, to ensure contracting firms are using taxpayer funds responsibly and to help prevent foreign adversaries from exploiting business relationships with contractors to interfere with American interests.

I am confident that we can all agree that Americans deserve full assurance that Federal contractors are providing transparency and avoiding any potential conflicts before they are awarded taxpayer dollars.

That is why we still have work to do.

Today's hearing will help us better identify and mitigate conflicts of interest in an ever-evolving global landscape. Our witnesses will examine inadequacies within existing Federal contracting rules as well as explore steps that can be taken to mitigate future risks.

I thank each of them for being here today and look forward to a very productive conversation.

I would now like to recognize Ranking Member Paul for his opening statement.

OPENING STATEMENT OF SENATOR PAUL

Senator PAUL. In a speech in 1985, Ronald Reagan addressed an audience of business and trade leaders, stating, "I, like you, recognize the inescapable conclusion that all history is taught. The freer the flow of world trade, the stronger the tides of human progress and peace among nations."

While today's topic is about conflicts of interest, this hearing is yet one more opportunity for Washington to reject this conclusion in its insatiable desire to impose sanctions on China and to restrict trade.

While it is clear that we have an adversarial relationship with China, there is another way. In the past 30 years it is undeniable that the economic interaction between the United States and China has been a substantial driver of both Chinese and American economic growth.

As President Reagan pointed out, nearly 40 years ago, trade will not only strengthen the tides of human progress but also increase prospects for peace. The London School of Economics recently found that trade with China has boosted the average American household purchasing power by \$1,500, just since 2001. These effects are substantially higher among low-income households, reaching as high as an additional \$1,700 per year in purchasing power.

Studies by Oxford and Harvard have found that trade with China has led to a net job creation. In 2019 alone, trade with China was directly responsible for 1.2 million American jobs. We should think twice before ending relations and ending trade with China. Despite the tense relationship we have had with China since 2017, China remains the U.S.'s third-largest trading partner behind Mexico and Canada, accounting for about 10 percent of all

American trade in 2024. China also remains the world's second-largest consumer market, only behind the United States.

Even so, many in the Senate and across Congress fail to recognize the tradeoffs that come with the antagonistic and extreme restrictions of foreign trade of goods and services. It is not just China that suffers from these policies but also American households, American small business owners, and even, at times, America's strategic objectives.

Some argue that we should prioritize domestic contractors. A recent report from the Peterson Institute found that in 2017 alone, Buy America requirements cost the U.S. taxpayer \$94 billion. This is effectively a \$715 tax per American family. To make matters worse, the same study found that the mandates had little to no effect on net job growth. So even American workers who are also consumers are made poorer by these requirements.

Another recent study found that repealing all Buy American mandates on U.S. procurement would even generate an additional 300,000 jobs and lead to significant advancements in U.S. infrastructure goals. Unserious legislation that seeks to comprehensively ban firms that sell to foreign markets from Federal contracts not only harms our competitiveness and dynamism of the U.S. business contracting with the Federal Government but also the strategic aims and interests of the U.S. Government itself.

People worry that contractors who work for the Chinese government will be influenced by Chinese communism. It is also that the reverse may be true, that American contractors, contracting for the Chinese government, may be bringing in influence from America and from American capitalism, as well.

I look forward to hearing from our witnesses about how simultaneously to mitigate the risks that may come from conflicts of interest, while still maintaining the competitiveness and dynamism brought about by the free markets and free trade that makes all Americans more prosperous.

Chairman PETERS. Thank you, Ranking Member Paul.

It is the practice of the Homeland Security and Governmental Affairs Committee (HSGAC) to swear in witnesses, so if each of you would please stand and raise your right hand.

Do you swear the testimony that you will give before this Committee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. TILLIPMAN. I do.

Dr. DOSHI. I do.

Mr. PACKARD. I do.

Mr. RILEY. I do.

Chairman PETERS. Thank you. You may be seated.

Our first witness is Jessica Tillipman. She is the Associate Dean for Government Procurement Law Studies and a Distinguished Professorial Lecturer in Government Contracts Law, Practice and Policy. Dean Tillipman is an internationally recognized expert and prolific author on government procurement integrity and compliance issues. She is also a senior advisor to the American Bar Association (ABA), International Anticorruption Committee, a faculty advisor to the Public Contract Law Journal, and an advisory board member of The Government Contractor.

Dean Tillipman, you are now recognized for your opening remarks.

TESTIMONY OF JESSICA TILLIPMAN,¹ ASSOCIATE DEAN FOR GOVERNMENT PROCUREMENT LAW STUDIES AND GOVERNMENT CONTRACTS ADVISORY COUNCIL, DISTINGUISHED PROFESSIONAL LECTURER IN GOVERNMENT CONTRACTS LAW, PRACTICE, AND POLICY, GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

Ms. TILLIPMAN. Thank you. Chair Peters, Ranking Member Paul, and Members of the Committee, thank you for inviting me to testify before the Committee today. I am Jessica Tillipman, the Associate Dean for Government Procurement Law Studies at the George Washington University (GWU) Law School.

Over the past several years, organizational conflicts of interest (OCIs), have received an increasing amount of attention, given high-profile incidents that have highlighted weaknesses in this area of the law. Although I was very pleased to see the enactment of the Preventing Organizational Conflicts of Interest in Federal Acquisition Act, which addresses several gaps in the current OCI framework, the Federal Acquisition Regulatory Council has yet to issue a proposed OCI rule in response to that legislation. This hearing provides an opportunity to renew focus on the issues that continue to hinder Federal agencies' ability to effectively address OCIs.

Today's hearing focuses primarily on a specific type of OCI, impaired objectivity, which may arise where a contractor's outside business interests and relationships create an economic incentive to provide biased advice under a government contract. Although OCIs have been regulated since the 1960s, they have become more frequent in recent decades due to industry consolidation and the outsourcing of services traditionally performed by the government.

OCIs are more likely to occur in contracts involving professional services, including management support, consultant, or advisory services, which is notable given the hundreds of billions of dollars the U.S. Government spends each year on these professional services.

Despite widespread acknowledgement for the past several decades that this could create fertile ground for conflicts of interest, government regulation of these potential hazards has not kept pace. The decades-long absence of an update to the Federal Government's approach to OCIs has weakened U.S. procurement system and left it vulnerable to integrity and national security risks.

Today's hearing is focused on a potential national security concern that may stem from companies that maintain intelligence or defense contracts with the United States while simultaneously contracting with foreign adversaries. If these interests are neither disclosed nor mitigated, it increases the risk that sensitive information may be exploited or fall into the wrong hands. It also increases the risk that contractors may be unable to provide impartial assistance or advice due to their competing relationships with certain foreign governments.

¹The prepared statement of Ms. Tillipman appears in the Appendix on page 32.

The current framework governing OCIs, which has remained largely unchanged since 1984, is outdated, inconsistent with modern procurement practices, and fails to address the growing risks associated with the government's increasing reliance on contractors to provide services, including advice and the exercise of judgment.

This has led some contracting officials to treat OCI assessments as a rote, check-the-box exercise rather than a meaningful, thorough, and rigorous analysis. Moreover, the lack of a standard FAR OCI solicitation provision or contract clause has left agencies to fill this vacuum with their own provisions and clauses, leading to severe inconsistencies in agency approaches to this area of the law.

Most glaringly, the FAR lacks critical definitions and does not thoroughly address compliance, disclosure, or mitigation obligations. This absence of guidance has led to a paradoxical issues of both over-and under-compliance. Some contracting officials may never even consider OCI risks, whereas other may reflexively and improperly exclude a contractor from competition.

A new OCI rule should provide clarity, more expansive definitions, greater guidance for contracting officers, updated illustrated examples, and enhanced disclosure and compliance requirements for relevant contractors. This effort should be buttressed by robust training requirements for contracting officials, as well.

As this Committee and the FAR Council consider remedies to these issues, a cautionary approach is necessary. Draconian approaches to addressing concerns cannot only undermine the goals of legislative and regulatory reform but create new problems.

Striking a balance between necessary and excessive regulation is never easy, but it is critical, and it is my hope that a thoughtful and nuanced approach to OCI reform will address integrity and security concerns, bring greater clarity to the existing regulations, and create a more uniform approach across the Federal Government.

Thank you for the opportunity to share these thoughts with you. I would be pleased to answer any questions you have for me.

Chairman PETERS. Thank you.

Our next witness Rush Doshi, is the C.V. Starr Senior Fellow for Asia Studies and Director of the China Strategy Initiative at the Council of Foreign Relations. His expertise includes China's foreign policy, U.S. strategy toward China, cross-strait issues, and Indo-Pacific security.

Before joining the Council of Foreign Relations, Dr. Doshi was Deputy Senior Director for China and Taiwan on the National Security Council, where he served from 2021 to 2024, and helped manage the Security Council's first China directorate.

Dr. Doshi is an Assistant Professor in Georgetown's School of Foreign Service. He is the author of *The Long Game: China's Grand Strategy to Displace American Order*. Dr. Doshi is also a co-editor of *Global China: Assessing China's Growing Role in the World*.

Dr. Doshi, welcome, and you are recognized for your opening statement.

STATEMENT OF RUSH DOSHI,¹ Ph.D., C.V. STARR SENIOR FELLOW FOR ASIA STUDIES, COUNCIL ON FOREIGN RELATIONS AND ASSISTANT PROFESSOR, GEORGETOWN UNIVERSITY

Dr. DOSHI. Thank you. Chair Peters, Ranking Member Paul, distinguished Members of the Committee, I appreciate the opportunity to testify today.

I will focus my remarks on four questions related to China. First, what are Beijing's ambitions? Second, how does Beijing create conflicts of interest for U.S. companies? Third, how do those conflicts threaten U.S. national security? And fourth, what can we do about it?

First, what are Beijing's ambitions? The People's Republic of China's (PRC) has a grand strategy to displace U.S.-led order. It seeks to catch up and surpass the U.S. technologically, to reduce dependence on others while increasing their dependence on China economically, and to acquire the capability to defeat U.S. military forces in the region. It is the leading industrial power globally and the first U.S. competitor to surpass 70 percent of the United States. Gross Domestic Product (GDP) in a century. It is mounting a campaign to compromise U.S. critical infrastructure and steal U.S. data and technology, aided in part by conflicts of interest among U.S. companies.

Second, how does Beijing create conflicts of interest? Unlike in the Cold War, U.S. companies are deeply involved in the PRC economy. One source of these conflicts is PRC threats to deny market access unless U.S. companies take steps against their interests or national interests, like to transfer intellectual property, enter joint ventures, censor their speech, or even refrain from taking China to court if they are treated unfairly. The PRC even threatens foreign executives with exit bans to keep them in China, and their companies with costly regulatory action, all without due process.

But there is another source of conflicts that is new and expansive, and that is PRC national security legislation, and I will list three broad trends.

First, the China's Communist Party (CCP) is pushing to embed Chinese Communist Party cells into foreign companies, and it wants them to play a role in corporate governance, strategic decisionmaking, personnel management, corporate charters, and even board processes.

Second, the PRC's National Intelligence Law and Counter-espionage Law would require U.S. subsidiaries, their employees, and their PRC partners to cooperate with PRC intelligence services and not to tell anyone. According to the Department of Homeland Security (DHS), that could mean supporting efforts to install back doors or steal U.S. data.

Third, these new PRC National Security Laws pry open the networks, encryption keys, and data of U.S. companies in the PRC and to the PRC. The Cybersecurity Law requires U.S. company data to be stored in China and accessible to the security services. The Encryption Law requires companies to turn over their encryption keys to the Chinese government. The Data Security Law says Beijing must approve cross-border data flows even for answering sub-

¹The prepared statement of Dr. Doshi appears in the Appendix on page 42.

poenas from committees like this one. The State Secrets Law expands the definition of covered data to virtually anything the PRC wants it to be.

How do these conflicts harm U.S. national security? As we all know, PRC cyber actors have compromised sensitive U.S. sectors, the USG email systems, defense companies, and critical infrastructure providers for gas and water and other systems. Yet the very companies that serve these sectors also operate in China in ways that could put those services here at greater risk.

Take software. The U.S. Government relies on Microsoft software, but to access China's market, Microsoft turned over source code for that software to the PRC. So did International Business Machines Corporation (IBM) and others. And that could plausibly create cybersecurity risks, and those risks should be accounted for in contracting.

Take cloud services. Microsoft and Amazon provide cloud services to the USG. But to enter China they had to turn over operation of their cloud services to a Chinese joint venture that is legally required to cooperate with PRC intelligence. That means the PRC can learn a good deal about the topology, architecture, and the vulnerabilities of these systems, and that too needs to be accounted for in contracting.

Take research. Many tech companies operate research centers in China. The PRC can access all that research. If those researchers discover what are called zero-day vulnerabilities, they have to turn those over to the PRC before they tell anyone else. Microsoft believes that the PRC uses this regulatory process to stockpile and weaponize its zero-day exploits against the United States.

Finally, take consulting. Companies that contract with the USG or U.S. companies should not use that knowledge and expertise to help the PRC government, and yet McKinsey affiliates helped China structure its industrial policy programs to do just that. Other consulting firms in China were rated by the PRC—Bain, Capvision, the Mintz Group. All of that also needs to be reflected in contracting.

What do we do about this? That is where I will end. I think Time to Choose is very important legislation, but it could be broader than consulting, and it could apply to the serious risks posed by technology service providers that I have discussed today.

In addition, Congress could prohibit firms that contract with the USG from hosting CCP cells, from complying with PRC national security laws, or from entering any arrangements with PRC entities that could plausibly threaten U.S. national security, from sharing source code to entering certain joint ventures. All this actually helps our companies do business in China by pushing back on unfair PRC demands.

I will end by noting that profits in China, for some of these companies, are falling, even as the risks to the United States are growing. China, for example, is only 1.5 percent of Microsoft's revenue. IBM is pulling out already.

The solutions that we are considering today are commonsense. They are less costly and disruptive today than they would have been years earlier. I think now is the time to consider them, and I thank you for your time.

Chairman PETERS. Thank you.

Our next witness is Clark Packard. Mr. Packard is a Research Fellow at the Herbert A. Stiefel Center for Trade Policy Studies at the Cato Institute. Prior to joining the Cato Institute, Mr. Packard was a Resident Fellow at the R Street Institute, focusing on international trade policy. He previously worked at the National Taxpayers Union, doing the same, and prior to those roles he served as an attorney and policy advisor to two South Carolina Governors. Earlier in his career he spent three years in private legal practice.

Mr. Packard is a contributor to *Foreign Policy* and has written for *National Review*, *Lawfare*, *LawWorks Business Insider*, *The National Interest*, and other publications.

Mr. Packard, welcome. You are recognized for your opening comments.

TESTIMONY OF CLARK PACKARD,¹ RESEARCH FELLOW, HERBERT A. STIEFEL CENTER FOR TRADE POLICY STUDIES, CATO INSTITUTE

Mr. PACKARD. Thank you. Chair Peters, Ranking Member Paul, Members of the Committee, thank you for the opportunity to testify today. My name is Clark Packard. I am a Research Fellow at the Cato Institute.

My work at Cato focuses on U.S. international trade and investment policy with a specific focus on the U.S.-China economic relationship. For that reason, I am especially grateful for the opportunity to testify today.

Let me state unequivocally at the outset that China does engage in abusive, and at times coercive, international trade and investment practices. Many of those activities are done in support of widespread industrial policy.

My testimony will focus on the potential, though, for abuse of national security-based protectionism and provide suggestions for outcompeting China in the 21st Century.

Free traders from Adam Smith to Milton Friedman have understood the need for limited exceptions for national security. An American firm providing consulting services to the Department of Defense, for example, should not also be advising the Chinese government or the Chinese Communist Party. At the very least, American firms should be required to disclose potential conflicts of interest when bidding on U.S. Government contracts for close scrutiny by American procurement officials.

To the extent that I have suggestions about legislation with such aims, it would be to ensure stringent guardrails are established to avoid stifling legitimate business practices. Too often national security is invoked as a pretext for simple protectionism.

The Trump Administration's national security tariffs on steel and aluminum imports, imposed despite President Trump's defense secretary at the time, nothing the U.S. military required only three percent of domestic steel and aluminum production, is a case in point. Indeed, the tariffs still apply to steel and aluminum from North Atlantic Treaty Organization (NATO) members and other long-standing allies like Japan and South Korea. Those tariffs are

¹The prepared statement of Mr. Packard appears in the Appendix on page 56.

extremely costly to the U.S. economy, harming industries that use steel and aluminum as inputs, U.S. consumers, and Americans targeted by foreign retaliation such as farmers and ranchers.

In addition, the tariffs undermine confidence in the United States as a reliable trading partner. Imposed under the guise of national security, the tariffs inflicted considerable economic damage—the expected result of protectionist measures—while doing nothing to bolster our national defense.

Likewise, national security-based arguments are being invoked as the rationale to block Nippon Steel's acquisition of U.S. Steel, but there is no security risk at all. Japan is the largest provider of foreign direct investment (FDI) in the United States, and U.S. Steel has no security contracts. For more than 60 years, Japan has been one of the United States' strongest allies and currently hosts more than 55,000 U.S. military personnel. It is incongruent that the United States would deploy nuclear weapons if necessary to defend Japan from attack, yet simultaneously claim Japanese investment is a national security risk to the United States. Today, Japan receives 90 percent of its defense-related imports from the United States. Simply put, Nippon would not be paying a premium to purchase U.S. Steel only to shutter it. Indeed, Nippon would most likely provide the investment necessary to strengthen the firm.

Turning to Beijing, it is worth noting that the Chinese economy is struggling and faces significant short-and longer-term headwinds that will surely constrain future growth. We should not overestimate its strength. Right-sizing the challenge is imperative to sound policy. That said, Beijing does pose very serious challenges to the United States, both economically and strategically.

The United States, however, should not respond to those challenges by turning inward and hiding behind protectionist walls. Instead, policymakers should work to strengthen trade and investment ties with close allies, particularly those in the Asia-Pacific region. While flawed, the Trans-Pacific Partnership (TPP) would have created an American-led trade bloc to offset China's gravitational pull in the region economically and established higher-quality trade and investment rules and norms.

In the absence of U.S. re-engagement in TPP, the United States should build on its successful bilateral agreement with South Korea, known as Korea Free Trade Agreement (KOR-US). Given the thawing in relations between Seoul and Tokyo, adding Japan and other allied countries to KOR-US presents a next-best option.

Likewise, policymakers should adopt the House's Select Committee on the Chinese Communist Party's wise recommendation to expedite Committee on Foreign Investment in the United States (CFIUS) review of FDI from trusted allies like Japan and South Korea.

The U.S.-China relationship is increasingly complex and is the top geopolitical issue facing the world. How these two countries will manage this relationship will greatly affect global peace, prosperity, and stability in the 21st Century. The guiding principle of our economic policy, vis-à-vis China, should focus on affirming market incentives that boost the performance and competitiveness of American firms and those of our allies.

I look forward to answering any questions the Committee may have. Thank you.

Chairman PETERS. Our last witness is Bryan Riley. Mr. Riley is Director of the National Taxpayers Union Free Trade Initiative. His background includes service in the Reagan Administration and years of research on the impact that trade has had on people in the United States. He has led grassroots campaigns in support of initiatives like the North American Free Trade Agreement, and has been quoted in publications, including *The Washington Post*, *The New York Times*, and *The Wall Street Journal*. He is an in-demand speaker who travels the country explaining the benefits of international trade and the investment that it brings to Americans.

Mr. Riley, welcome. You are recognized for your opening comments.

TESTIMONY OF BRYAN RILEY,¹ DIRECTOR, FREE TRADE INITIATIVE, NATIONAL TAXPAYERS UNION

Mr. RILEY. Thank you, Chair Peters. Thank you, Ranking Member Paul.

Founded in 1969, National Taxpayers Union (NTU) is the oldest taxpayer group in the United States. We serve as the “Voice of America’s Taxpayers” and strive to represent their best interests before governments at all levels. NTU appreciates your Committee’s important work in protecting our national security and the opportunity to be here today.

With respect to Federal contracting specifically, NTU encourages Congress to make the best use of taxpayer dollars. Chair Peters, I duly noted your mention of the importance of using taxpayer funds responsibly in your introductory remarks.

With respect to Buy American laws, former President and Supreme Allied Commander Dwight Eisenhower observed it is unfair to the taxpayer for the government to pay a premium on its purchases. Senator Paul has already pointed out that in 2017, these Buy American restrictions cost taxpayers an estimated \$94 billion, an amount that is certainly higher today.

Improving these Buy American laws would help control spending. This is especially important in a year in which the Federal Government is projected to spend more on interest payments than on the military for the first time in U.S. history. Removing barriers to goods and services provided by U.S. allies would also strengthen our national security.

We submit the following considerations with respect to the proposed Time to Choose Act and similar proposals. As a disclaimer, these comments are based on the text available on the publicly available version of the text. There have been some modifications which may mitigate some of these concerns, but I believe they still broadly apply, and are even more broadly applicable to similar efforts.

This legislation, in particular, does not appear to require a demonstration of a specific national security threat resulting from covered transactions. It is simply, you provide a service to the Chinese government, you get banned here.

¹The prepared statement of Mr. Riley appears in the Appendix on page 92.

Such legislation could represent a slippery slope. For example, China is the largest export market for U.S. agricultural producers, with products often purchased by State-owned enterprises in China. This does not necessarily mean that it would be wise for the government to ban the purchase of farm products by the Department of Agriculture (USDA) or school lunch programs.

In addition, in the future it is possible that a company that contracts with the Federal Government could conceivably be penalized for doing business in a country with different environmental, labor, or social practices that go far beyond the scope of this particular law.

These are not just hypothetical concerns. As Clark Packard has already pointed out, we already restrict purchases of steel and aluminum from friendly countries, including Israel, the United Kingdom (UK), based on dubious national security grounds. I welcome thoughts from anyone who can explain to me how these national security tariffs and quotas strengthen our security.

Moreover, when some politicians and policymakers are seeking to reduce the U.S.-China trade deficit, it should be noted that any restrictions on U.S. firms being able to provide goods and services to China or other countries would tend to increase that deficit, exacerbating calls for tariffs and other restrictions.

To be clear, National Taxpayers Union supports efforts to protect our national security interests, but we urge you to keep these risks in mind.

My final point, with respect to efforts from many to decouple the United States and China economies, keep in mind that perhaps the strongest link between our economy and China's is not from the private sector but is represented by the \$776.5 billion that the Federal Government owes China. Reducing that debt would be a good starting point in distancing our economy from China's, as would adopting tax and regulatory measures that would make us the best place in the world to do business.

Thank you again for your time and for your work and for the opportunity to testify today, and I would be glad to answer any questions. Thank you.

Chairman PETERS. Last Congress my bill, the Preventing Organizational Conflicts of Interest in Federal Acquisition Act, was signed into law. It requires modernizing the Federal Acquisition Regulation to make it easier for agency contracting officers to identify and to address conflicts of interest.

Unfortunately, the updated guidance that was due in June of this year has yet to be issued, and yesterday I sent a letter to the Federal Acquisition Regulatory Council urging them to swiftly implement my law to ensure that taxpayer dollars are used in the best interests of the American people.

Dean Tillipman, until the FAR issues updated guidance, based on this law that has passed, would you explain to the Committee how Federal agencies are currently addressing potential conflicts of interest involving their contractors?

Ms. TILLIPMAN. Thank you, Senator. Unevenly is the best way to describe it. Without a standardized FAR clause or solicitation provision, each agency is basically left on their own to come up with

their own approach to organizational conflicts of interest, which has led to severe inconsistencies among agency approaches.

Moreover, given the failure of the Federal Acquisition Regulatory Council to update the FAR in several decades, we have outdated definitions and guidance that have not appropriately captured the many risks that continue to grow and create more conflicts of interest, ranging from the security concerns we are talking about here, to commercial conflicts of interest, to even the risks associated with emerging technology.

So by not providing those updated definitions or illustrated guides, we are lacking that additional information to give contracting officers not only the awareness to approach this proactively, but the comfort to look to guidance to support their decisionmaking.

Chairman PETERS. If you could give us perhaps a little more detailed answer as to what tools specifically do you believe are needed for agency contracting officers to more effectively identify, in the first place, those conflicts of interest, and why.

Ms. TILLIPMAN. Sure. Currently, the FAR provides very minimal guidance when it comes to how contracting officials should approach OCIs. Most of the guidance that they turn to comes from decisions that come from Government Accountability Office (GAO) and from the Court of Federal Claims. It is not necessarily the FAR itself. The FAR could truly benefit from providing greater procedural directives and guidance for the contracting officials.

The next is that the illustrative definitions and illustrated guidance in the FAR does not reflect modern procurement practices, so it does not have additional guidance to help contracting officials even identify potential OCIs, or the growing risks that may be out there.

At a baseline, there needs to be a standard FAR clause or provision to guide agencies across the Federal Government. The way that they are currently approaching it, with agencies using their own clauses, again, has led to severe inconsistencies.

I think this also needs to be buttressed by robust training requirements. Too many contracting officials, frankly, do not understand this issue, are not aware of this issue, and as I noted before, it has led to an issue where some contracting officials may be nervous about the threat, for example, of a bid protest, and they reflexively eliminate a contractor from competition. Whereas, other contracting officials may not even be aware that they are looking at an OCI risk and may do nothing at all.

Again, having greater guidance, having greater definitions, and greater directives, I think will really do a lot to further this area of the law.

Chairman PETERS. In addition to all those changes and clauses, what specifically should be put into Federal contracts, do you believe, to ensure that the issues that you raise are addressed?

Ms. TILLIPMAN. Sure. I think, at a baseline, having a standard OCI provision or clause is going to be key. Currently agencies rely on their own guidance, so again that has led to different approaches, depending on which agency a contractor is working with at that time. We appreciate uniformity in the Federal procurement space, and this clearly lacks it.

The other thing, when we are talking about clauses, you really do not need to reinvent the wheel. A lot of agencies have fairly robust contracting clauses that they already use. I think it should be fairly broad. There is language that would basically require contractors to identify any facts that any reasonably prudent person may cause them to question a contractor's impartiality or potential bias. Something very broad I think is important. Something that gets flowed down throughout the supply chain I think would be critical.

Again, we have that there. I think the other key component is to make sure that it is an ongoing assessment. The concern is that if you have contractors basically only disclosing, potentially, OCI risks at the outset, it does not necessarily capture any OCIs that may occur during performance of a contract. The U.S. procurement system is not great at ongoing oversight during contract performance when it comes to these issues, but it could truly benefit from having at least that component of the clause, because it places the onus or the burden on the contractor to make those affirmative disclosures.

Chairman PETERS. In your testimony you mentioned the concept of impaired objectivity, a type of conflict of interest. If you could give the Committee some examples of what you mean by this type of conflict. Second, why are Federal contracts with consulting firms or technology service providers particularly susceptible to this conflict?

Ms. TILLIPMAN. So impaired objectivity OCIs can arise in a variety of contexts. Commonly, within the Federal space, it would be a scenario where, for example, a contractor would be required to review its own performance or the performance of an affiliate on a separate contract. That happens fairly frequently where it might have to evaluate its own performance. Clearly, there could be bias there.

In the context of what we are discussing here, and even in the context of what we were discussing in 2022, before the House Oversight Committee, we are dealing with competing interests. There is a competing commercial interest or a competing foreign interest, or frankly, even with emerging technologies, there can be competing interest and bias there, as well. Because of that there is a concern that the advice that is given to the government might be biased in some way because of that external competing interest.

How these contracts, in particular, pose a greater risk, well, now we are relying on contractors to provide advice and something that requires the exercise of judgment. Here there is much greater risk rather than, buying a pen or buying a boat, that somebody could give advice that is tainted because of that competing interest or because they are put in the position to evaluate their own performance.

Chairman PETERS. Thank you. Ranking Member Paul, you are recognized for your questions.

Senator PAUL. Over the years I have been an outspoken critic of socialism, in general, Chinese socialism, Mao, the history of trying to get to absolute socialism in China. I wrote a book, *The Case Against Socialism*. I wrote a book recently called *Deception: The Great Coronavirus Disease 2019 (COVID-19) Coverup*, talking

about how the Chinese government encouraged this gain-of-function research, which we also funded, but also that there was a coverup in trying to discover the cause of the origin of the virus.

That being said, I am worried about legislation that begins to ban trade with China. If you sell, we are going to only ban consultants that do consulting for the Chinese communist government. We do not want them doing business with our government then. We are not going to prevent them from doing business, but they can still do it, but they lose government.

The problem with that is the government is such a big consumer in our country of it, they probably will have to give up one or the other. The other thing is, let's say they decided to keep doing work in China. It damages their ability in the private marketplace because you have now given them a scarlet letter. You have decided that, like the McCarthyites of old, you are going to brand them as communist friendly. This could be consulting, but, we have mentioned some big companies. Microsoft has done business. Maybe a little less than they used to, but they have done business in China.

So has Apple. They agree to things that we might disagree with. We might say they should not accept these things where they give the Chinese access to their data, which is primarily to spy on Chinese citizens because people buying Apple phones over there realize that all those data and all those services are run by the Chinese. You can disagree with it, but it really is not any of your business. You can say, well, we are going to ban Apple then from doing work with the U.S. Government. Half the people on this dais have Apple phones. Are we going to prevent anybody in government from having Apple phones because Apple has made this compromise to do business in China?

I think that Mr. Riley mentioned the slippery slope. The slippery slope goes on and on and on, and where do you end.

There also is a real question whether or not, Apple, that sells a lot of cellphones, or McKinsey or any of these other American companies that work in China, are they being influenced by Chinese communism or worried they are going to come over here and then be a conduit to steal our stuff? You know, McCarthy would be proud. He would love to be part of this conversation to ban stuff, go after the communists in our government.

But it is also possible that the complete opposite is true, that they actually influence the Chinese more toward American ways, that the more we do business in China, the more they see and deal with Americans on a one-to-one basis, the better it is to try to influence the communist culture.

Look, we tried this in Cuba. Let's get those commies. Let's quit trading with communist China. We will defeat the Castros. Well, guess what? It did not work. It objectively did not work. Over a 40-, 50-year period, communism did not necessarily thrive but continued under the iron fist of the Castros. Trade embargos do not work. Sanctions, frankly, do not work.

And you say, well, the Chinese do all this stuff. What are they doing? Are they doing it de novo out of nowhere? No. And we do not like a lot of it, and some of it is theft. Some of it is downright illegal, and we ought to do stuff about things that are illegal. If any

contractor, is coordinating something that is illegal they ought to be banned from doing business, without question, illegal.

But the thing is that we put all these sanctions on China. Some of the things China does are not de novo. They are not out of nothing. They do it in response to the things we do to them. This is the way trade wars work. It is not really we have been in a trade war, although there is some of that now, but it has been the sanctions, sanctions after sanctions. Everybody that comes in from the State Department, I say, well, how are those sanctions working? Can you name me one Chinese policy where they have changed their policy because of a sanction? No. They just get annoyed with us, and they go further toward Russia and further toward Korea.

That is what is going to happen from all this. Every day there is a new bill banning business with China, and 10 percent of our trade is with them. You guys want to end it. People want to end it tomorrow; you will have no antibiotics. You will not have any pharmaceuticals. Trade is good. I said in my opening, the average taxpayer still is saving \$1,000 or \$1,500 from trade with China.

As you begin to ban things, as you ban consultants there is collateral damage to these companies, because you cannot be a company, and most of America being banned from U.S. Government business, because U.S. Government is a big purchaser. But also it kills your private business too. Who wants to do business with, communist-loving X company that does business with communists?

So we have to take a breath and step back from all of this.

Mr. Riley, do you think it is a good idea to end trade with China? Are there not benefits that Americans still have from trade with China?

Mr. RILEY. I think you could go from extreme as anything goes, with no restraints, to we are stopping everything. A lot of the discussion seems to be pointing toward that we are just going to stop everything and somehow that is going to fix everything.

I think the most recent, and maybe clearest example of how these policies do not work in the way they are allegedly intended to is our Section 301 tariffs on China, which have cost the average household about \$1,700 so far, and counting. President Biden's U.S. trade representative studied the effects of these over four years, and came out with a long report, detailing all the ways in which China's policies, not only have they not improved, they have gotten worse.

What we do, we are adding even more tariffs on top of that. If the goal of the tariffs is to change China, we have plenty of evidence that they do not work in that regard, and I think we need to do something smarter. Probably expanding trade with our allies would be a really good step in the right direction.

Senator PAUL. Well see, it gets back to how do you convince people to do something you want. If you scold them or tell them not to do things, they often will do the opposite. For example, there was a discussion recently in China. We would like them to quit selling dual-use parts to Russia, that Russia is using in the war with Ukraine. So you think scolding them works? No, it does not work. They do the opposite.

There are things we could trade. What we have traded is tariffs get higher, their tariffs get higher. We could offer to lower some of

the tariffs on their goods in exchange for better behavior. That would be a transaction. That would be we give you something, you give us something. But instead, everything is about ending trade, stopping business, more sanctions. You are going to keep getting the same response. You want better relations with China or you just want to end it all. You can end it all. It will be a disaster for everybody. Or you can say how does it work? Do we do more sanctions? Do we yell at them? Do we travel to their country and scold them, or do we say, very quietly when we are in their country, hey, what about where we might reduce some of our trade barriers, some of our sanctions, if you will do X. You would get a lot more with honey than you will with vinegar.

This is a big issue, and bigger than even this particular panel. But we have to have these discussions. It goes on and on, because every day there is a new bill that bans trade and bans companies from China. Many of these employ Americans, in my State and other States, and we need to get away from this protectionism. Remember what Bastiat said, "when goods don't cross borders, soldiers will". Thank you.

Chairman PETERS. Senator Hawley, you are recognized for your questions.

OPENING STATEMENT OF SENATOR HAWLEY

Senator HAWLEY. Thank you very much, Mr. Chair. Thank you for calling this hearing. Thanks to each of the witnesses for being here today on this important topic.

Dr. Doshi, if I could just start with you. Since 2008, the McKinsey Company has done nearly a billion dollars in consulting work for the United States Government, a billion dollars, and its top client has been the Defense Department. In fact, it has contracts with the Defense Department, with the U.S. Department of the Navy, with the Homeland Security Department, with U.S. Customs and Border Patrol (CPB). I think in 2021 alone, McKinsey had Defense Department or other security agency contracts worth \$850 million. It is absolutely extraordinary.

Yet, at the same time, they are also doing business with the Chinese government. They are simultaneously taking a billion dollars from the United States and its security agencies and also getting money from not just China, in general, from the Chinese government and Chinese-controlled entities.

Explain to us why that is a problem. I think any normal American who is sitting out there and hears that would be absolutely outraged by it, and rightly so. Why are they getting taxpayer money advising our military and simultaneously advising the Chinese military? But just explain to us, why is this a national security concern?

Dr. DOSHI. Thank you, Senator Hawley. I agree this is a national security concern. I would go further. The nature of the work that McKinsey did reportedly involved helping China consider how to outcompete U.S. technology firms, how to strengthen Made in China 2025. The goal was to help them advance their goals for technological dominance. That is directly at odds with the interests not just of the U.S. Government but also of the corporate clients they had in the United States that they were also advising.

So there is a clear conflict of interest there, and it is also the kind of conflict of interest that even if McKinsey had exercised better judgment about the projects it took on, other firms doing business in China are getting raided by the Chinese government. Oftentimes that means that their data is no longer secure. If they have U.S. client data on those servers, well, that is now Chinese data.

There are a lot of concerns, I think, that we can raise here. One is the nature of the work. Another is being a vector for the transfer of information and data. There is a third concern too, where is that some of these firms have mutually irreconcilable obligations to the United States and to China. China is basically saying if you want to comply with the subpoena from this Committee, you cannot, because we have a data security law saying you cannot. That is three different kinds of conflicts beyond the one, Senator, that you just identified.

Senator HAWLEY. That is terrific. As we think about the different things that McKinsey has advised China on, they are, for example, a major proponent and promote of China's Belt and Road Initiative. So here they are, again, taking a billion dollars in contracts from the United States military, simultaneously advising China on their Belt and Road Initiative, which is meant to undermine our military and also to undermine American companies all across the world. McKinsey has advised 9 of the top 15 Chinese contractors for the Belt and Road Initiative, as of 2018. It is shameless when you think about it. It is absolutely shameless.

Interestingly, I recently obtained a document related to a contract, just to give one example involving semiconductors. Semiconductors, McKinsey entered into a contract with the U.S. Government, our Defense Advance Research Project Agency (DARPA), in 2021, related to semiconductors. The DOD asked McKinsey if there was any conflict that they might have with the Chinese government. According to these documents recently released to me pursuant to a Freedom of Information Act (FOIA) request,¹ McKinsey submitted documentation that said that there were no conflicts, no conflicts at all. In fact, as we now know, they were simultaneously advising the Chinese government on a very similar project.

To me, it seems like such common sense. The Chair and I wrote to the GAO asking for an analysis of the conflict of interest law and analysis of the procurement and contract awarding process to see if there were any strictures, limitations in current law that would prevent companies like McKinsey from simultaneously making billions from the United States and making billions from China.

That report has just come back, just a couple of days ago. What it shows is there are no such restrictions in United States law currently, which is why our legislation, the Time to Choose Act, which the Chair and I cosponsor together, introduced, and passed this Committee almost unanimously—I think only one no vote—is so important, because it would prevent what we see on this poster behind me.

Ms. Tillipman, do you want to add to this, why this sort of commonsense set of restrictions, telling consulting firms you cannot

¹The USAF FOIA request appears in the Appendix on page 97.

consult for the U.S. Government and rake in billions from American taxpayers and consult for our chief adversary at the same time, why this is important and why it is a matter of national security?

Ms. TILLIPMAN. Thank you, Senator. I read that GAO report, and I join you in your concern about the lack of laws and guidance right now currently guiding contracting officials on this issue.

One thing I will note is that the FAR provisions related to conflicts of interest are quite broad and could capture some of this, but most government officials will not feel comfortable taking this sort of action without greater guidance and directives explicitly giving them something that they can look to in taking these sorts of actions.

I share similar concerns as you. I get nervous when things are too restrictive and there are too many absolutes. But you raise very good points about why contracting officials need better laws and need to be empowered to make these types of decisions.

Senator HAWLEY. Yes, very good. Mr. Riley, let me just ask you, because your exchange with Senator Paul, I thought, was illuminating. You said that there is a continuum between banning everything, on the one end, and then everything goes on the other end. I take it from your testimony today you are on the “anything goes” side of the spectrum.

Mr. RILEY. No.

Senator HAWLEY. So you support this bill then?

Mr. RILEY. As I mentioned in my comments earlier, we support the goals, but we are concerned that it leads to a slippery slope potentially. We 100 percent support legislation that would advance our national security and protect our national security.

I will say based on the conversation I have heard this morning, if these companies are giving China advice, either they are giving pretty bad advice or China is not taking it very well, because their economy is on the downhill slide instead of going up.

Senator HAWLEY. Wait a minute. They are on the march in the Pacific. McKinsey advised them on building out islands in the South China Sea, at the same time it was getting defense contracts.

Is your position that you are opposed to—you want companies to be able to get taxpayer money from the United States and simultaneously get money from the Chinese government? That’s fine?

Mr. RILEY. My concern, Senator, is how do you differentiate between that, how you draw the line between that, and a soybean farmer which depends on China for its exports and simultaneously—

Senator HAWLEY. The soybean farmer is not advising the Chinese military on how to take over the United States.

I come from a State where our No. 1 agricultural product is soybeans.

Mr. RILEY. Right.

Senator HAWLEY. We are a State of soybean farmers. I can tell you, I think they would take great offense to you comparing them to a consulting firm that is taking a billion dollars in money from the United States military while simultaneously advising the Chinese military on how to harm the United States. Are you saying

that soybean farmers harm the security interests of the United States? I think that is a ridiculous position.

Mr. RILEY. As I said with respect to 232 national security legislation, it starts out here. The next thing you know we are restricting trade with the United Kingdom, with Israel, with our allies.

Senator HAWLEY. That is not this legislation.

Mr. RILEY. How do you know that is not going to happen again? That is all I am asking.

Senator HAWLEY. Because we wrote the bill.

Mr. RILEY. We need to have guardrails to make sure that our soybean farmers and other producers are not harmed like we have been in recent years by our trade policy.

Senator HAWLEY. Yes, I think that is the most, frankly, absurd instance of what-aboutism.

Mr. RILEY. It is history.

Senator HAWLEY. Just listening to you say it refutes itself.

Mr. RILEY. I am not talking about hypotheticals. I am talking about what has actually happened, and I do not want to see that repeat.

Senator HAWLEY. You are talking about something that is not in this bill, and you are equating soybean farmers with a consulting firm that is advising the Chinese military. It is absolutely absurd.

Mr. RILEY. I am equating national security.

Senator HAWLEY. Here you are opposing—in the name of—you represent taxpayers, you are here testifying in favor, apparently, of allowing a company to take tax money—this is tax money—this is a billion dollars in taxpayer money McKinsey is raking in while also going to our chief adversary, selling our secrets, essentially, and making money from them. What could be worse for the American taxpayer? I cannot think of anything, which is why this bill passed overwhelmingly in this Committee.

I thank you all for your testimony today. Thank you, Senator Peters, again for your hard work on this and support. I appreciate it. Thanks for holding this hearing.

Chairman PETERS. I appreciate your leadership on the issue, as well, Senator.

Senator Hassan, you are recognized for your questions.

OPENING STATEMENT OF SENATOR HASSAN

Senator HASSAN. Thank you, Mr. Chair, and I want to thank you and Ranking Member Paul for holding this hearing. I want to thank the witnesses for providing your testimony and expertise on this topic.

Dr. Doshi, I understand you are here stepping away from parental leave, that you have a brand new baby, so we are appreciative of you taking the time, and congratulations on your expanding family. That is wonderful.

I am going to ask questions, some of which have been touched on earlier, but I just wanted to kind of get into a dialog with all of you on some of these issues. I am going to start with you, Dean Tillipman, following up on a line of questions that I understand Senator Peters asked you about.

McKinsey & Company, a well-known consulting firm, advised Purdue Pharma on how to influence the Food and Drug Adminis-

tration's (FDA) process for evaluating drug safety, while at the same time advising the Food and Drug Administration on how to evaluate the safety of the powerful opioids produced by Purdue Pharma.

In 2022, the President signed into law the bipartisan Preventing Organizational Conflicts of Interest in Federal Acquisitions Act, which Senators Peters, Grassley, Ernst, and I introduced, to strengthen Federal protection against conflicts of interest in response to McKinsey's really egregious behavior.

We are pushing the Federal entity responsible for implementing this bill to take swift action to fully implement it as soon as possible. Once it is fully implemented, how will this law help prevent private companies from exploiting their relationships with Federal agencies to benefit their other clients, as we saw McKinsey do with the Food and Drug Administration and Purdue Pharma?

Ms. TILLIPMAN. Thank you, Senator. At a baseline it is going to help inform them that this is, in fact, a conflict of interest. I think prior to this hearing, there was confusion, even among the procurement community, that a commercial conflict could create the type of organizational conflict of interest that we are concerned about. The hearing alone brought attention to the fact that the law is broad but needs to be broader, and there needs to be additional guidance and directives for the contracting community to make these determinations.

But more importantly, it needs to put contractors on notice that these types of conflicts are not acceptable. They need to put compliance programs in place to better disclose these types of conflicts of interest so that procurement officials can make educated, informed business decisions about this, and how best to mitigate the risks or, frankly, avoid contracting with those entities in the first place.

Senator HASSAN. From my perspective as somebody whose State has been extraordinarily hard hit early on by the opioid epidemic, the notion that any entity would serve both the FDA and Purdue Pharma on this issue just is extraordinary. I expect when somebody contracts with the Federal Government that they will put the people of the United States interests first. That is very hard to do when you are also talking to the very manufacturer who, through lies and greed and malevolence, have harmed so many people. I thank you for the feedback and will continue to work on it.

Dr. Doshi, following up on this same question, because of congressional oversight that we did, the Food and Drug Administration no longer contracts with McKinsey because of McKinsey's work for Purdue Pharma. However, several other Federal agencies continue to work with McKinsey in other capacities. For example, the Department of Defense recently awarded two exclusive contracts to McKinsey, including to evaluate the Army's ammunition supply chain and provide advice to the Space Force.

We also know that McKinsey contracts with the Chinese government, again following up on Senator Hawley's line here, and advised the Chinese on how to develop an intimidating military presence in the South China Sea.

Does it concern you that the United States continues to work with McKinsey despite this track record? Do you think it is in the

best national security interests of the United States to continue contracting with McKinsey?

Dr. DOSHI. Thank you, Senator. I think that it is important for this legislation to be widened to address exactly the question that you have raised. One is that it is not just a question of whether they contract with the Department of Defense. It is a number of Federal agencies that are going to contract with these consulting firms. All of that should be considered.

The second thing that I am worried about is not just our consulting firms that are doing contracting with the Federal Government and the Chinese government. It is our technology service providers. Because the U.S. Government relies on these technology service providers for critical services. The Department of Defense, our defense industrial base, our water sector, our power sector, transportation, telecommunications. If we have a conflict of interest where those companies go to China, share their source code, or enter into a joint venture, which can compromise that service, it affects all of us.

I do have a concern, Senator, to address your question directly, with that ongoing work, and I think that concern could apply to other companies, as well.

Senator HASSAN. Thank you. Another question for you, Dr. Doshi. As part of last year's National Defense Authorization Act (NDAA), some Department of Defense contractors will now be required to certify that they do not have similar contracts with China or other foreign entities. Once the Department of Defense fully implements this law it will provide additional safeguards against conflicts of interest that compromise our national security.

How could Congress expand this requirement to agencies other than the Department of Defense? Are you concerned about workarounds or waivers that can undermine the intent of this law?

Dr. DOSHI. Thank you, Senator. I am concerned about the possibility that if the legislation were written in such a way, or if contracting guidelines were scoped in such a way that companies could find loopholes, then that would be disastrous for us.

Again, when it comes to technology service providers, the stakes are so high that we want these companies to think, from a risk perspective, that the risk of partnering with the PRC or working with the PRC or giving into their demands is not going to be worth it given the significant revenue hit that they will take from being cut-off not just from the Department of Defense but a number of U.S. Government agencies. I want that balance to be in a more conservative direction.

Senator HASSAN. Thank you for that.

Last question, and it is to Dean Tillipman. Earlier this year, in violation of U.S. law, consulting companies McKinsey, Boston Consulting Group, M. Klein & Company, and Teneo, all of whom are based in the United States, initially refused to comply with subpoenas issued by the Senate Permanent Subcommittee on Investigations (PSI). Those subpoenas sought information on the relationship between these companies and the Saudi Arabian government's attempts to influence U.S. policy.

While refusing to comply with our subpoenas, these companies chose to follow a ruling from a Saudi court rather than follow U.S.

law. It is outrageous that these companies—and let's be clear, they are American companies. They benefit from being able to be based in the United States, with all the privileges and opportunities that that brings to citizens and to businesses—it is outrageous that they are putting profiting off of their deals with the Saudis over protecting the national security interests of the United States.

Simply put, if you want to contract with the U.S. Government, the world's largest buyer of goods and services, then at a bare minimum you need to comply with U.S. law, which includes complying with subpoenas from Congress.

How can Congress or the Federal Acquisition Regulation Council make clear that U.S. law supersedes the law of a foreign country in the event of a conflict between the United States and the law of the foreign country, especially in cases involving Federal contractors that work with our adversaries?

Ms. TILLIPMAN. I think you have put your finger, Senator, on the complexities of multinational companies in doing business with many countries at the same time. I do not have a significant amount of faith that the FAR Council, even with its talented members could come to an exact solution for that precise problem.

But I think you have put your finger also on the fact that this is what occurs when you have contractors encountering these competing interests. There is a reason that you named the bill the Time to Choose, right?

Senator HASSAN. Right.

Ms. TILLIPMAN. I think this is one of the inherent problems with empowering this type of activity, and I think it is why, as the FAR Council continues to hopefully, and more speedily, consider these issues, it will come down with some more guidance about what a contracting official should be considering.

I am not sure I would empower a contracting official to speak directly to the issue that you raise. I do agree with you that if companies want to benefit from doing business with the United States or benefit from doing business at all in the United States, that this needs to become a priority.

Senator HASSAN. Thank you very much. I really appreciate all of you. Thank you, Mr. Chair.

Chairman PETERS. Thank you, Senator Hassan.

Dr. Doshi, in your testimony you specified concerns with a U.S. Federal contractor providing similar services to an entity with ties to the Chinese Communist Party. My question for you is, do these concerns also apply where a U.S. Federal contractor provides services to another foreign government entity besides China?

Dr. DOSHI. Thank you, Senator. I think they could apply to foreign governments that have an adversarial relationship with the United States. Let me take a step back, Senator. A lot of companies are going to be involved in conflicts of interest by the fact that they are involved in multiple jurisdictions.

What makes China different from other countries is that this is a country that is planning for conflict with the United States, that is taking American intellectual property, that is working to compromise our critical infrastructure. So here the stakes of those conflicts are so much higher than they are in other cases, including

Saudi Arabia or the United Arab Emirates (UAE). This is a fundamentally different magnitude of harm.

Senator, I agree that this could apply to other governments. It is just that the Chinese government is the one that I am most concerned about.

Chairman PETERS. I want to build on that. You wrote in your testimony about what you call the “China cycle,” where the Chinese government tilts the playing field in their favor when contracting with companies that are based here in the United States. They are also tilting the playing field in their favor in the electric and autonomous vehicle market by heavily subsidizing their electric vehicles (EV) and that industry and flooding foreign markets with these highly subsidized vehicles.

Earlier this month, I sent a letter, along with my Republican colleague, Senator Blackburn, to several Chinese automakers, pressing for more transparency into their ties with the Chinese government and highlighting the significant national security concerns associated with importing vehicles made by companies with ties to the Chinese Communist Party.

My question for you, Dr. Doshi, is besides imposing tariffs or similar measures like that, what else can we do to level the playing field, or tilt the field back?

Dr. DOSHI. Thank you for that question, Senator, and maybe I will spend a moment briefly on the China cycle. The idea here is that multinational companies or U.S. companies are attracted by the lure of China’s market. It makes sense. They try to do well in China. Maybe they do well for a period of time.

But China has a goal, an industrial policy goal, to indigenize those companies and push them out of China after a period of time. Even our best companies in China have met this fate. Take Apple. They spent decades building China’s smartphone industry. They spent billions on building China’s machine tools industry. Now its very suppliers have essentially risen in the supply chain to become producers of smartphones. They pushed Apple, essentially, to below top five in market share in China.

Take Tesla, as well. It is a similar story. Tesla did very well in China. It had a good arrangement with the Shanghai government. But its supply chain in China, that it built, helped catalyze some of the innovation that helped China’s electric vehicle manufacturers outcompete Tesla in Europe, and potentially down the road in the United States.

To answer your specific question, Senator, about what we can do to tilt the playing field on EVs, I mention just a few points. First, I would note that a lot of companies in China, 90 percent of the top 500 enterprises, have Chinese Communist Party cells within them, that are involved in the governance of those companies. So strict independence between those companies and the Chinese government is very difficult to imagine. We cannot mirror image. It is a different system than ours.

The second point, Senator, that I would make is that tariffs really are not going to get the job done. They are an important step, but the problem that we face is rules of origin. China can partner with other countries to make these same EVs in Mexico, Indonesia, or elsewhere.

What we really need are regulatory solutions, and what the Biden administration has recently done, as of yesterday, is move forward with an approach that would say for software or hardware that goes into these internet-connected vehicles, if that is from China then it cannot be sold in the United States. It is for a very simple reason, Senator. Internet-connected vehicles are a form of critical infrastructure, and we know the Chinese are trying to compromise U.S. critical infrastructure in power, in water, in telecommunications, and in transportation. It stands to reason we should worry about that possibility in EVs, as well.

This regulatory approach is easier to coordinate with allies and partners. It is actually something the executive can do pretty quickly. I think it is actually more effective than tariffs alone.

Chairman PETERS. Another question for you, Dr. Doshi. Another important factor we must consider when we aggressively combat the China cycle, as you call it, are what the potential impacts on the American scientific and technological competitiveness would be if we overly restrict U.S. collaborations with foreign entities, on basic research, for example.

The question for you is what are the consequences of overreach there, and how can we prevent overreach?

Dr. DOSHI. Thank you for that question, Senator, and I think nothing that I have advocated today would dramatically tamp down on trade with China, nor would it necessarily compromise our ability to work with China in science and technology (S&T). Those are both important. We are just trying to put guardrails in place so that can be done more safely and effectively.

That said, the United States currently has a science and technology agreement with China that has been in place since normalization. It has lapsed at times and been renewed. One of the biggest challenges we face, Senator, is that the ecosystem in the United States is very open. Anybody can access it. But the ecosystem in China is very closed, so we do not have symmetry. We have an asymmetry here.

What that means in practical terms is that China can benefit more from our ecosystem than we can from theirs. Right now, the legislation in China on national security that I outlined in my testimony makes it very difficult for us to continue with scientific research because we cannot get our data out. One of the biggest sticking points to renewing the science and technology agreement has been the question of whether we can come to some kind of agreement with China on questions related to data.

What I would say, Senator, is that what we are talking about here, in Time to Choose, will not affect science and technology cooperation. If anything, it might give us another piece of leverage, another angle, which we can use to pry open China's approach on national security to make it a bit more symmetrical with our own. I think that is where we want to end up, because China is an innovative country. It is not just stealing American technology. Its science and technology ecosystem is quite advanced. We need to have some exchange with it, but we have to make sure it is done in a way that is fair.

Chairman PETERS. Right. Final question I am going to ask Dean Tillipman and Dr. Doshi, and we will start with you, Dean. Should

the Federal contracts that we have include specific restrictions and penalties around sharing information and data with non-U.S. Government clients related to work that is being done for the United States Government? Dean Tillipman first, and then Dr. Doshi, and then we will wrap it up.

Ms. TILLIPMAN. Yes. Resoundingly yes. Absolutely. It is one thing for a contracting officer to learn about a potential conflict of interest and to consider whether it needs to mitigate, avoid, neutralize that particular conflict of interest. It is another thing for a contractor to share the information that they have obtained during the performance of a contractor, particularly with an adversarial government. But even just sharing the basic information is problematic.

So yes, there should be extreme penalties for something like that. Frankly, we already have some systems for the disclosure of this type of information in existence. But what you are describing, it absolutely should be banned.

Chairman PETERS. Thank you. Dr. Doshi.

Dr. DOSHI. Senator, I could not agree more that this is a critically important element of any kind of protection we want to implement here. Right now we know that there are three ways in which China can compromise any data that might be within China. First, there are institutions it is putting in companies. These include Chinese Communist Party Cells.

Second, there is the requirement that any employee of a U.S. subsidiary that is from China or, quite frankly, any Chinese partner of that subsidiary, has to comply with PRC intelligence and has to make sure that that compliance is never reported. That is an actual legal requirement of the National Security Law from 2017.

Third, of course, as I mentioned, access to networks, data, encryption—it is all transparent now under the existing regulatory regime in China. You have to turn over your encryption keys to the Chinese government. What that means in practice, Senator, is that even a company that has the best data protections, that is extremely careful, that might put its data on the Microsoft cloud in China, cannot be assured that that data does not end up in the hands of the Chinese government which means that the question of whether or not this kind of sensitive information gained from working with the U.S. Government, or with U.S. companies, that must be protected. It cannot be used in fulfillment of contracts with the Chinese government, and probably should not be migrated to China, because once it is, it is theirs.

Chairman PETERS. Great. Thank you.

I would like to thank our witnesses for joining us here today to share their testimony and their expertise with the Committee. Congress and the entire Federal Government must work together to ensure government contracts are awarded in the best interests of the American people by removing conflicts of interest from contractors' work. Americans certainly deserve full assurance that when their tax dollars are spent on Federal contracts they get the result that benefits them and not have those funds go to contractors who are working on both sides of the issue in a way that undermines our national security interests. I look forward to our continued work together on this issue.

The record for this hearing will remain open for 15 days, until 5 p.m. on Wednesday, October 9, 2024, for the submission of statements and questions for the record.

This hearing is now adjourned.

[Whereupon, at 11:21 a.m., the hearing was adjourned.]

A P P E N D I X

**Chairman Peters Opening Statement As Prepared for Delivery Full Committee Hearing:
Safeguarding the Homeland: Examining Conflicts of Interest in Federal Contracting to
Protect America's Future
September 24, 2024**

Federal contractors are a key part of our government's operations. The services and products they provide play a critical role in delivering services to the American people, as well as keeping our nation safe.

From advanced defense systems to cutting edge cybersecurity, contractors are entrusted with information and responsibilities that can impact the national and economic security of our nation.

From modernizing and enhancing the safety of our infrastructure and power grid, to providing critical intelligence that safeguards our nation from foreign and domestic threats, the scope of government contractors' support is immeasurable.

To ensure that government contractors are working in the best interests of Americans, we must ensure they are meeting the highest standards of integrity, impartiality and transparency, by removing conflicts of interest from their work.

Conflicts of interest are not minor infractions. They pose threats that undermine our national security and economic competitiveness and can dangerously erode the American people's trust in government.

Over the past decade, there have been alarming reports of federal contractors who are simultaneously promoting competing interests, including those of our foreign adversaries. Interests that directly contradict our national security needs and hurt our economic competitiveness.

For example, in the summer of 2023, in one of the largest intrusions of U.S. government cloud services, Chinese state-backed hackers gained access to the emails of high-level officials compromising the information security of U.S. officials who work on national and economic security matters.

This attack has raised serious concerns that China-backed hackers were able to steal this information because of the service provider's partnership with a Chinese entity while they were providing services to the U.S. government at the same time.

In 2015, a consulting firm responsible for advising the U.S. government on national security strategy, cybersecurity, and cutting edge-technology, was simultaneously advising Chinese state-run enterprises.

This consulting work for Chinese enterprises involved China's naval fleet and the Chinese government's efforts to raise its profile and strengthen its power globally, a goal in direct competition with American interests.

In another example, the same firm's research and recommendations allegedly assisted in the creation of the Chinese government's *Made in China 2025* industrial plan in opposition to U.S. foreign policy objectives, and our national and economic security.

These examples demonstrate the need to strengthen our laws, specifically around disclosure of foreign ties, particularly where federal contractors are providing services to authoritarian governments who seek to bolster their economic and geographic assets in competition with our nation.

In sectors like defense and cybersecurity, the stakes are incredibly high. Just last week, FBI Director Wray announced the FBI had successfully disrupted a malware attack targeting over 200,000 devices in the U.S. and worldwide by a Chinese-backed hacking group called the Flax Typhoon.

The Chinese cyber actor exploited known vulnerabilities, including in a major U.S. cloud service provider that receives billions in U.S. taxpayer dollars each year, to support the federal government's I-T services.

It goes without saying that major U.S.-based technology service providers working for foreign adversaries while performing multibillion dollar contracts for the U.S. government risk exposing vulnerabilities that can be exploited by adversaries.

We can and must stop this.

In 2022, my bipartisan bill, the *Preventing Organizational Conflicts of Interest in Federal Acquisition Act*, was signed into law. The bill seeks to end conflicts of interest from federal contracts that provide critical services to the American people.

I directed the Federal Acquisition Regulatory Council, or FAR Council, to provide clear guidance to agencies and federal contractors on ways to identify, mitigate and even avoid conflicts of interest.

Despite being signed into law nearly two years ago, the FAR Council is late on issuing guidance required by my law, which is why yesterday I led the cosponsors of this legislation in a letter pressing for quick action to issue this desperately needed guidance.

I continue to call on the FAR Council, which includes the General Services Administration, NASA, the Department of Defense, and the Office of Federal Procurement Policy to provide better guidance to agencies on how to handle conflicts of interest.

Earlier this year, I also worked with Senator Hawley on his bill, the *Time to Choose Act of 2024*, which would add guardrails to prevent consulting firms that contract with foreign adversaries from simultaneously providing services to the Department of Defense and other federal agencies.

I joined the bill along with Senators Rick Scott and Marco Rubio to ensure contracting firms are using taxpayer funds responsibly and to help prevent foreign adversaries from exploiting business relationships with contractors to interfere with American interests.

I am confident that we can all agree – Americans deserve full assurance that federal contractors are providing transparency and avoiding any potential conflicts before they are awarded taxpayer dollars.

And that is why we still have work to do.

Today's hearing will help us better identify and mitigate conflicts of interest in an ever-evolving global landscape.

Our witnesses will examine inadequacies within existing federal contracting rules as well as explore steps that can be taken to mitigate future risks.

I thank them for being here today and look forward to a productive discussion.

THE GEORGE WASHINGTON UNIVERSITY
WASHINGTON, DC

Testimony of

JESSICA TILLIPMAN
ASSOCIATE DEAN FOR GOVERNMENT PROCUREMENT LAW STUDIES
THE GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

Before the Senate Committee on Homeland Security & Governmental Affairs

Safeguarding the Homeland: Examining Conflicts of Interest in Federal Contracting to Protect America's Future

September 24, 2024

Chairman Peters, Ranking Member Paul, and Members of the Committee, thank you for inviting me to testify before the Committee today. I am Jessica Tillipman, the Associate Dean for Government Procurement Law Studies at The George Washington University Law School. In addition to leading the Law School's Government Procurement Law Program, I teach our Anti-Corruption & Compliance course, which focuses on anti-corruption, ethics, and compliance issues in government procurement.

Two years ago, I testified before the House Committee on Oversight and Reform concerning deficiencies in the organizational conflicts of interest (OCIs) regulatory framework and potential legislative solutions.¹ At issue then was McKinsey & Company's alleged conflicts of interest between its work for the Food and Drug Administration (FDA) and its pharmaceutical manufacturer clients.

More recently, I was very pleased to see the enactment of the Preventing Organizational Conflicts of Interest in Federal Acquisition Act.² As we await the proposed OCI rule in response to that legislation, this hearing provides an opportunity to

¹ See *McKinsey & Company's Conduct and Conflicts at the Heart of the Opioid Epidemic: Hearing Before the H. Comm. on Oversight & Reform*, 117th Cong. (2022) (statement of Jessica Tillipman, Assistant Dean for Government Procurement Law Studies, The George Washington University Law School), available at <https://ssrn.com/abstract=4109288>.

² Preventing Organizational Conflicts of Interest in Federal Acquisition Act, Pub. L. No. 117-324, 136 Stat. 4439 (2022).

focus on the issues that continue to hinder federal agencies' ability to effectively avoid, neutralize and mitigate OCIs. To fully appreciate why this issue is so important, some context is appropriate.

Maximizing Competition in Government Procurement

Competition remains a primary goal of the U.S. procurement system. "By maximizing the effective use of competition, the government receives its best value in terms of price, quality, and contract terms and conditions. Contractor motivation to excel is greatest when private companies, driven by a profit motive, compete head-to-head in seeking to obtain work."³ To help ensure competition is not undermined by corruption, misconduct, or unfairness, the United States has enacted numerous laws that address, among other things, the integrity of the competitive marketplace. These laws range from criminal prohibitions (e.g., collusion, procurement integrity, conflicting financial interests) to regulatory restrictions (e.g., impartiality, personal conflicts of interest involving contractors performing acquisition functions, and organizational conflicts of interest).⁴

The Federal Acquisition Regulation (FAR) regulates two types of contractor conflicts of interest: Personal Conflicts of Interest (PCIs)⁵ and Organizational Conflicts of Interest (OCIs).⁶ Contractor PCIs are present when an *individual* contractor-employee has a "financial interest, personal activity, or relationship that could impair the employee's ability to act impartially and in the best interest of the Government when performing under the contract."⁷ In contrast, OCIs occur when "because of other activities or relationships with other persons, a person is unable or potentially unable to render impartial assistance or advice to the government, or the person's objectivity in performing the contract work is or might otherwise be impaired, or a person has an unfair competitive advantage."⁸ The term "person" in this definition includes companies and other contracting entities.⁹

Even though both PCIs and OCIs may undermine competition and the integrity of the procurement process, they are treated very differently by the FAR and in practice.

³ See Steven L. Schooner, *Desiderata: Objectives for a System of Government Contract Law*, 11 PUB. PROCUREMENT L. REV. 103 (2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=304620.

⁴ See generally Jessica Tillipman, *United States*, in ROUTLEDGE HANDBOOK OF PUBLIC PROCUREMENT CORRUPTION (Williams & Tillipman eds., Routledge, 2024).

⁵ See FAR 3.11 and FAR 52.203-16.

⁶ See FAR 9.5.

⁷ FAR 3.1101

⁸ FAR 2.101

⁹ See generally Daniel I. Gordon, *Organizational Conflicts of Interest: A Growing Integrity Challenge*, 35 PUB. CON. L.J. 25 (Fall 2005).

Personal Conflicts of Interest (PCIs)

Contractor PCIs are regulated by FAR Part 3 (Improper Business Practices and Personal Conflicts of Interest). This FAR part prohibits different forms of misconduct and is designed to ensure, among other things, that government officials and contractors do not taint procurements with unfair competitive advantages and favoritism towards particular vendors.

In response to growing concerns about the increased outsourcing of acquisition-related work traditionally performed by government officials, in 2011, the Federal Acquisition Regulatory Council (FAR Council) published a final rule: "Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions." The resulting FAR Subpart (3.11) and clause (52.203-16 – Preventing personal Conflicts of Interest) requires contractors to identify and prevent personal conflicts of interest of their employees performing acquisition functions (e.g., planning acquisitions, developing statements of work, evaluating contract proposals, developing evaluation criteria, awarding or administering contracts, etc.) and prohibits the employees from using nonpublic information gained from their performance on a government contract from using such information for personal gain.

This FAR coverage addresses concerns that when the U.S. government retains contractors to perform acquisition functions, there is a greater risk that a conflict between a contractor employee's personal financial interests and the government work it is performing could result in favoritism or bias, ultimately undermining competition.

Organizational Conflicts of Interest (OCIs)

Unlike personal conflicts of interest, organizational conflicts of interest are regulated by FAR Part 9 (Contractor Qualifications). Although OCIs have been regulated since the 1960s, they have become more frequent in recent decades due to consolidation in the information technology and defense industries, and the government's increasing reliance on contractors to provide services traditionally performed by public servants, "especially where the contractor is tasked with providing advice to the Government."¹⁰ Indeed, OCIs are more likely to occur in contracts involving professional services, such as management support, consultant, or advisory services. This is particularly notable

¹⁰ See The Federal Acquisition Regulation; Organizational Conflicts of Interest, 76 Fed. Reg. 23236 (Apr. 26, 2011).

given the hundreds of billions of dollars the U.S. government spends each year on professional services.¹¹

The current framework for analyzing whether an OCI exists derives primarily from FAR subpart 9.5 and decisional precedent from the Government Accountability Office (GAO) and the U.S. Court of Federal Claims (COFC).¹² OCIs are generally separated into three categories:¹³

1. **Impaired objectivity** – may arise where a contractor's outside business relationships create an economic incentive to provide biased advice under a government contract.
2. **Biased ground rules** – may occur when, as part of its work under one procurement, the contractor has helped set the procurement's ground rules, such as writing the statement of work or developing specifications, for another procurement.
3. **Unequal Access to Information** – may occur when a contractor obtains access to nonpublic information as part of its contract performance which gives it an advantage in a later competition for a government contract.

FAR 9.504 (Contracting Officer Responsibilities) requires a Contracting Officer (CO) to "identify and evaluate potential organizational conflicts of interest as early in the acquisition process as possible; and avoid, neutralize, or mitigate significant potential conflicts before contract award." To fulfill this obligation, CO's depend upon contractors to disclose, among other things, "any facts that may cause a reasonably prudent person to question the Contractor's impartiality because of the appearance or existence of bias."¹⁴

¹¹ U.S. GOV'T ACCOUNTABILITY OFF., *A Snapshot of Government-Wide Contracting for FY 2023 (interactive dashboard)* (June 25, 2024), at https://files.gao.gov/multimedia/Federal_Government_Contracting/index.html?_gl=1*hfjfp*_ga*NTk3NTA4ODY5LjE3MjUxMjQ5MTg.*_ga_V393SNS3SR*MTcyNTEvNDkxOC4xLjAuMTcyNTEvNDkxOC4wLjAuMA. See also U.S. GOV'T ACCOUNTABILITY OFF., GAO-24-106932, *FEDERAL CONTRACTING: TIMELY ACTIONS NEEDED TO ADDRESS RISKS POSED BY CONSULTANTS WORKING FOR CHINA 1 (2024)* [hereinafter *CONSULTANT RISKS*], available at <https://www.gao.gov/products/gao-24-106932> ("From fiscal years 2019 through 2023, federal agencies obligated more than \$500 billion on contracts associated with a broad range of consulting services.")

¹² See generally Keith Szeliga, *Conflict and Intrigue in Government Contracts: A Guide to Identifying and Mitigating Organizational Conflicts of Interest*, 35 PUB. CONT. L. J. 639 (2006) (citing FAR 2.101).

¹³ See FAR 9.502.

¹⁴ 48 C.F.R. § 1352.209-74 (U.S. Department of Commerce's OCI clause). See also 48 C.F.R. § 3452.209-70 (requiring, in Department of Education contracts, disclosure of all such relevant information if such a conflict of interest appears to exist to a reasonable person with knowledge of the relevant facts or if such a person would question the impartiality of the contractor).

Notably, unlike many other FAR requirements, there is no standard OCI solicitation provision or contract clause under FAR Part 52 (Solicitation Provisions and Contract Clauses). Instead, agencies have developed their own solicitation provisions and contract clauses. For example, U.S. Department of Commerce contracts may contain the following language:

The warrant and disclosure requirements of this paragraph apply with full force to both the contractor and all subcontractors. The contractor warrants that, to the best of the contractor's knowledge and belief, there are no relevant facts or circumstances which would give rise to an organizational conflict of interest, as defined in FAR Subpart 9.5, and that the contractor has disclosed all relevant information regarding any actual or potential conflict. The contractor agrees it shall make an immediate and full disclosure, in writing, to the Contracting Officer of any potential or actual organizational conflict of interest or the existence of any facts that may cause a reasonably prudent person to question the contractor's impartiality because of the appearance or existence of bias or an unfair competitive advantage. Such disclosure shall include a description of the actions the contractor has taken or proposes to take in order to avoid, neutralize, or mitigate any resulting conflict of interest.¹⁵

Failure to disclose the information required by an applicable OCI clause can lead to a multitude of adverse consequences, including, but not limited to contract termination, prosecution for the making of false statements (including fines and imprisonment), or suspension or debarment. In addition, a false OCI certification could trigger potential civil and criminal liability under the False Claims Act, resulting in treble damages, penalties, imprisonment, and fines.¹⁶

Reform is Overdue

For the past several decades, there has been widespread acknowledgment that the increased outsourcing of work to government contractors could create fertile ground for conflicts of interest. A 2007 Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the United States Congress noted:

. . . the trend toward more reliance on contractors . . . raises the possibility that the government's decision-making processes can be

¹⁵ 48 C.F.R. 1352.209-74.

¹⁶ See generally 31 U.S.C. §§ 3729 – 3733. See also *United States ex rel. Ervin & Assocs., Inc. v. Hamilton Sec. Grp., Inc.*, 370 F. Supp. 2d 18, 51-52 (D.D.C. 2005) (“A government contractor's failure to disclose an [OCI] constitutes a false claim under the False Claims Act”).

undermined . . . [u]nless the contractor employees performing these tasks are focused upon the interests of the United States, as opposed to their personal interests or those of the contractor who employs them, there is a risk that inappropriate decisions will be made.¹⁷

This risk has been exacerbated in contracts for consulting and advisory services.¹⁸ To be clear, this issue is not unique to the United States.¹⁹ A simple internet search provides numerous examples of “consultant conflicts” plaguing public procurement systems around the world. Yet despite decades of red flags relating to these types of contracts, government regulation of these potential hazards has not kept pace.²⁰

In 2011, the FAR Council attempted to refine OCI rules to make the regulation more reflective of modern procurement practices.²¹ That effort failed and the rule was

¹⁷ See generally ACQUISITION ADVISORY PANEL, REPORT OF THE ACQUISITION ADVISORY PANEL TO THE OFFICE OF FEDERAL PROCUREMENT POLICY AND THE UNITED STATES CONGRESS (Jan. 2007), available at https://login.acquisition.gov/sites/default/files/page_file_uploads/ACQUISITION-ADVISORY-PANEL-2007-Report_final.pdf.

¹⁸ See The Federal Acquisition Regulation; Organizational Conflicts of Interest, 76 Fed. Reg. 23236 (Apr. 26, 2011) (“ . . . organizational conflicts of interest are more likely to arise when at least one of the contracts involved is for acquisition support services or advisory and assistance services”). FAR 2.101 (Definitions) does not define “consulting services,” but defines “advisory and assistance services” as including “the furnishing of professional advice or assistance rendered to improve the effectiveness of Federal management processes or procedures . . . [such as] information, advice, opinions, alternatives, analyses, evaluations, recommendations, training and the day-to-day aid of support personnel needed for the successful performance of ongoing Federal operations.”

¹⁹ For example, while advising the Australian government on anti-tax avoidance laws, a former PWC partner allegedly shared this confidential information “to generate business and sell ‘tax avoidance schemes’ to some of the biggest companies in the world.” See generally Eoin Burke-Kennedy, *Consulting Firms Accused of Exploiting Conflicts of Interest Around the World by Australian Senator*, IRISH TIMES (Aug. 24, 2023, 5:05 AM), <https://www.irishtimes.com/business/2023/08/24/consulting-firms-accused-of-exploiting-conflicts-of-interest-by-australian-senator/>.

²⁰ See generally Schooner, Steven L. and Greenspahn, Daniel S., *Too Dependent on Contractors? Minimum Standards for Responsible Governance*, 8 J. CONT. MGMT. 9-25 (Summer 2008), available at https://papers.ssm.com/sol3/papers.cfm?abstract_id=1263358. See also TENNESSEE VALLEY AUTHORITY, Memorandum from the Office of the Inspector General (Dec. 2, 2022), <https://www.oversight.gov/sites/default/files/oig-reports/TVA/2022-17347.pdf> (finding that the Tennessee Valley Authority’s controls for identifying and mitigating consultant conflicts of interest were not operating effectively); OFFICE OF INSPECTOR GENERAL, CONSUMER FINANCIAL PROTECTION BUREAU, *The CFPB Can Strengthen Its Controls for Identifying and Avoiding Conflicts of Interest Related to Vendor Activities* (March 15, 2017), https://www.oversight.gov/sites/default/files/oig-reports/cfpb-vendor-conflicts-of-interest-mar2017_1.pdf (finding that the CFPB did not actively enforce its conflict of interest disclosure and mitigation requirements in vendor contracts).

²¹ See The Federal Acquisition Regulation; Organizational Conflicts of Interest, 76 Fed. Reg. 23236 (Apr. 26, 2011).

ultimately withdrawn, ten years later, on March 19, 2021.²² As the FAR Council now attempts to address the issues left unfinished by this abandoned proposed rule, it should strongly consider drawing from some of its findings and recommendations.

In its 2011 proposed rule, the FAR Council noted that OCIs have the ability to undermine the integrity²³ of the competitive acquisition system, which “affects not only the Government, but also other vendors, in addition to damaging the public trust in the acquisition system.” For example, as previously noted, in 2022, the House Committee on Oversight and Reform investigated allegations concerning McKinsey & Company’s alleged conflicts of interest between its work for the FDA and its opioid manufacturer clients. The investigation and hearing relating to this matter brought widespread attention to deficiencies in the current OCI framework and highlighted the damage to public trust that can be caused by even the appearance of unmitigated OCIs.

More recently, this Committee has focused on potential national security concerns that may stem from conflicts of interest involving consulting and advisory services.²⁴ As U.S. government contractors continue to expand their work with foreign governments, the growing number of risks that may stem from unmitigated OCIs become clearer. Specifically, companies that maintain intelligence or defense contracts with the United States may jeopardize U.S. national security by simultaneously contracting with foreign adversaries.²⁵ If these potentially competing interests are neither disclosed nor mitigated, it increases the risk that sensitive information may be exploited or fall into the wrong hands. It also increases the risk that, among other things, contractors may be unable to provide impartial assistance or advice due to their “competing” relationships with certain foreign governments. Additionally, by working with foreign adversaries, these companies may erode the trust of the national security professionals who are the ultimate end users of their services. Outside of the national security realm this lack of confidence is concerning; however, within national security circles, this mistrust can very well have life-and-death consequences.

²² See The Federal Acquisition Regulation; Organizational Conflicts of Interest, 86 Fed. Reg. 14863 (Mar. 19, 2021).

²³ See, e.g., Press Release, U.S. Department of Justice Office of Public Affairs, *Government Contractor Agrees to Pay \$425,000 for Alleged False Claims Related to Conflicts of Interest* (May 20, 2022), <https://www.justice.gov/opa/pr/government-contractor-agrees-pay-425000-alleged-false-claims-related-conflicts-interest>.

²⁴ See generally U.S. SENATE COMMITTEE ON HOMELAND SECURITY & GOVERNMENTAL AFFAIRS, *Peters & Hawley Call on GAO to Assess Potential National Security Risks & Conflicts of Interest Posed by Consulting Firms that Contract with US And Chinese Governments*, Majority News (Jan. 24, 2023), <https://www.hsgac.senate.gov/media/dems/peters-hawley-call-on-gao-to-assess-potential-national-security-risks-conflicts-of-interest-posed-by-consulting-firms-that-contract-with-us-and-chinese-governments/>.

²⁵ See CONSULTANT RISKS, *supra* note 11, at 1 (noting that of the \$500 billion spent on consulting contracts between 2019-2023, “Departments of Defense (DOD) and Homeland Security (DHS) accounted for over 50 percent of those obligations and have national security focused missions.”).

Deficiencies in Law and Practice

The current framework governing OCIs remains (1) outdated, (2) inconsistent with modern procurement practices, and (3) fails to address the growing risks associated with the government's increasing reliance on contractors to provide services which include advice and the exercise of judgment.²⁶ One need only look to the FAR's approach towards PCIs to understand the glaring absence of guidance and uniformity in the current approach to OCIs.²⁷

First, by locating OCIs in FAR Part 9 (Contractor Qualification) instead of FAR Part 3 (Improper Business Practices), it signals that OCIs pose less significant integrity concerns than those embodied by the other business practices addressed in Part 3. As the proposed rule noted in 2011: "While the ability to provide impartial advice and assistance is an important qualification of a Government contractor, the larger issues that underlie efforts to identify and address OCIs are more directly associated with some of the business practices issues discussed in FAR part 3." Experience suggests that its continued placement in FAR Part 9 has led some contracting officials to treat OCI assessments as a rote, check-the-box exercise, rather than a meaningful, thorough, and rigorous analysis. Granted, there are innumerable instances where an OCI may not raise integrity and security concerns, but continuing to treat *all* OCIs as a mere qualification factor minimizes the potential for harm.

Second, as previously noted, unlike PCIs and many other FAR requirements which demand compliance through standard solicitation provisions and contract clauses found in FAR Part 52, no standard FAR OCI solicitation provision or contract clause mandates inclusion in solicitations or contracts. Because agencies have been left to fill this vacuum with their own solicitation provisions and contract clauses, there are now severe inconsistencies and deficiencies in agency approaches to this area of the law.

Third, and most glaringly, FAR Subpart 9.5 (Organizational and Consultant Conflicts of Interest) fails to provide sufficient guidance regarding how to avoid, neutralize, or mitigate OCIs. Unlike FAR Subpart 3.11 (Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions) and 52.203-16 (Preventing Personal Conflicts of Interest), FAR Subpart 9.5 lacks critical definitions, does not

²⁶ These issues are exacerbated in the national security context. See *CONSULTANT RISKS*, *supra* note 11, at 1 ("Current acquisition regulations do not specifically direct agencies to consider if contractors consulting for the U.S. government also have consulting contracts with China. Therefore, acquisition personnel do not typically collect information on, assess, or mitigate potential national security risks posed by these consultants when awarding contracts.")

²⁷ See Ethan A. Syster, *Business Risk And Competitive Integrity: A Discretionary Approach To Organizational Conflicts Of Interest In Federal Procurement*, 53 *PUB. CON. L.J.* 825 (Summer 2024).

thoroughly address compliance, disclosure, and mitigation obligations, and fails to adequately warn contractors of the potential consequences of non-compliance. The absence of guidance and directives has led to a paradoxical issue of both over- and under-compliance. Whereas some contracting officials, lacking guidance, training and awareness, may never even consider OCI risks,²⁸ others, plagued by an outsized fear of bid protests, may reflexively and unnecessarily exclude a contractor from competition – ultimately undermining procurements and misspending taxpayer dollars. Moreover, with respect to national security risks, the lack of guidance and directives has created hesitancy among acquisition personnel to proactively address the national security risks that may be caused by contractors simultaneously providing consulting services to the United States and foreign adversaries.²⁹ A new OCI rule should provide clarity, more expansive definitions, greater guidance for contracting officers, updated illustrative examples, and enhanced disclosure and compliance requirements for relevant contractors. This effort should be buttressed by robust training requirements for contracting officials as well.

A Call For Balanced Reform

Although there are important differences between the two types of conflicts of interest, their shared potential to undermine competition, integrity, and national security, demands more equal treatment by the FAR and in practice. The decades-long absence of an update to the federal government's approach to OCIs has weakened the U.S. procurement system and left it vulnerable to abuse, incompetence, and security risks.

Despite a legitimate need to address gaps in the current framework, as this Committee and the FAR Council consider potential legislative and regulatory remedies to these issues, a cautionary approach is necessary. Draconian and heavy-handed approaches to addressing concerns can not only undermine the goals of the legislative and regulatory reform, but create new problems. For example, as the 2011 proposed rule notes, some OCIs are of a lesser concern and Government's business interests may sometimes be assessed as an acceptable performance risk, and therefore empowering contracting officials with (guided) flexibility and discretion to address these issues is critical. Moreover, overly rigid or inflexible frameworks often result in substantial barriers

²⁸ See *generally* Steel Point Solutions, LLC, B-419709, 2021 WL 3172103 (Comp. Gen. July 7, 2021) (finding that the agency did not perform an OCI review until after the contract was protested).

²⁹ See CONSULTANT RISKS, *supra* note 11, at 2-3 (“DOD and DHS officials noted that current regulations and policies do not specifically direct acquisition personnel to collect information, assess, or mitigate these types of national security risks when awarding most contracts for consulting services.” Acquisition professionals also “expressed concerns about attempting to do so without more guidance in acquisition regulations.”).

to entry, causing existing contractors to forego opportunities and dissuading new, innovative, and small companies from engaging in the federal marketplace.

Striking a critical balance between necessary and excessive regulation is never easy, but it is critical. It is my hope that a thoughtful and nuanced approach to OCI reform will address integrity and security concerns, bring greater clarity to the existing regulations, and create a more uniform approach across the federal government.

Thank you for the opportunity to share these thoughts with you. I would be pleased to answer any questions you may have for me.

China's New National Security Laws: Risks to American Companies and Conflicts of Interest

Prepared statement by

Dr. Rush Doshi

*C.V. Starr Senior Fellow and Director of the China Strategy Initiative, Council on Foreign Relations
Assistant Professor of Security Studies, Georgetown University Walsh School of Foreign Service*

Before the

U.S. Senate Committee on Homeland Security and Governmental Affairs

United States Senate

2nd Session, 118th Congress

Hearing on "Safeguarding the Homeland: Examining Conflicts of Interest in Federal Contracting to Protect America's Future"

Chairman Peters, Ranking Member Paul, distinguished members of the Committee, thank you very much for the opportunity to testify at today's hearing on conflicts of interest in federal contracting.

My remarks will focus on a few items. First, I will discuss how the People's Republic of China's (PRC) geopolitical ambitions and leverage over U.S. companies in the PRC – gained through threatening market access and through a new regime of national security laws – create conflicts of interest. Second, I will discuss how these conflicts might play out in specific sectors, namely the consulting industry. Third, I will examine conflicts in the technology sector given risks to U.S. data, critical infrastructure, and government networks. Fourth, I will offer a few recommendations for U.S. policy to help firms resist PRC pressure and avoid conflicts of interest.

I. The PRC's Geopolitical Ambitions, Leverage over U.S. Companies, and Conflicts of Interest

The PRC uses a variety of forms of leverage, including threats to withhold market access and national security legislation, to pressure U.S. companies to advance PRC objectives. Accordingly, U.S. companies operating in the PRC face a challenging environment that can exacerbate conflicts of interest, particularly

for those companies that might contract with the U.S. government, handle sensitive U.S. government data, or operate sensitive platforms upon which the U.S. government relies.

PRC Objectives

The PRC leadership seeks to restore China to its past position of preeminence, and accordingly, has developed a grand strategy coordinated across multiple instruments of statecraft to displace U.S.-led order. As I argue in *The Long Game: China's Grand Strategy to Displace American Order*, the PRC leadership has made clear its intent to "catch up and surpass" the U.S. technologically; to reduce dependence on the West and increase global dependence on China economically (part of a policy it calls "dual circulation" [双循环]); to be able to defeat U.S. forces in a regional clash militarily while building a global power projection capability; and to reset global norms politically.¹

Intention must be matched by capability to be taken seriously. On that metric, the PRC is the first U.S. competitor to surpass 70% of U.S. GDP. It is already the world's leading industrial power and exceeds U.S. capability in certain technology sectors, including some military sectors. It fields military forces that some experts believe could defeat the United States in regional conflict. It has also mounted aggressive efforts to develop access to U.S. critical infrastructure. Accordingly, the United States faces a situation many believe resembles a new Cold War but from a position that is more tenuous than against past competitors.

A key difference between this competition and the Cold War, however, is that U.S. companies are deeply involved in the PRC economy. In some sectors, and particularly for companies that also work closely with the U.S. government, that activity creates the possibility of conflicts of interest. This is especially true considering (1) PRC threats to deny market access and (2) the PRC's security-focused regulatory regime.

Weaponizing Market Access

An enduring source of PRC leverage over U.S. companies has been access to the PRC market. The promise of market access, and the explicit or implicit threat to withhold it, is a tool the PRC uses to advance various state objectives. For Beijing, these objectives include gaining access to technology, know-how, data, sensitive U.S. government information, or compliance with PRC political positions, among others.

PRC threats to withhold market access have led U.S. companies to take steps that are contrary to their own long-term interests, and at times, to U.S. national interests. The PRC has successfully pressured U.S. companies to transfer intellectual property to China, to engage in joint ventures that ultimately boost PRC capability, to increase investment in China at the expense of the United States or other locations, and even to refrain from complaining about these pressure tactics. PRC officials have directly told U.S. companies in some cases to transfer intellectual property in order to receive market access. In other cases, joint venture partners have stolen intellectual property from U.S. companies and set up their own competitive ventures while trapping the U.S. partner in a now defunct joint venture. Sometimes, when foreign companies have sought recourse for intellectual property theft in foreign courts, they have been punished in China's market through judicial action.

In addition to facing threats to market access, U.S. companies operating in the PRC can also be subject to a variety of other legal and even personal threats. Many companies can be tied up by PRC regulatory actions or costly litigation to coerce acquiescence on items important to the PRC. Foreign executives have sometimes been prohibited from leaving the country under "exit bans." If a court sides with a local

company's litigation against a foreign company, which could occur in a secret hearing, an executive could be "trapped" in the PRC without much notice or resource.

The PRC's credible implicit or explicit threats to withhold market access – or to target the safety of executives – can create conflicts of interest for U.S. firms. The payoff from complying with the PRC's conditions or demands, however, continues to fall. American companies are increasingly vocal about the fact that complying with the PRC's conditions is no guarantee of consistent market access, and the PRC's long game is to replace foreign firms and businesses with PRC alternatives.

New National Security Laws

Second, in addition to restrictions on market access, the PRC's expansive set of new national security laws creates another source of challenges – and conflicts of interest – for the operations of U.S. companies in China. Under this legal regime, the Party can (1) insert Party cells into foreign-owned companies; (2) compel PRC entities and individuals to cooperate with the PRC's intelligence services and keep the fact of that cooperation secret; and (3) access the data of foreign companies.

I'll now turn to discuss each of these three challenges.

1. **Conflicts of Interest from Party Cells in Chinese and Foreign-Owned Companies:** PRC laws, notably the [1993 Company Law](#), require PRC companies to establish and maintain Chinese Communist Party (CCP) cells. The purpose of a CCP cell is to better align the activities of the company with the PRC's objectives. More than 90% of the PRC's top 500 enterprises have Party cells, according to data from a Party-led body.² In 2020, the PRC issued guidelines clarifying the roles of CCP cells. These guidelines indicated that Party cells should play a role in corporate governance, strategic decision-making, and personnel management, and that they could work to revise corporate charters to recognize the leading role of the CCP.³ Members of Party cells sometimes sit on boards, and boards sometimes consult with Party cells on major decisions. Since 2016, the PRC has increasingly pushed subsidiaries of foreign-owned companies to establish Party cells. The PRC released new requirements in 2018 and 2022 that call for foreign joint ventures that are publicly listed to open Party cells as well as certain foreign-owned financial institutions.⁴ HSBC Holdings, for example, set up a CCP cell in 2022 in its investment banking subsidiary in China, with executives reportedly concerned about the optics of potentially exposing strategic decisions and client data to the CCP.⁵ "Big Four" accounting firm EY created a CCP cell as well which later required its members to wear Chinese Communist Party badges.⁶ Mercedes-Benz reportedly has a party cell in its Chinese joint venture which is involved in management meetings.⁷ Most firms do not want to host a Chinese Communist Party cell, but as FBI Director Chris Wray noted in testimony last year, "The CEOs I've talked to are afraid to say something."⁸
2. **Conflicts of Interest from New Laws Mandating Cooperation with PRC Intelligence Agencies:** Several PRC laws force Chinese individuals and entities, including subsidiaries of U.S. companies, to cooperate with PRC intelligence agencies. For example, the [2017 National Intelligence Law](#) (Article 7 and 14) requires Chinese individuals and entities, including subsidiaries of U.S. companies in China, to affirmatively support PRC national intelligence work, comply with demands from PRC intelligence and law enforcement agencies, and "keep the secrets of national intelligence work from becoming public."⁹ The Department of Homeland Security warns companies that, under this law, the PRC could require a PRC entity to provide data from a U.S. person or business or compel a company to install backdoors in equipment.¹⁰ The [2021 Counterespionage Law](#) similarly mandates that Chinese nationals cooperate with national security

agencies. It also requires businesses, universities, and other organizations to cooperate with PRC intelligence services to monitor Chinese citizens with access to sensitive information when they travel overseas and to train them in counterespionage.

3. **Conflicts of Interest from New Laws That Allow PRC Access to Networks, Encryption Keys, and Data:** Other pieces of legislation put onerous restrictions on data transfer and provide the PRC access to networks, encryption keys, and data. For example, the [2017 Cybersecurity Law](#) requires that data in undefined critical industries be stored in China and that PRC public security and intelligence agencies be able to conduct spot checks of networks, which could include access to data. The PRC's Cyberspace Administration of China (CAC) can launch "cybersecurity reviews" of U.S. companies at any time to demand virtually anything from data to source code from the targeted company.¹¹ Regulations issued in 2021 also force companies in China, including foreign companies, to report software vulnerabilities to the PRC government before informing anyone else – allowing the PRC to stockpile these vulnerabilities for offensive advantage.¹² Similarly, the [2020 Encryption Law's](#) Article 31 requires the State Cryptographic Administration (SCA) to have access to commercial cryptography systems for certification purposes, which could allow SCA access to decryption keys and passwords, according to the Department of Homeland Security.¹³ In practice, most firms will use PRC-certified encryption rather than compromise the encryption they may rely on in their home markets. While this practice may seem sophisticated, the reality is that it will not provide protection against the PRC government.¹⁴ Encryption aside, the [2021 Data Security Law](#) mandates that any company processing important data is subject to a periodic security review by Chinese officials. It also prohibits the release of any data to a foreign judicial or law enforcement agency – which has at times been interpreted to apply to administrative agencies – without PRC government approval, regardless of where the data originated from. This provision could complicate compliance with a subpoena or regulatory action. The [2023 update to the Counterespionage Law](#) widens covered information beyond "state secrets and intelligence" to include "documents, data, materials or items related to national security and interests." This broad definition creates a legal foundation to gather data from foreign firms and their employees with little justification. It also includes authority to inspect their electronic devices. Additionally, a [2024 update to the state secrets law](#) introduced a new, nebulous concept called "work secrets" defined as information that is not a state secret but "will cause certain adverse effects if leaked." This could apply to anything the Party-state decides could cause "adverse effects" if leaked.

Implications of Conflicts of Interest

As FBI Director Chris Wray told this committee in 2019, "Chinese law essentially compels Chinese companies and typically compels U.S. companies that are operating in China to have relationships with different kinds of Chinese companies to provide whatever information the government wants whenever it wants."¹⁵ Since 2019, the situation has only deteriorated.

PRC leverage over U.S. companies can undermine U.S. interests and national security in several distinct ways. U.S. companies could (1) inadvertently act as vectors for the PRC to access sensitive information, data, intellectual property, etc.; (2) be caught between mutually exclusive U.S. and PRC demands; and (3) could, in some cases, seek to profit from conflicts.

1. **Vectors for the PRC to Access Sensitive Information:** U.S. companies may inadvertently act as vectors for the PRC government to access U.S. intellectual property, trade secrets, sensitive data, or sensitive networks. Such transfer could occur through the actions of Party cells within U.S. subsidiaries or their partners. It could occur through laws that compel a U.S. subsidiary, employee,

or PRC private sector partner to comply with requests from the PRC intelligence service. It could also occur through the ability of law enforcement and other bodies to outright inspect or seize data as well as their ability to bypass encryption due to the requirement for commercial encryption to be registered with PRC regulators. As a practical matter, this means that sensitive data stored by a U.S. company could be transferred to the PRC without the company's knowledge. It also could mean that, for example, U.S. companies providing cloud services in China with even the very best protections could inadvertently provide access or information relevant for facilitating PRC cyber attack to their local PRC operators, such as network topology or architecture relevant for U.S. operations.

2. **Conflicting and Mutually Irreconcilable Compliance Requirements:** Second, U.S. companies face conflicts between the obligations they have to the U.S. or allied and partner governments and those that they face under PRC law. For example, the PRC's 2021 Anti-Sanction Law and 2023 Foreign Relations Law allows the PRC to punish U.S. companies if they comply with sanctions or legislation the PRC seems discriminatory. Moreover, companies may be unable to comply with Congressional subpoenas or requests by law enforcement or administrative agencies for information relevant to regulations without being out of compliance with PRC laws on data transfer. This, in effect, forces companies to choose whether to be compliant with one system or another.
3. **Profiting from Conflicts of Interest:** U.S. companies may lean into conflicts of interest for financial benefit. For example, a company could conceivably share information or experience gained from working with the U.S. government, including sensitive information U.S. policy or government practices, to support work done with PRC entities.

While the costs and likelihood of these conflicts of interest are growing, the benefits of complying with PRC pressure tactics are clearly falling. Compliance with the PRC's pressure tactics might provide some short-term market access, but the PRC's ultimate objective is to eventually replace these companies with indigenous PRC companies. The "China cycle," as the writer Noah Smith calls it, involves (1) a multinational company setting up in the PRC to access the PRC market; (2) a multinational company complying with terms that effectively result in the transfer of their technology or know-how to PRC companies; (3) the PRC government then helping PRC companies push out the multinational; and (4) the PRC companies then competing with the multinational for market share in other countries, often with some state support.¹⁶

Increasingly, foreign multinationals and the trade associations that represent them are raising direct concerns publicly. Jens Eskelund, president of the European Chamber of Commerce in China, said in a statement that, "The scope of issues deemed 'sensitive' seems to be constantly expanding, which makes it more difficult for companies to access information necessary for making investment decisions related to their China operations."¹⁷ Similarly, the US-China Business Council wrote in its most recent member survey that, "American companies that conduct business in China continue to encounter systemic challenges around market access and barriers to investment, opaque rules and uneven regulatory enforcement, and rising compliance requirements, particularly around data security and privacy."¹⁸ Meanwhile, the PRC has not taken action to address these concerns. The growing influence and power of the security services has, instead, created additional obstacles. China's Ministry of State Security has published a series of web comics to educate citizens about the national security risks it faces from foreigners. One example included a special investigator going undercover at a consulting firm and demonstrating it was selling sensitive information.¹⁹

II. The Consulting Industry

Since 2023, the PRC has taken a number of aggressive steps against U.S. consulting and due diligence firms, which heighten already existing conflicts of interest that may be present when these firms conduct work for the U.S. government and for PRC state-affiliated entities.

PRC Crackdowns on Consulting Firms

PRC state media has stressed that the activities of foreign firms must not be contrary to PRC national interests, but this standard remains nebulously defined. Data on macroeconomic trends or the performance of individual companies, often critical to facilitating U.S.-China investment and economic exchange, can now fall within the vague definition of “state secrets,” “work secrets,” or information that harms China’s “national security.” This creates wide-ranging vulnerabilities for consulting firms in the PRC that can amplify conflicts of interest.

In 2023, the PRC began taking broad action against foreign consulting firms in the PRC.

- PRC law enforcement raided the offices of Bain & Company. They detained and questioned several employees and seized phones and computers and the data stored on them.²⁰
- PRC authorities also raided the offices of international advisory and knowledge services firm Capvision in Beijing, Shenzhen, Shanghai, and Suzhou as part of an investigation into their alleged failure to protect “state secrets.” PRC authorities seized devices and even sentenced one of their senior experts who had been kept on retainer to six years in prison.²¹ Capvision was forced to acknowledge that it had caused harm to PRC national security.
- The PRC raided the Mintz Group’s Beijing offices, closed the branch, and detained five local employees, ultimately fining the company for failing to obtain approval of statistical survey work and then raising the fine the following year.²² The raids came after the company issued an article on due diligence related to the Uyghur Forced Labor Prevention Act.²³

Due in part to the crackdown, the *Financial Times* reported last year that U.S. consulting firms are already reducing business in China. Many are struggling to find work, delaying start dates for new employees, and failing to meet revenue projections.²⁴ The risk and likelihood of conflicts interest from operations in China has increased while the reward has decreased.

Conflicts of Interest for Consulting Firms

In some cases, as this Committee has helped reveal, U.S. consulting firms have provided services to the U.S. government while also consulting for the PRC. McKinsey, for example, has worked on over 60 contracts for the U.S. military and law enforcement over a dozen years in areas including weapons systems, the Defense Department’s IT network, shipyard modernization, technology for military services, FBI intelligence gathering, and other projects – some of which require a security clearance.²⁵ Since 2008, it made more than \$850 million in contracts with the U.S. federal government. But it has simultaneously conducted work for PRC state-owned enterprises and private companies, and according to one McKinsey website, for the PRC government as well.²⁶ McKinsey has indicated it does not “serve clients on issues related to defense, intelligence, justice, or police issues” in the PRC, but a McKinsey-affiliated group reportedly advised the PRC government on its Made in China 2025 industrial policy plan, advocated for civil-military integration, and recommended the PRC push foreign companies out and indigenize their roles in the PRC economy – proposals that harmed U.S. interests. These proposals were evidently directly presented to former Premier Li Qiang.²⁷ It is possible that expertise gained from working with U.S.

industry and the U.S. government could have informed work on a PRC plan that, at its core, seeks “catch up and surpass” the United States in technology. It is not in the national security interests of the United States for companies providing support to U.S. industry to support the PRC’s industrial policy efforts to the outcompete the United States, nor is it in the interests of their U.S. clients.

McKinsey is not the only U.S. consulting firm that has served both the U.S. and PRC governments. Bain and Boston Consulting Group also have operations in China. These firms may have protections in place to ensure sensitive U.S. data could not be transferred by the PRC, but it is unclear how sufficient those protections are given the PRC’s ability to compromise the data of U.S. companies operating in the PRC and demand compliance from PRC entities and individuals to share that data. Similarly, even if these firms have extensive internal firewalls to ensure special knowledge about U.S. government or corporate strategies would not inadvertently or deliberately be transferred to projects in China, it is unclear whether these are sufficient given the increasingly challenging regulatory environment in the PRC.

The fact that U.S. consulting firms conducting sensitive work for the U.S. government were not previously required to disclose to the U.S. government that they had projects with the PRC creates a serious national security risk. The compliance requirements for consulting firms imposed by the federal government are, in other words, even lower than those for U.S. military personnel or civil servants holding security clearance who would certainly be required to disclose work done for the PRC or other foreign actors.

Moreover, PRC law complicates any compliance with a U.S. subpoena or request for information on their business in the PRC, effectively allowing a foreign power to dictate the terms of U.S. oversight of the relationship between these companies and a foreign power – an untenable position. Together, this suggests the need for a different approach to regulating those companies that have the privilege of providing services to the U.S. government.

III. The Tech Industry – Software, Cloud, and Networks

The conflicts faced by U.S. consulting firms are serious, but those faced by some U.S. technology companies who serve both the U.S. government and the Chinese market are potentially far more consequential. The risks involve not only the transfer of sensitive data but also the compromise of platforms upon which the U.S. government relies, as well as risks to critical infrastructure.

Risks to United States Platforms and Critical Infrastructure

With respect to platforms, for example, the communications of the U.S. government have repeatedly been compromised by PRC cyber actors. Most recently, the PRC targeted Microsoft Exchange Online, which allowed it to compromise 60,000 State Department emails and the account of U.S. Commerce Secretary Gina Raimondo, U.S. Ambassador to China Nicholas Burns, and others. It is still unknown how the PRC was able to do this, and the incursion was first detected by the State Department and not industry.

In addition to these risks, government officials and private sector leaders have increasingly called attention to PRC activity in U.S. critical infrastructure that could pose a direct threat to homeland security. Earlier this year, CISA, NSA, FBI, and Five Eyes partners assessed that, “that People’s Republic of China (PRC) state-sponsored cyber actors are seeking to pre-position themselves on IT networks for disruptive or destructive cyberattacks against U.S. critical infrastructure in the event of a major crisis or conflict with the United States,” and that a PRC group called “Volt Typhoon” had comprised infrastructure providers in several sectors.²⁸ At the Munich Security Conference a few weeks later, Deputy National Security Adviser Anne Neuberger explained further that, “For a long time when we all in the industry

talked about cyber security our key focus was theft of data...what has shifted as captured in the Volt Typhoon threat vector is countries pre-positioning in the critical infrastructure of another country.” Neuberger explained that “we know it is not for espionage purposes, because when we look at the sectors like water sectors and civilian airport sectors, those have very little intelligence value.” She continued, “That is a concern because a potential disruption of critical infrastructure could be used to put pressure on a government during a crisis or could be used to put pressure or try to message to a population during a crisis.”²⁹ As Jen Easterly said to the Select Committee on the CCP, the PRC is ready to “launch destructive cyber-attacks in the event of a major crisis or conflict with the United States,” including “the disruption of our gas pipelines; the pollution of our water facilities; the severing of our telecommunications; the crippling of our transportation systems.” These steps would be designed to “to incite chaos and panic across our country and deter our ability to marshal military might and citizen will.”³⁰

The private sector is aware of the problem. As Microsoft CEO Brad Smith explained, “we’ve seen from China in particular this prepositioning of so-called web shells. Think of it as tunnels into our water system, our electrical grid, into the air traffic control system, the kind of thing that you look at and you say, this is only useful for one thing and...they have it in place in the event of a war or hostilities.”³¹ In an annual report last year, Microsoft noted it had been tracking some of the relevant threat actors focused on U.S. critical infrastructure for several years.

As Congress develops more advanced conflict of interest guidelines, it may be worth considering the risks posed by U.S. technology companies that do business in the PRC. Companies that support the U.S. government or critical infrastructure in the United States might, through operations in the PRC, inadvertently create vulnerabilities for their operations in the United States that would affect national security, especially as Beijing puts more pressure on these companies.

Conflicts of Interest in The Technology Sector

First, several U.S. technology companies that serve the U.S. government have provided the PRC government the source code of the systems that the U.S. government and most Americans rely on. In 2003, Microsoft allowed China to participate in its Government Security Program which it indicated “provides national governments with controlled access to Microsoft Windows source code.”³² More recently, in 2016, Microsoft launched a “Transparency Center” in China to provide “access to documents and source code” for “Windows, Windows Server, Office, Exchange Server, SQL Server, and SharePoint Server,” services upon which the U.S. government also depends.³³ Similarly, in 2015 IBM decided to allow the Chinese government review its source code in a controlled environment.³⁴ Even when companies do not voluntarily provide such information, they could conceivably be compelled to provide it not as a condition of market access but as part of a regulatory action. For example, the PRC’s “cybersecurity review,” which was directed against Micron in 2023 in retaliation for U.S. semiconductor export controls, lack due process and can be used to demand sensitive information and to levy heavy penalties.³⁵ Notably, in this more challenging regulatory environment, both Microsoft and IBM have reduced operations in China. In August 2024, IBM reportedly closed its operations in China, including its China Development Lab and China Systems Lab, in favor of labs in other countries, including India.³⁶ Similarly, in May 2024, Microsoft asked several hundred employees in China to relocate to other countries as it reduced cloud-computing and AI research.³⁷

Second, U.S. cloud service providers that support the U.S. government and that operate in the PRC almost certainly face conflicts given the PRC’s regulatory environment. As detailed previously, over the last seven years, the PRC has introduced a National Intelligence Law, Counterespionage Law, Encryption Law, Data Security Law, and updates to its definition of state secrets. This regime gives the PRC the ability to

demand PRC entities and individuals comply with requests from the intelligence services, provide access to encryption keys, insert personnel on site, or outright seize equipment and data. In that regime, the fact that U.S. cloud operators in China are required by the Chinese government to partner with a Chinese operator is concerning. Microsoft, for example, partners with 21 Vianet, to operate Microsoft's cloud services in China, including Azure; Amazon partners with Beijing Sinnet Technology Co., Ltd. (Sinnet) and Amazon Web Services Ningxia Region run by Ningxia Western Cloud Data Technology, Co., Ltd. (NWCD). Others, like Google and Oracle, do not offer services in mainland China.³⁸ For those that do, the concern is whether their systems in China are adequately firewalled from systems in the United States, or whether compromise of cloud infrastructure in China could be used to compromise U.S. systems. Even with such firewalls, it is conceivable that PRC operating partners could gain important insights into how their U.S. partners provide cloud services to clients in the United States, such as important information about network topology and architecture. More fundamentally, the fact that PRC operators may be operating a PRC cloud with encryption keys provided to the PRC government all under a regime that gives broad authority to PRC intelligence services to embed themselves in the operator suggests data stored in U.S. cloud systems in the PRC is not secure. The idea that the PRC would exploit access to cloud services to gain access to those who use them is not farfetched. PRC Ministry of State Security cyber actors are known to have hacked into technology service providers, gaining access to their clients, which included 5G provider Ericsson and U.S. defense company Huntington Ingalls, among others.³⁹ Foreign governments have also noted that, in overseas markets, PRC cyber threat actors have sought to compromise cloud service providers. Accordingly, it stands to reason they would do so within China as well.⁴⁰

There are reasons to believe the PRC is focused on gaining advantages from these kinds of entanglements in China. For example, technology companies supporting the U.S. government may be forced to cooperate with China's cybersecurity legislation by providing information on zero-day exploits that the PRC government appears to be promptly weaponizing. Microsoft has publicly accused the PRC of using the country's new vulnerability disclosure requirements to stockpile zero-day exploits. "China's vulnerability reporting regulation went into effect September 2021," it wrote in a 2022 report, "marking a first in the world for a government to require the reporting of vulnerabilities into a government authority for review prior to the vulnerability being shared with the product or service owner." Based on the data, Microsoft concludes that, "the increased use of zero days over the last year from China-based actors likely reflects the first full year of China's vulnerability disclosure requirements for the Chinese security community and a major step in the use of zero-day exploits as a state priority."⁴¹

Asymmetric Advantages for the PRC

What is particularly concerning is the possibility that the PRC may be learning more about systems on which the U.S. relies while reducing its own reliance on U.S. systems. Conversely, the United States may not be able to gain comparable information about PRC systems. Over time, this creates a structural asymmetric vulnerability. This is not a purely academic consideration. In 2016, President Xi stressed the country's information technology systems needed to be "controllable," with PRC agencies determining foreign software could not meet these standards.⁴² This year, *the Wall Street Journal* reported that the PRC issued a guidance – "Document 79" – requiring state-owned enterprises in strategic sectors to replace all foreign IT software by 2027, colloquially known in China as "Delete A" where "A" refers to America.⁴³ Meanwhile, the PRC seeks to spread its own services around the world.

The PRC is well underway towards reliance on "controllable" systems. For example, even as Microsoft was increasing PRC visibility into its products, the PRC was reducing its reliance on Microsoft products and forcing public service providers and others to switch to the indigenous PRC HarmonyOS system.

During the recent outage related to a CrowdStrike update, PRC public services – in contrast to U.S. services – experienced a “minimal impact.” PRC government employees boasted that this “proved that the country has made progress in achieving its goal of ‘safe and controllable’ computing systems.”⁴⁴ Accordingly, there are risks that the information shared with the PRC about U.S. technology systems could create asymmetric vulnerabilities. Similarly, although U.S. cloud providers do have some market share in the PRC, that share is small compared to Chinese cloud providers who have successfully increased their market share. Three PRC companies, for example, have 80% market share within the PRC. As with consulting, the benefits from involvement in the PRC marketplace are likely falling while the risks are growing. As Microsoft CEO Brad Smith noted in recent testimony, the PRC accounts for about 1.5% of Microsoft’s revenue and the company is scaling down its engineering team in the PRC too. At the same time, the PRC is backing its own cloud providers in foreign markets, and the opportunity for U.S. providers in the market is shrinking while the risks continue to grow.⁴⁵

More broadly, in cloud, the PRC’s lead cloud operators - Alibaba, Baidu, and Tencent - all operate in the United States in an environment that is far more permissive than one available to U.S. cloud companies in China. None of these companies, for example, are forced to have a local joint venture partner. Accordingly, the United States has no direct visibility into their networks, topology, or encryption even though the Trump and Biden Administrations have expressed concerns about the security risks posed by PRC cloud companies operating in the United States, including access to data, among other considerations.⁴⁶ The fact that the regulatory environment for technology companies in the United States and the PRC is fundamentally not reciprocal provides advantages to the PRC.

IV. Recommendations that Build on Provisions Already Included in the *Time to Choose Act*

U.S. companies face an unenviable position in the PRC. Prudent regulatory action from Congress could help these companies better withstand PRC pressure. Rather than refuse to comply with PRC requests independently, they could – with these steps – instead point to the U.S. government as the reason for their non-compliance, possibly buying them some space with the PRC. In some cases where this approach is not viable, certain U.S. companies may indeed have to choose work with the U.S. government over considerably less lucrative and diminishing opportunity in the PRC market. These provisions below would not affect the vast majority of companies operating in the PRC, but they would affect those upon which the United States government depends.

- **Congress could consider legislation that prohibits, or at a minimum requires disclosure of, Chinese Communist Party cells within foreign companies or their subsidiaries.** Congress could apply this standard to companies listed on public exchanges, as some proposed legislation does. This Committee could consider prohibiting cells in companies contracting with the federal government. A blanket prohibition would allow companies to blame Washington – rather than their own decision-making – for refusing PRC pressure to establish such cells.
- **Congress could consider legislation that prohibits U.S. companies and their subsidiaries from complying with PRC national security laws.** The PRC’s recent national security laws – especially the Counterespionage Law, National Intelligence Law, Cybersecurity Law, Encryption Law, and Data Security Law – create a regime that forces companies to take action contrary to their interests and those of their clients, including the U.S. government. Taken together, these laws give the PRC the ability to demand PRC entities and individuals comply with requests from the intelligence services, provide access to encryption keys, insert personnel on site, or outright seize equipment and data. This Committee could prohibit compliance with certain features of PRC

legislation for those companies contracting with the federal government. In the present, companies effectively have no excuse *not* to comply, which only facilitates greater PRC pressure.

- **Congress could consider prohibiting companies that contract with the federal government, especially technology companies, from entering arrangements with PRC entities that could plausibly threaten U.S. national security.** Companies that provide software or cloud services for the U.S. government, for example, could be prohibited from sharing source code with the PRC government or nominally private sector PRC companies. For companies providing cloud services to the U.S. government, a minimum requirement could be disclosure of any arrangements with the PRC and PRC entities, especially if these could conceivably compromise the security of the service provided to the U.S. government. This could be written to specify operation of PRC cloud infrastructure by PRC entities, the provision of encryption keys to PRC regulators, or other such items. In addition to require notification, Congress could also presumptively prohibit such activity at risk of losing U.S. government contracts.

Endnotes

- ¹ Rush Doshi, *The Long Game: China's Grand Strategy to Displace American Order* (Oxford: Oxford University Press, 2021).
- ² Neil Thomas, "Party Committees in the Private Sector: Rising Presence, Moderate Prevalence," Commentary, Macro Polo, December 16, 2020, <https://macropolo.org/party-committees-private-sector-china/?rp=n>.
- ³ Jérôme Doyon, "Influence without Ownership: the Chinese Communist Party Targets the Private Sector," Expressions, Institut Montaigne, January 26, 2021, <https://www.institutmontaigne.org/en/expressions/influence-without-ownership-chinese-communist-party-targets-private-sector>.
- ⁴ Dennis Kwok and Sam Goodman, "Chinese Communist Cells in Western Firms?" *Wall Street Journal*, July 11, 2022, <https://www.wsj.com/articles/communist-cells-in-western-firms-business-investment-returns-xi-jinping-11657552354>.
- ⁵ Patrick, Mulholland, "HSBC Unit Installs Chinese Communist Party Committee," *Telegraph*, July 21, 2022, <https://web.archive.org/web/20220728222230/https://www.telegraph.co.uk/business/2022/07/21/hsbc-unit-installs-chinese-communist-party-committee/>.
- ⁶ Cheng Leng and Ryan McMorrow, "EY China staff encouraged to wear Communist party badges," *Financial Times*, February 27, 2023, <https://www.ft.com/content/cfa55e7d-1294-4c4f-85cc-03c6ec63550a>.
- ⁷ Michael Cunningham and Bryan Burack, "Don't Give the CCP Backdoor Influence Over U.S. Companies," Commentary, Heritage Foundation, June 12, 2023, <https://www.heritage.org/asia/commentary/dont-give-the-ccp-backdoor-influence-over-us-companies>.
- ⁸ Kevin Breuninger and Eamon Javers, "Communist Party Cells Influencing U.S. Companies' China Operations, FBI Director Wray Says," *CNBC*, July 12, 2023, <https://www.cnn.com/2023/07/12/communist-cells-influence-companies-in-china-fbi-director.html>.
- ⁹ For more, see U.S. Department of Homeland Security, Office of Strategy, Policy, and Plans and Office of Trade and Economic Security, *Data Security Business Advisory: Risks and Considerations for Businesses Using Data Services and Equipment from Firms Linked to the People's Republic of China*, December 22, 2020, <https://www.dhs.gov/publication/data-security-business-advisory>, (accessed July 24, 2024).
- ¹⁰ *Ibid.*
- ¹¹ Lester Ross and Kenneth Zhou, "China Launches Cybersecurity Review Against Micron," *WilmerHale*, April 11, 2023, <https://www.wilmerhale.com/insights/client-alerts/20230411-china-launches-cybersecurity-review-against-micron>
- ¹² Dakota Cary and Kristin Del Rosso, "Slight of Hand: How China Weaponizes Software Vulnerabilities," Atlantic Council, September 6, 2023, <https://www.atlanticcouncil.org/in-depth-research-reports/report/sleight-of-hand-how-china-weaponizes-software-vulnerability/#few-good-options>
- ¹³ For more, see U.S. Department of Homeland Security, Office of Strategy, Policy, and Plans and Office of Trade and Economic Security, *Data Security Business Advisory: Risks and Considerations for Businesses Using Data Services and Equipment from Firms Linked to the People's Republic of China*, December 22, 2020, <https://www.dhs.gov/publication/data-security-business-advisory>, (accessed July 24, 2024).
- ¹⁴ "China's New Cryptography Law: Still No Place to Hide," *China Law Blog (Blog)*, Harris Stiwoski, November 7, 2019, <https://harris-stiwoski.com/chinalawblog/chinas-new-cryptography-law-still-no-place-to-hide/>.
- ¹⁵ Office of Senator Josh Hawley, "FBI Director: China Can Compel Tech Companies Doing Business In Country To Turn Over Any Information China Wants," press release, November 5, 2019, <https://www.hawley.senate.gov/fbi-director-china-can-compel-tech-companies-doing-business-country-turn-over-any-information-china/>.
- ¹⁶ Noah Smith, "Why China is Defeating Tesla," April 17, 2024, <https://www.noahpinion.blog/p/why-china-is-defeating-tesla>
- ¹⁷ Daisuke Wakabayashi, Keith Bradsher, and Claire Fu, "China Expands Scope of 'State Secrets' Law in Security Push," *New York Times*, February 28, 2024, <https://www.nytimes.com/2024/02/28/world/asia/china-state-secrets-law.html>.
- ¹⁸ US-China Business Council, *Member Survey*, 2023, 1, <https://www.uschina.org/reports/2023-member-survey>.

- ¹⁹ Wakabayashi, Bradsher, and Fu, "China Expands Scope of 'State Secrets' Law in Security Push"; A link to the cartoon is available here <https://mp.weixin.qq.com/s/K9QDFFOKTCHUZ-iA5R-zQQ>.
- ²⁰ Martin Purbrick, "Chinese National Security Laws Hinder Foreign Companies' Operations in China," *China Brief* 23, no. 19 (October 20, 2023): 11-15, <https://jamestown.org/program/chinese-national-security-laws-hinder-foreign-companies-operations-in-china/>.
- ²¹ Nectar Gan and Juliana Liu, "'Everybody Is Worried': China Raids Offices of Consultancy Firm Capvision In Widening Industry Crackdown," *CNN*, May 9, 2023, <https://edition.cnn.com/2023/05/09/business/china-capvision-consultant-industry-crackdown-intl-hnk/index.html>.
- ²² Daisuke Wakabayashi and Keith Bradsher, "U.S. Consulting Firm Is the Latest Target of a Chinese Crackdown," *New York Times*, April 27, 2023, <https://www.nytimes.com/2023/04/27/business/bain-china.html>; Chun Han Wong, "China Raises Fines on Mintz Due-Diligence Firm," *Wall Street Journal*, March 12, 2024, <https://www.wsj.com/world/china/china-raises-fines-on-mintz-due-diligence-firm-c7486aeb>.
- ²³ Purbrick, "Chinese National Security Laws Hinder Foreign Companies' Operations in China."
- ²⁴ Ryan McMorro, Joe Leahy, Nian Liu, and Eleanor Olcott, "Work Dries Up for US Consultancies In China After National Security Raids," *Financial Times*, July 23, 2024, <https://www.ft.com/content/0b869421-10f1-41e7-8280-5d09a224062f>.
- ²⁵ Dan De Luce and Yasmine Salam, "Advising Both Chinese State Companies and The Pentagon, McKinsey & Co. Comes Under Scrutiny," *NBC News*, November 13, 2024, <https://www.nbcnews.com/politics/national-security/advising-both-chinese-state-companies-pentagon-mckinsey-co-comes-under-n1283777>.
- ²⁶ Stephen Foley, Ryan McMorro, and Demetri Sevastopulo, "McKinsey website touted its advice to Chinese government ministries," *Financial Times*, February 27, 2024, <https://www.ft.com/content/159f27df-5758-4be2-881e-1bf3025bc98b>.
- ²⁷ De Luce and Salam, "Advising Both Chinese State Companies and The Pentagon, McKinsey & Co. Comes Under Scrutiny."
- ²⁸ United States of America, Australian Government, Dominion of Canada, United Kingdom of Great Britain and Northern Ireland, New Zealand, *Joint Cybersecurity Advisory: PRC State-Sponsored Actors Compromise and Maintain Persistent Access to U.S. Critical Infrastructure*, Cyberssecurity & Infrastructure Security Agency (US), National Security Agency (US), Department of Justice (US), Department of Energy (US), Environmental Protection Agency (US), Transportation Security Administration (US), Signals Directorate (AUS), Cyber Security Centre (AUS), Communications Security Establishment (CAN), Centre for Cyber Security (CAN), National Cyber Security Centre (NZ), National Cyber Security Centre (UK), AA24-038A, February 7, 2024, https://www.cisa.gov/sites/default/files/2024-03/aa24-038a_csa_prc_state_sponsored_actors_compromise_us_critical_infrastructure_3.pdf.
- ²⁹ Anne Neuberger, "MCSC 2024: Fireside Chat: Anne Neuberger," Sicherheitsnetzwerk München, March 11, 2024, YouTube video, <https://www.youtube.com/watch?v=WlvCT3aPb2k>.
- ³⁰ Jen Easterly, "Opening Statement by CISA Director Jen Easterly," Blog, News, Cybersecurity & Infrastructure Security Agency, January 31, 2024, <https://www.cisa.gov/news-events/news/opening-statement-cisa-director-jen-easterly>.
- ³¹ *A Cascade of Security Failures: Assessing Microsoft Corporation's Cybersecurity Shortfalls and the Implications for Homeland Security*, 118th Congress, 2nd session, 2024, (Statement of Brad Smith, Vice Chairman and President, Microsoft).
- ³² Geoffrey Cain has written extensively about these linkages. See also, "Microsoft and China Announce Government Security Program Agreement," Stories, Microsoft, February 28, 2003, <https://news.microsoft.com/2003/02/28/microsoft-and-china-announce-government-security-program-agreement/>; "China Information Technology Security Certification Center Source Code Review Lab Opened," Stories, Microsoft, September 26, 2003, <https://news.microsoft.com/2003/09/26/china-information-technology-security-certification-center-source-code-review-lab-opened/>; "Microsoft Gives Chinese Government Access to Windows Source Code," *People's Daily*, March 4, 2003, http://en.people.cn/200303/04/eng20030304_112657.shtml.
- ³³ Laramillersft and MicrosoftGuyJFlo, "Transparency Centers," Articles, Microsoft Security, Microsoft, February 2, 2024, <https://learn.microsoft.com/en-us/security/engineering/contenttransparencycenters>.

-
- ³⁴ Eva Dou, "IBM Allows Chinese Government to Review Source Code," *Wall Street Journal*, October 16, 2015, <https://www.wsj.com/articles/ibm-allows-chinese-government-to-review-source-code-1444989039>.
- ³⁵ Lester Ross and Kenneth Zhou, "China Launches Cybersecurity Review Against Micron," *WilmerHale*, April 11, 2023, <https://www.wilmerhale.com/insights/client-alerts/20230411-china-launches-cybersecurity-review-against-micron>
- ³⁶ Ivana Saric, "IBM is Latest U.S. Tech Giant to Pull Back from China," *Axios*, August 26, 2024, <https://www.axios.com/2024/08/26/ibm-rd-division-china-us-tech-competition>
- ³⁷ *Ibid.*
- ³⁸ "Cloud Locations," Google, <https://cloud.google.com/about/locations#asia-pacific>; Public Cloud Region Locations, Oracle, <https://www.oracle.com/cloud/public-cloud-regions/>.
- ³⁹ Jack Stubbs, Joseph Menn, and Christopher Bing, "Inside the West's Failed Fight Against China's 'Cloud Hopper' Hackers," *Reuters*, June 16, 2019, <https://www.reuters.com/investigates/special-report/china-cyber-cloudhopper/>
- ⁴⁰ "Cyber threat bulletin: Cyber Centre urges Canadians to be aware of and protect against PRC cyber threat activity," *Canadian Centre for Cyber Security*, June 3, 2024, <https://www.cyber.gc.ca/en/guidance/cyber-threat-bulletin-cyber-centre-urges-canadians-be-aware-and-protect-against-prc-cyber-threat-activity>
- ⁴¹ Microsoft, *Microsoft Digital Defense Report*, Security Insider, Microsoft, 2022, 39-40, <https://www.microsoft.com/en-us/security/security-insider/intelligence-reports/microsoft-digital-defense-report-2022>.
- ⁴² Rush Doshi, Emily De La Bnyere, Nathan Picarsic, and John Ferguson, "Chinas a 'Cyber Great Power': Beijing's Two Voices in Telecommunications," *Brookings Institution*, April 2021, https://www.brookings.edu/wp-content/uploads/2021/04/FP_20210405_china_cyber_power.pdf, p. 10.
- ⁴³ Liza Lin, "China Intensifies Push to 'Delete America' From Its Technology," *The Wall Street Journal*, March 7, 2024, <https://www.wsj.com/world/china/china-technology-software-delete-america-2b8ea89f>.
- ⁴⁴ Wency Chen, Coco Feng, and Che Pan, "Microsoft Outage Leaves China Largely Untouched as Tech Self-Sufficiency Campaign Pays Off," *South China Morning Post*, July 19, 2024, <https://www.scmp.com/tech/big-tech/article/3271171/microsoft-outage-leaves-china-largely-untouched-tech-self-sufficiency-campaign-pays>
- ⁴⁵ Mark Montgomery and Eric Sayers, "Don't Let China Take Over the Cloud — US National Security Depends On It," *Hill*, November 13, 2023, <https://thehill.com/opinion/national-security/4307002-dont-let-china-take-over-the-cloud-us-national-security-depends-on-it/>.
- ⁴⁶ David McCabe, "China's Cloud Computing Firms Raise Concern for U.S.," *New York Times*, June 21, 2023, <https://www.nytimes.com/2023/06/21/technology/china-cloud-computing-concern.html>
-



Testimony of

Clark Packard

**Research Fellow
Cato Institute**

Before the

**Homeland Security and Governmental Affairs Committee
United States Senate**

September 24, 2024

**"Safeguarding the Homeland: Examining Conflicts of Interest in Federal Contracting
to Protect America's Future"**

Chairman Peters, Ranking Member Paul, and members of the Homeland Security and Governmental Affairs Committee, thank you for the opportunity to testify today. My name is Clark Packard. I'm a Research Fellow at the Cato Institute, an independent, nonpartisan public policy research organization dedicated to advancing the principles of individual liberty, limited government, free markets, and peace.

My work at Cato focuses on U.S. international trade and investment law and policy with a specific focus on the U.S.-China economic relationship. For that reason, I'm especially grateful for the opportunity to testify this morning.

Let me state unequivocally at the outset: China engages in abusive—and at times coercive—international trade and investment practices. These include the forced transfer of technology as a condition of doing business within China; utilizing opaque and unevenly applied licensing procedures; the widespread abuse of intellectual property; state-directed cyber hacking into commercial networks; deploying non-commercially-based outward investment practices; providing large scale subsidies to domestic companies; and forced labor in Xinjiang, among others.¹ Many of these activities are done in support of widespread industrial policies.

My testimony will focus on the potential for abuse of national security-based protectionism and provide suggestions for outcompeting China in the 21st century.

Conflicts of Interest in Government Procurement

While I analyze public policy through a framework that favors openness and skepticism of heavy government intervention in cross-border trade and investment, free traders from Adam Smith to Milton Friedman have understood the need for limited exceptions for national security.

An American firm providing consulting services to the Department of Defense, for example, should not also be advising the Chinese government or the Chinese Communist Party. At the very least, American firms should be required to disclose potential conflicts of interest when bidding on U.S. government contracts for scrutiny by American procurement officials.

To the extent I have suggestions about legislation with such aims, it would be to ensure stringent guardrails are established to avoid stifling legitimate business practices. Too often national security is invoked as a pretext for simple protectionism.

The Trump administration's national security tariffs on steel and aluminum imports, imposed despite President Trump's defense secretary at the time noting the U.S. military required only 3 percent of total domestic steel and aluminum production, is a case in

¹ Office of the U.S. 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](#)," March 22, 2018.

point.² Indeed, the tariffs still apply to steel and aluminum from NATO members and other longstanding U.S. allies like Japan and South Korea. Those tariffs are extremely costly to the U.S. economy, harming industries that use steel and aluminum as inputs, U.S. consumers, and Americans targeted by foreign retaliation such as farmers and ranchers.³ In addition, the tariffs undermined confidence in the U.S. as a reliable trading partner. Imposed under the guise of national security, the tariffs inflicted considerable economic damage — the expected result of protectionist measures — while doing nothing to bolster the country's defense.

Likewise, national security-based arguments are being invoked as the rationale to block Nippon Steel's acquisition of U.S. Steel, but there's no security risk at all. Japan is the largest provider of foreign direct investment (FDI) in the United States. U.S. Steel has no military contracts. For more than 60 years, Japan has been one of the United States' strongest allies and today hosts more than 55,000 U.S. military personnel and thousands of DoD civilian contractors. It is incongruent that the United States would deploy nuclear weapons if necessary to defend Japan from attack, yet simultaneously claim Japanese investment is a national security threat. Today, Japan receives 90 percent of its defense-related imports from the United States. Simply put, Nippon would not pay a premium to purchase U.S. Steel only to shutter it. Indeed, Nippon would most likely provide the investment necessary to strengthen the firm.

A Smarter Approach to Competing With China

Turning to Beijing: it is worth noting that the Chinese economy is struggling and faces significant short-and-longer term headwinds that will surely constrain future growth.⁴ We should not overestimate its strength. Right-sizing the challenge is imperative to sound policy. That said, Beijing does pose very serious challenges to the United States both economically and strategically.

The United States should not respond to those challenges by turning inward and hiding behind protectionist walls. Instead, policymakers should work to strengthen trade and investment ties with close allies, particularly those in the Asia-Pacific region. While flawed, the Trans-Pacific Partnership would have created an American-led trading bloc to offset China's gravitational pull in the region economically and established higher-quality trade and investment rules and norms.

² Bureau of Industry and Security, "The Effect of Imports of Steel on the National Security: An Investigation Conducted under Section 232 of the Trade Expansion Act of 1962, as Amended," Department of Commerce, January 11, 2018.

³ Alex Durante, "[How the Section 232 Tariffs on Steel and Aluminum Harmed the Economy](#)," Tax Foundation, September 20, 2022.

⁴ Clark Packard, "[China's Economic Headwinds](#)," Cato Institute Defending Globalization: Foreign Affairs, October 10, 2023.

In the absence of U.S. re-engagement in TPP (since renamed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership), the U.S. should build on its successful bilateral agreement with South Korea known as KOR-US. Given the thawing in relations between Seoul and Tokyo, adding Japan and other allied countries to the KOR-US agreement presents a next-best option.

Likewise, policymakers should adopt the House's Select Committee on the Chinese Communist Party wise recommendation to expedite CFIUS review of FDI from trusted allies like Japan and South Korea.

The U.S.-China relationship is increasingly complex and is a top geopolitical issue facing the world. How the two countries manage this relationship will greatly affect global peace, prosperity, and stability in the 21st century. The guiding principle of our economic policy vis-à-vis China should focus on affirming market incentives that boost the performance and competitiveness of American firms and those of our allies.⁵

I look forward to answering any questions the Committee may have.

⁵ Note: Attached are two relevant, longer form pieces

Course Correction

Charting a More Effective Approach to U.S.-China Trade

BY CLARK PACKARD AND SCOTT LINCICOME

EXECUTIVE SUMMARY

Over the past several years the U.S.-China economic relationship has soured and become subordinated to broader concerns about national security and geopolitics. After a decades-long reform agenda in China that lifted hundreds of millions out of grinding poverty, Chinese president Xi Jinping has increasingly turned inward—reembracing Maoist socialism and heavy-handed central planning. Washington’s response to these worrisome developments has been reflexively hawkish economically, scattershot, and woefully inadequate for the economic challenge that China presents.

Fearing that China is inexorably poised to become the world’s leading economy, policymakers in the United States have embraced tariffs, investment restrictions, export controls, and massive domestic subsidies to favored industries such as semiconductor manufacturing. These moves have failed to change Beijing’s behavior, but they have

counterproductively weakened the U.S. economy and alienated allies that Washington needs to rally in defense of market-based democracy against 21st-century mercantilism.

This analysis explains that instead of mimicking China’s increasingly interventionist economic policies, the United States should focus on promoting the competitiveness of the American economy and the economies of our allies. Policymakers should rely on the market-oriented policies that propelled the United States to unprecedented wealth and power, including openness to international trade and investment; liberalized immigration; lighter-touch regulation, particularly in the burgeoning technology industry that sits at the epicenter of the economic competition with China; and smarter tax policies. These policies are not a panacea with respect to all that ails the U.S.-China economic relationship, but they would be much more successful than the failed status quo.



CLARK PACKARD is a research fellow at the Cato Institute’s Herbert A. Stiefel Center for Trade Policy Studies.
SCOTT LINCICOME is vice president of general economics and the Herbert A. Stiefel Center for Trade Policy Studies.

INTRODUCTION

The U.S.-China relationship is increasingly complex and is the top geopolitical issue facing the world today. How the two countries manage this relationship will greatly affect global peace, prosperity, and stability in the 21st century. Concerning economic and trade policy specifically, the United States should focus on affirming the market incentives that boost the performance and competitiveness of American companies and those of our allies. Unfortunately, Washington policymakers have instead embraced economically hawkish rhetoric and policies that are at best superficial and at worst counterproductive. As former treasury secretary Henry Paulson astutely observed, “We have a China attitude, not a China policy.”¹

“China faces a significant brain drain among technology workers and other entrepreneurs, most of whom prefer the freedom offered by the United States and other Western countries.”

The bipartisan consensus in policymaking circles around Washington today is that China is an economic juggernaut, inexorably poised to overtake the United States as the world’s leading economy. To many policymakers, Beijing’s increasingly interventionist and mercantilist policies have supercharged its economy and promise to displace the United States at the top of the global order unless Washington matches China’s economic interventionism.

This consensus is rife with problems. For starters, China’s economic rise has a lot more to do with its brief abandonment of heavy central planning decades ago than it does with today’s reembrace of industrial policy and Maoist socialism. Indeed, the Chinese economy today is not the powerhouse many believe it to be. Short-term issues and longer-term systemic trends will further constrain future economic growth and dynamism in China—obstacles created in no small part by China’s relatively recent shift away from economic liberalization.

Beijing’s draconian “zero-COVID” policy shuttered large portions of the Chinese economy in 2022. President

Xi Jinping’s embrace of heavy intervention in the tech industry has paralyzed a once dynamic and growing sector of the economy.² The country’s real estate sector is overinflated and has led to a debt default by giant property developer Evergrande.³ And China’s ever-expanding bureaucracy has been paralyzed by the inevitable conflict between eradicating COVID-19 and hitting Beijing’s pre-determined growth targets.⁴

These forecasts are notoriously difficult, especially given the uncertainties caused by the pandemic and China’s recent reopening.⁵ However, China’s longer-term headwinds are more certain and daunting. Productivity is slowing and has been for quite some time.⁶ China also has an enormous demographic problem, exacerbated by its cruel, now abandoned One Child Policy, that will both slow growth and strain government social spending.⁷ China faces a significant brain drain among technology workers and other entrepreneurs, most of whom prefer the freedom offered by the United States and other Western countries.⁸ Likewise, China has seen its international standing erode in recent years for myriad reasons, including human rights abuses such as forced labor in the Xinjiang region; effectively annexing Hong Kong in 2020 with the passage of the national security law meant to quash dissent and criticism of Beijing; an aggressive foreign policy posture in the region, including threatening Taiwan’s sovereignty; and its misinformation about the origins of COVID-19. This analysis will focus almost exclusively on the U.S.-China economic relationship. China engages in several repressive practices, which deserve a straightforward U.S. response, but those are beyond the scope of this analysis.

That is not to say that the United States should do nothing about China’s economic practices. There are legitimate concerns about numerous international trade and investment policies pursued by Beijing, its increasingly brutal human rights practices, and its geopolitical bellicosity and coziness with Russia and rogue regimes, which all demand attention. Yet concerning the challenges that China poses economically, U.S. policymakers seem intent on rejecting the very policies that have propelled the United States to enormous wealth and global influence and instead are mimicking Beijing’s heavy-handed industrial policies and interventionism. That would be a mistake. There is a better way: one that relies on America’s traditional strengths.

CHINA'S TROUBLING INTERNATIONAL ECONOMIC PRACTICES

There is an emerging awareness in Washington and other Western market-oriented democracies that China's international trade and investment practices pose significant challenges to the United States and the rules-based trading system.

In 2017, then president Donald Trump directed his United States Trade Representative (USTR) to begin an investigation into Chinese commercial practices pursuant to Section 301 of the Trade Act of 1974.⁹ Over the next seven months, USTR compiled a 301 Report that served as an indictment of China's international trade and investment practices. The overarching theme of the report is that China uses a number of unfair and malicious methods to acquire U.S. technology in service of Beijing's high-tech indigenous innovation policies known as "Made in China 2025."¹⁰ According to USTR, these policies inhibit U.S. exports; undermine American innovation, manufacturing, and services; and bolster jobs in China at the expense of American workers.

The list of complaints is long, and it encompasses both major problems as well as smaller irritants. First, China engages in widespread and unauthorized state-sponsored cyber espionage into U.S. commercial networks in order to steal trade secrets and abuse intellectual property. These stolen materials include "trade secrets, technical data, negotiating positions, and sensitive and proprietary information internal communications." Many of these cyber intrusions target American firms that operate in markets and industries deemed strategic by Beijing, including those with a national security nexus.¹¹

Next, China uses hidden industrial policy and foreign discrimination, including via its numerous state-owned enterprises (SOEs), that hurt American competitors. This is done on a massive scale and in a completely nontransparent way. It is worth noting that the International Monetary Fund (IMF) estimates that Chinese SOEs are about 20 percent less productive than private sector competitors in the same market.¹² Beijing's increasing reliance on SOEs will slow growth in China over the long run, but it hurts U.S. firms in the short run and erodes business confidence in foreign trade.

Next, China uses foreign ownership restrictions "to require or pressure technology transfer from U.S. companies

to Chinese companies" as a condition of accessing the Chinese market. This is done, for example, through requirements that U.S. companies establish a China-based joint venture partner. Pressure is then exerted on the foreign manufacturers to turn over cutting-edge and core technologies to their Chinese joint venture partners.¹³

"Despite identifying many of the problems with China's international trade and investment practices, the U.S. approach to addressing these challenges has been woefully inadequate across the last two presidential administrations."

Beijing also uses opaque and unevenly applied licensing restrictions to discriminate against American firms that are seeking to operate in China and reach consumers in its market. The 301 Report describes how the Chinese government often requires firms to turn over sensitive technical information to secure approval to operate in the country but does not require the same of domestic Chinese firms.¹⁴

Likewise, there is a "pervasive" state-sponsored effort to direct and facilitate investment in, and acquisition of, U.S. companies and assets by Chinese companies. Such investments and acquisitions have strategic and military goals. These transactions are often undertaken by China's numerous SOEs and state-supported banks and investment funds, which are not subject to market disciplines.¹⁵

In total, the 301 Report casts doubt on Chinese international economic practices—essentially 21st-century high-tech industrial policy on a massive scale—and demonstrates how such policies undermine the U.S. economy, both workers and firms. These are real challenges and require a concerted response, one that has thus far failed to materialize.

THE FAILING APPROACH

Despite identifying many of the problems with China's international trade and investment practices, the U.S. approach to addressing these challenges has been woefully inadequate

across the past two presidential administrations. First, the United States levied a series of tariffs, which triggered predictable retaliation from Beijing, in the past few years. Then, in 2022, policymakers decided to copy Beijing's inefficient industrial policy by establishing our own subsidies for favored industries. Neither tariffs nor domestic subsidies are up to the serious task of outcompeting China in the 21st century.

In total, tariffs now cover about 70 percent of all imports from China and the average rate is nearly 20 percent, which is more than six times higher than before the trade wars began. Meanwhile, retaliatory tariffs cover about 60 percent of American products and services sent to China, at an average rate above 21 percent, which is up from about 7 percent before the trade wars.¹⁶ Together, the tariffs and reprisals constitute an even larger share of GDP than the infamous Smoot-Hawley tariffs, which exacerbated and prolonged the Great Depression according to recent research by Pablo Fajgelbaum of Princeton University and Amit Khandelwal of Columbia University.¹⁷

In January 2020, Washington and Beijing signed a truce informally known as the Phase One Agreement. The two sides agreed to forgo additional tariffs, but the existing tariffs remain in place. China agreed to purchase large quantities of American exports over a two-year period and promised to make certain structural changes to its economic practices. Now, after more than two years, the status quo—tariffs and the Phase One Agreement—has failed on multiple levels.

First, despite Trump's repeated statements to the contrary, countless academic studies have found that Americans, not the Chinese, paid the tariffs (and continue to do so).¹⁸ As a result, the tariffs' economic harms to the U.S. economy were significant. The New York Federal Reserve, for example, estimates that the tariffs increased costs for average American households by about \$830 per year, accounting for direct costs and efficiency losses, and resulted in approximately \$1.7 trillion in lost

Table 1

Selected estimates of the cost of Section 301 and other tariffs

| Study | Tariffs covered | Costs considered | Average annual cost per household |
|--------------------------------------|--|--|-----------------------------------|
| American Action Forum (2022) | Section 301 tariffs (25 percent on \$250 billion of imports and 7.5 percent on \$112 billion of imports) | Higher tax burden | \$379 (gross) |
| Amiti, Redding, and Weinstein (2019) | Tariffs imposed from February 2018 to May 2019 | Higher tax burden and deadweight (efficiency) losses | \$831 (gross) |
| Congressional Budget Office (2020) | Tariffs imposed between January 2018 and January 2020 | Loss in output and higher consumer prices | \$1,277 (net) |
| Fajgelbaum et al. (2021) | Tariffs imposed from February 2018 to September 2019, plus foreign retaliation | Gross: higher tax burden and deadweight (efficiency) losses Net: loss in output | \$894 (gross) \$194 (net) |
| Tariffs Hurt the Heartland (2022) | Tariffs imposed from February 2018 to April 2021 | Higher tax burden | \$737 (gross) |
| Tax Foundation | Section 301 tariffs (25 percent on \$250 billion of imports and 7.5 percent on \$112 billion of imports) | Loss in output | \$405 (net) |
| Trade Partnership (2019) | Tariffs imposed or announced as of November 2018, plus foreign retaliation | Loss in national income | \$574 (net) |

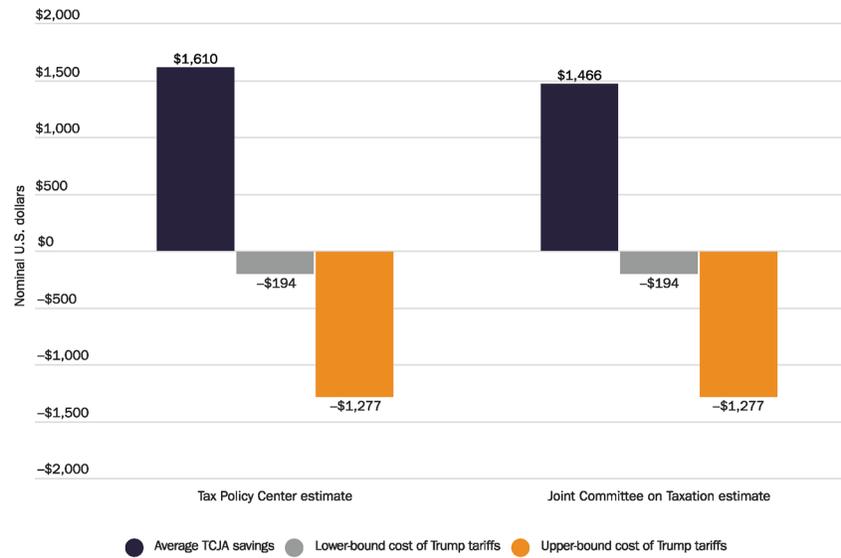
Sources: Tom Lee and Jacqueline Varas, "The Total Cost of U.S. Tariffs," American Action Forum, May 10, 2022; Mary Amiti, Stephen J. Redding, and David E. Weinstein, "New China Tariffs Increase Costs to U.S. Households," *Liberty Street Economics* (blog), Federal Reserve Bank of New York, May 23, 2019; Congressional Budget Office, "The Budget and Economic Outlook: 2020 to 2030," January 28, 2020, p. 33; Pablo D. Fajgelbaum et al., "Updates to Fajgelbaum et al. (2020) with 2019 Tariff Waves," January 21, 2020; "New Data Shows Trade War Has Cost Americans Nearly \$94 Billion, Including Close to \$14 Billion in First Four Months of 2021," press release, Tariffs Hurt the Heartland, June 18, 2021; Erica York, "Tracking the Economic Impact of U.S. Tariffs and Retaliatory Actions," Tax Foundation, April 1, 2022; and "Estimated Impacts of Tariffs on the U.S. Economy and Workers," Trade Partnership Worldwide, LLC, February 2019, p. 10.

Notes: The average annual cost per household was obtained by dividing the total cost of the tariffs reported by each study by the number of households in the United States in 2018 (127.6 million). For the Congressional Budget Office (2020), the average annual cost per household was obtained directly from the report. "Gross" refers to costs considering higher tax burden and deadweight (efficiency) losses resulting from the tariffs, while "net" refers to costs that also contemplate offsetting factors (i.e., producer gains and tariff revenues).

market capitalization for firms through investment slow-downs.¹⁹ Meanwhile, Moody's Analytics estimates that the trade wars cost about 300,000 jobs.²⁰ Table 1 summarizes academic research on the tariff's economic costs. Figure 1 shows that these costs erased up to half of the average household's savings from the tax cuts enacted by the Tax Cuts and Jobs Act of 2017.

Second, in a Sisyphean attempt to close the bilateral trade deficit, the United States spent considerable political capital to get the Chinese to agree to specific purchase requirements over a two-year period. This distorted markets, angered allies, and empowered Chinese SOEs, which were used to make the purchases. Moreover, by the end of the two-year period, China was well short of the level of

Figure 1
Annual savings from Tax Cuts and Jobs Act of 2017 minus annual costs of Trump tariffs in 2018, averaged by household*



Sources: The lower-bound estimate for the impact of Trump tariffs is from Pablo D. Fajgelbaum et al., "Updates to Fajgelbaum et al. (2020) with 2019 Tariff Waves," January 21, 2020. The upper-bound estimate for the impact of Trump tariffs is from "The Budget and Economic Outlook: 2020 to 2030," Congressional Budget Office, January 28, 2020, p. 33. For alternative estimates on the impact of Trump tariffs, see Table 1 in this paper. Estimates for the impact of the Tax Cuts and Jobs Act of 2017 are from "Distributional Analysis of the Conference Agreement for the Tax Cuts and Jobs Act," Tax Policy Center, December 18, 2017; and "Distributional Effects of Public Law 115-97," JCX-10-19, Joint Committee on Taxation, Congress of the United States. Author's calculations are described in the note below.

Note: Estimates of the impact of Section 301 tariffs also include the effects of other tariffs imposed by the Trump administration from January 2018, but the Section 301 tariffs account for the largest share of the observed effect. The aggregate impact of Trump tariffs is divided by the number of U.S. households in 2018 (approximately 127.6 million). The Tax Policy Center divides the aggregate impact of the Tax Cuts and Jobs Act of 2017 by "tax units," which is defined as an "individual, or a married couple, that files a tax return or would file a tax return if their income were high enough, along with all dependents of that individual or married couple." The Tax Policy Center estimates that the amount of tax units in a given year exceeds the number of households reported by other sources. The Joint Committee on Taxation reports the aggregate change in federal taxes and a distinct number of taxpayer units. Thus, aggregate savings from the Tax Cuts and Jobs Act of 2017, according to the Joint Committee on Taxation's estimates, are divided by the committee's number of taxpayer units (177 million) to obtain the average.

American products it had promised to buy. As Chad Bown of the Peterson Institute for International Economics noted, “In the end, China purchased only 57 percent of the total US goods and services exports over 2020–2021 that it had committed to” under the Phase One Agreement.²¹

Third, and perhaps most importantly, Beijing has done little to overhaul its troubling economic and trade practices, as U.S. Trade Representative Katherine Tai herself admitted before Congress.²² Instead, as the U.S.-China Economic and Security Review Commission’s 2021 report to Congress highlighted, Beijing’s pursuit of industrial policy continues apace.²³ The *Wall Street Journal* recently reported, in fact, that “China has *doubled down* on the state-led economic model the Trump administration had set out to change. Chinese authorities increased their use of subsidies—including cash infusions, discounted loans and cheap land—to dominate high-technology industries.” And the U.S. approach may have hardened attitudes in Beijing and among the Chinese public. As former U.S. trade representative Charlene Barshefsky noted, Chinese leaders “did not change their economic model one iota, reinforcing to Xi Jinping that their economic model can withstand even aggression by the United States.”²⁴ Recent research also found that the trade war reduced Chinese citizens’ support for both trade with the United States and international trade in general.²⁵

“Mimicking Beijing’s 21st-century industrial policy is simply not a panacea in the economic competition between the United States and China.”

Likewise, Congress recently passed the Chips and Science Act of 2022 on a bipartisan basis. At the center of the legislation is about \$80 billion in federal grants and tax credits for semiconductor production. The supposed purpose of the trade-distorting subsidies is to induce firms to produce more semiconductors and related technologies domestically. Policymakers argued that such subsidies are necessary because China heavily subsidizes its own industrial production of semiconductors and it could invade Taiwan, a U.S. ally and a major supplier of chips to the U.S. and global markets.

Yet there are compelling reasons to be circumspect about the transformative power of these subsidies. If history is any guide, this bout of industrial policy will be no more successful than previous iterations.²⁶ Indeed, it is likely that inefficient semiconductor subsidies will dampen innovation, enrich rent seekers, and trigger trade tensions with the very allies the United States needs to rally to exert pressure on Beijing to curtail its predatory commercial practices.

Mimicking Beijing’s 21st-century industrial policy is simply not a panacea in the economic competition between the United States and China. Likewise, the U.S.-China trade war—easily the most aggressive bout of unilateral, tit-for-tat protectionism in decades—is imposing enormous costs on innocent bystanders in a misguided effort to fundamentally change Beijing’s mercantilism and nationalism. Indeed, it most likely has made things *worse*.

SMARTER POLICY RESPONSES

There is a far better approach to China than ineffective bellicosity and sclerotic protectionism. This approach focuses less on trying to change Chinese government behavior, which seems unlikely, and more on using time-tested policy tools to supercharge the U.S. economy and reassert America’s global leadership.

International Trade Tools

First, policymakers should lift the Section 301 tariffs, which are doing significantly more harm than good to the United States. They have utterly failed to discipline China’s mercantilism and instead have imposed significant costs on the American economy, especially American manufacturers. Other tariffs should also be liberalized, particularly those on industrial inputs. More than half of all imports in the United States are capital goods, raw materials, or intermediate inputs used by American firms to make products here. Tariffs on these goods raise manufacturers’ production costs and instantly make them less globally competitive than foreign competitors who have freer access to the same inputs. Policymakers should unilaterally eliminate existing duties on such capital goods, raw materials, and intermediate inputs, which would strongly enhance America’s global competitiveness.

The most obvious place to start in this regard is the Trump administration's tariffs on imported steel and aluminum, which were implemented on bogus "national security" grounds and have harmed both metal-consuming American manufacturers and relations with key trading partners.²⁷ The tariffs also triggered predictable retaliation, ensnaring unrelated industries like agriculture into the morass. The tariffs' big winners have been a handful of politically connected U.S. companies and unions and American manufacturers' *global competitors* who pay far less for these critical industrial inputs.²⁸ The United States should also reform its trade remedy system, which has resulted in duties on hundreds of imported products—primarily industrial inputs—that are imposed with no regard to their potential harms to downstream consuming industries.²⁹

“The tariffs’ big winners have been a handful of politically connected U.S. companies and unions and American manufacturers’ global competitors who pay far less for these critical industrial inputs.”

Removing these tariffs would not only make American manufacturers more competitive vis-à-vis their Chinese competitors, but also provide some relief for inflation-weary American families. While today's historic inflation has been primarily caused by loose fiscal and monetary policy and various supply-side bottlenecks, recent research from the Peterson Institute finds that eliminating the Trump administration's trade war tariffs (both on China and metals) could save American families hundreds of dollars per year.³⁰ Eliminating tariffs will not completely solve inflation or fix U.S.-Sino commercial relations, but it is a good and obvious place to start.

Second, the United States should end its blockade of new appointments to the World Trade Organization's (WTO) Appellate Body, the highest court of international trade. As a result of U.S. intransigence, the WTO's dispute settlement system is paralyzed.³¹ Where there are legitimate grievances about Chinese protectionism in violation of Beijing's commitments under the World

Trade Organization Agreements, the United States and its like-minded allies should pursue dispute settlement in the Geneva-based tribunal. Many of the practices highlighted by the United States in the 301 Report are prohibited by WTO rules, including forced technology transfer, while there is an affirmative—and enforceable—obligation to protect intellectual property.³² Research from the Cato Institute finds that China has an imperfect but decent record of complying with adverse decisions by the WTO.³³

Third, the United States should rejoin the Trans-Pacific Partnership (TPP), which was subsequently renamed the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) after the Trump administration's ill-advised withdrawal from the partnership at the beginning of Trump's term in office. The TPP was a U.S.-led effort to create a major trading bloc in the Asia-Pacific region, which was launched in the waning days of the George W. Bush administration and finalized in October 2015. It was signed by the 12 Pacific Rim countries in February 2016. The agreement's objectives were threefold:

- **Economics:** the TPP/CPTPP reduced a number of trade barriers between the parties to the agreement. This would lead to increased efficiency, productivity, and economic growth for the members. The Peterson Institute found that, if implemented, the TPP would have raised real incomes in the United States by \$131 billion annually by 2030 and increased U.S. exports by nearly \$360 billion over that span, more than 9 percent above the 2014 baseline used by the authors of the study.³⁴ The U.S. International Trade Commission found that by 2032, the TPP would have raised real incomes by \$57.3 billion, increased gross domestic product by \$42.7 billion, and created 128,000 jobs, while exports to new trading partners would have grown by nearly 20 percent.³⁵ These are small but significant gains for the United States.
- **New Trade Rules:** the TPP/CPTPP also included new rules covering various aspects of the modern economy that were not captured by previous trade agreements, including the North American Free Trade Agreement (NAFTA) and the WTO Agreements. Such disciplines included digital trade, industrial subsidies, and SOEs. Even though it was not a member of TPP,

China loomed large in the agreement's negotiations: these rules targeted a lot of Beijing's "state capitalist" trade and investment practices. The goal was to write new rules and eventually "multilateralize" them at the WTO. The TPP thus established a high bar for any eventual Chinese accession to TPP and helps WTO members to pressure China into accepting the new rules on a multilateral level.

- **Geopolitics:** although the TPP made economic sense, foreign policy benefits drove the agreement. At its core, TPP was designed to counter China's growing influence in the Asia-Pacific region. First, TPP members would have an alternative market to China: the United States. Countries tend to trade with large nearby countries under what's known as a "gravity model." The TPP's elimination of trade barriers was intended to offset China's massive gravitational pull in the region. This could help reorient supply chains out of China and into neighboring TPP member countries as well as the United States. The TPP also provided a forum to promote regional cooperation, consultation, and dispute settlement, similar to the WTO, albeit in a nimbler form. Finally, TPP was intended to be an ever-growing platform for new members to join, especially close allies in the region like South Korea and Thailand. (Seoul recently applied to join CPTPP.) Adding members would give the agreement extra heft and increase the leverage of the United States while bolstering the "TPP supply chain." China would be faced with a choice: raise its commercial standards to join the ever-growing TPP bloc or face competitive disadvantages in its own backyard.

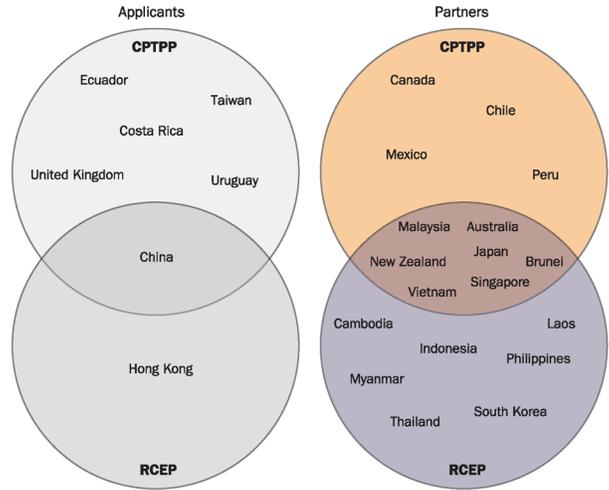
But the TPP was far from perfect: it contained a fair amount of special-interest protectionism (e.g., on intellectual property and textiles), while certain laudable provisions (e.g., constraining subsidies and state-owned enterprises) were diluted to appease certain signatories. But, as the Cato Institute's chapter-by-chapter analysis of the agreement concluded in 2016, it was on-net liberalizing—by a significant margin—and deserved support.³⁶ This conclusion has since been bolstered because CPTPP signatories have removed some of the most offending provisions.

The TPP's original motivations, moreover, have since proven sound. Unfortunately, American exporters are on the outside of the agreement looking in: they face significantly higher trade barriers than their competitors within the TPP bloc. Lost market access is an especially acute problem for American farmers and ranchers attempting to reach notoriously closed Asian agriculture markets, which were pried open in TPP negotiations. Likewise, American consumers face higher tariffs and other trade barriers than consumers in TPP countries—relief that would have been welcome during a period of high inflation and supply chain chaos. And perhaps most tragically, the United States forfeited its economic leadership role in the Asia-Pacific region, ceding the ground to China. Beijing is working hard to fill that void. At the beginning of 2022, the China-led Regional Comprehensive Economic Partnership (RCEP)—a large, albeit lower-quality trade agreement than TPP—went into effect. The imperative to rejoin CPTPP grows every day as China's influence and assertiveness in the region grows. Figure 2 shows the parties to the CPTPP and the RCEP, as well as countries currently applying to join the former agreement.

“The Indo-Pacific Economic Framework is simply no substitute for rejoining the CPTPP and expanding its membership to include longtime allies like South Korea, Taiwan, and the post-Brexit United Kingdom.”

The Biden administration is now seeking to reassert American international economic leadership in the Asia-Pacific region with its Indo-Pacific Economic Framework (IPEF) initiative. The IPEF negotiations recently began, but the administration's refusal to put market access issues on the table means the impact of the agreement will be extremely limited.³⁷ The IPEF is simply no substitute for rejoining the CPTPP and expanding its membership to include longtime allies like South Korea, Taiwan (a high-tech manufacturing hub), and the post-Brexit United Kingdom, all of whom have expressed an interest in joining the pact.

Figure 2
Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and Regional Comprehensive Economic Partnership Countries (RCEP)



Sources: Jeffrey J. Schott, "Which Countries Are in the CPTPP and RCEP Trade Agreements and Which Want In?," Peterson Institute for International Economics, March 2, 2023; "CPTPP Accession," New Zealand Ministry of Foreign Affairs and Trade; and "Hong Kong Applies to Join RCEP Trade Agreement," Nikkei Asia, February 23, 2022.
 Notes: South Korea and Thailand have publicly indicated their interest in applying to join CPTPP, but they have not initiated the process yet. Bangladesh is reportedly considering applying to join RCEP.

Fourth, the United States should pursue more trade-liberalizing agreements with other partners, either through the CPTPP or outside of it. It has now been more than 10 years since the United States entered into a new trade agreement (the last bilateral agreements were with South Korea, Panama, and Colombia, respectively). The rest of the world has moved on while the United States has dithered. As mentioned, RCEP went into effect in early 2023 and the African Continental Free Trade Agreement is now in place. Over the long term, a stagnant U.S. trade agenda will lead to a less dynamic and slower-growing U.S. economy, not to mention a decline in American prestige and influence over foreign policy decisions made around the globe.

The most obvious place to start is the Transatlantic Trade and Investment Partnership (T-TIP) with the European Union, which stalled during the Trump administration but

has received newfound attention following Russia's invasion of Ukraine.³⁸ The T-TIP has the potential to be a high-quality, comprehensive modern trade agreement between economic superpowers. Cutting trade and investment barriers and streamlining regulatory recognition would be a boon on both sides of the Atlantic. (Just imagine, for example, if the FDA had accepted European regulatory practices *before* the U.S. infant formula crisis.) Like TPP, T-TIP would strengthen important geostrategic ties in the face of an increasingly aggressive Russia and reaffirm the United States' commitment to the transatlantic relationship. It would also provide the United States with another trading bloc committed to high-quality commercial rules that could be leveraged to help discipline Beijing's trade and investment transgressions.

Another trade tool available to policymakers concerned about U.S.-China trade and investment is the Generalized

System of Preferences (GSP), the authorization for which lapsed at the end of 2020. The GSP cuts tariffs on certain products coming to the United States from about 120 developing countries, including several of China's competitors, including Thailand, the Philippines, Cambodia, and Indonesia. As the *Wall Street Journal* recently documented, after the Trump administration's tariffs, many companies relocated manufacturing out of China and into GSP-beneficiary countries to take advantage of the tariff disparity.³⁹ Now that GSP has lapsed and tariffs have increased on products from GSP countries, however, several of those companies are moving production back into China—at the same time a bipartisan chorus of policymakers is urging producers to exit the Chinese market. As Dan Anthony, the executive director of the Coalition for GSP, and Steve Lamar, the president and CEO of the American Apparel and Footwear Association, wrote in the *Wall Street Journal* in late 2022 urging renewal of GSP, “Companies are looking to Congress for a signal. So far Congress is telling them to go to China.”⁴⁰ Thus, Congress should quickly reauthorize and expand the GSP.

“The United States should employ other tools of economic statecraft, but in a far more narrowly tailored way than has been recently proposed.”

Finally, the United States should repeal the Jones Act (i.e., Section 27 of the Merchant Marine Act of 1920), which restricts domestic shipping services to vessels that are built in the United States, owned by Americans, U.S.-flagged, and U.S.-crewed. As a result of this act, our shipping laws are some of the most protectionist in the world. The Jones Act was once justified as necessary to ensure adequate domestic shipbuilding capacity and a supply of merchant mariners in times of war or other national emergency, but over the last 100-plus years it has become apparent that the act fails to bolster national security, while it serves as a drag on the economy.⁴¹ The Jones Act inflates shipping costs because the transport of cargo between U.S. ports and inland waterways is off-limits to foreign competition. These higher shipping costs have ripple effects throughout the economy: they

increase demand for alternative forms of transportation, including trucking, rail, and pipeline services, which raises those modes' rates and increases business costs throughout the supply chain, especially in manufacturing. Likewise, the Jones Act is a source of constant irritation to several trading partners, thus discouraging U.S. exports in those markets.

Sanctions, Investment Screening, and Export Controls

The United States should employ other tools of economic statecraft, but in a far more narrowly tailored way than has been recently proposed. For example, lawmakers recently bolstered the government's ability to monitor and restrict potentially malicious foreign investment in domestic firms through the Committee on Foreign Investment in the United States (CFIUS). But CFIUS reviews should be scrutinized because they often lack transparency and could be (and arguably have been) used as a protectionist cudgel in industries with a tenuous national security nexus. Nevertheless, limited restrictions on Chinese investment (especially by SOEs) applied in a transparent and consistent manner can ensure that American trade secrets and sensitive technologies are not controlled by or transmitted to the Chinese government.

Narrow sanctions on specific bad actors—individuals or firms—can also be a legitimate policy tool. Sanctioning SOEs controlled by the Chinese Communist Party or targeting Chinese firms that engage in cyber espionage to steal American trade secrets may be justified in certain cases. These measures would be dramatically better than the blanket tariff regime currently in place, but—as with CFIUS actions—they must be narrowly tailored, thoroughly documented and supported, and fully transparent.

Likewise, export controls can be a useful tool to protect and advance American foreign policy and technological interests, but they can also be misapplied to the detriment of important U.S. companies and national interests. It is reasonable, for example, to restrict the export of materials used exclusively to make nuclear weapons. However, it is a muddier calculus when the product in question has both civilian and military applications, such as semiconductors. Policymakers considering deploying export controls should implement some basic guardrails to ensure a proper balance

between protecting national security and ensuring the relative free flow of goods across borders, which is instrumental to American prosperity and security. In particular:

- Policymakers should clearly define national security concerns tied closely to defense and defense-related goods and services. The Trump administration's flagrant abuse of tariffs on imported steel and aluminum shows the dangers in loosely defining "national security."
- Policymakers should also be required to balance the security and economic ramifications of export controls. Like import tariffs, export restrictions can harm domestic exporters, who lose foreign sales, or harm importing firms that are denied access to inputs by foreign retaliatory "copycat" export control measures. An overly restrictive export control regime could dissuade foreign firms from even opening operations in the United States.
- When there is a legitimate national security product or service involved and the threat outweighs the potential economic costs of the export restriction, unilateral sanctions should be avoided in all but the rarest of circumstances. In a globalized world with various suppliers of virtually every product, unilateral controls can lose their effectiveness and simply deny sales to a U.S. firm by diverting trade to a less-efficient producer while doing nothing to enhance national security.
- Policymakers should establish transparent procedures before and after export controls are implemented to ensure they are not unduly burdensome. The executive branch should work with the private sector to determine if there are ways to mitigate potential national security risks associated with the export of a product or service in question and to understand the full economic effect of the proposed control. Likewise, there should be a robust and timely judicial review process that allows appeals to be heard quickly. A time-limited sunset for proposed export controls also makes sense.
- Finally, export controls should be tailored as narrowly as possible. There is a high potential for sanctions to hurt people without achieving the desired policy aims. Serious scholars have questioned the efficacy of various sanctions, including export controls, when they remain in place for long periods of time.⁴²

As an example of the danger of these policies, overbroad export controls caused certain Chinese firms to hoard semiconductors in recent years. That exacerbated a growing global shortage in semiconductors that became acute during the pandemic.⁴³

Liberalize Immigration

If the United States is going to outcompete China in the 21st century, particularly in the fields that are likely to drive future growth, Washington needs to welcome far more immigrants into the country. Unique among the most powerful nations of the world, the United States is a nation of immigrants, and they are one of our greatest assets. Yet in recent years policymakers have unwisely restricted immigration. For example, it is estimated that legal immigration fell by about 50 percent between fiscal years 2016 and 2021, spurred by the false belief that immigrants somehow reduce Americans' living standards.⁴⁴ Such zero-sum thinking is antithetical to American values and conflicts with both historical evidence and economic research. It risks undercutting an asymmetric advantage the United States has over China: the ability to attract and retain talented foreigners. Although immigration levels have returned to their pre-pandemic levels during the last two years, given the aging population in the United States, more needs to be done to increase immigration.⁴⁵ Indeed, immigration levels remain millions behind where we should be today.

“If the United States is going to outcompete China in the 21st century, particularly in the fields that are likely to drive future growth, Washington needs to welcome far more immigrants into the country.”

First, the academic literature is clear that immigrants are net job creators because they tend to be more entrepreneurial than nonimmigrants.⁴⁶ Some of America's most innovative and globally competitive firms were founded by immigrants, including Google, Uber, Qualcomm, Tesla, eBay, Yahoo, and Pfizer.⁴⁷

Immigration is crucial if the United States is to continue leading the technology sector, which is at the nexus of the geopolitical competition with China. As economist Kimberly Clausing notes in her recent book, *Open: The Progressive Case for Free Trade, Immigration, and Global Capital*, “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.”⁴⁸

Figure 3 depicts the increase in the U.S. foreign-born STEM [science, technology, engineering, and mathematics] workforce from 2000 to 2019. Research shows that immigrants are particularly prevalent in, and essential for, important technology industries such as semiconductors and artificial intelligence.⁴⁹ Openness to immigration is therefore essential to keeping R&D-intensive multinationals in the United States and out of China, which has long struggled to retain or attract skilled human capital.⁵⁰

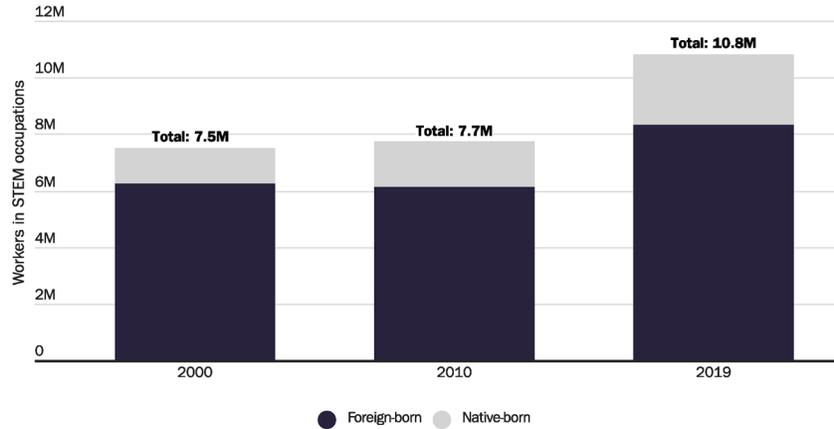
Furthermore, it is estimated that between 1990 and 2010, the “inflows of foreign STEM workers explain between

30% and 50% of the aggregate productivity growth” in the United States.⁵¹ Immigrants are about twice as likely to be granted patents as nonimmigrants because they disproportionately have degrees in science and engineering. The same study found positive spillover effects from skilled immigration: “A 1 percentage point rise in the share of immigrant college graduates in the population increases patents per capita by 9–18 percent.”⁵² In other words, skilled immigrants provide a direct benefit to the United States, but they also spur innovation among nonimmigrants.

America’s colleges and universities have long been breeding grounds of innovative research and technology. Students who hold visas make up a disproportionate number of graduate-degree-seeking students in science, computer science, and engineering.⁵³ Yet research by David Bier of the Cato Institute found that the Trump administration oversaw an enrollment decline of about 700,000 students in U.S. colleges and universities.⁵⁴

At the same time, the United States remains a far more attractive spot than China for international scientists and engineers.⁵⁵ Yet instead of capitalizing on China’s woes in

Figure 3
U.S. Science, Technology, Engineering, and Mathematics (STEM) workforce by nativity, selected years 2000–2019



Source: “Foreign-born STEM Workers in the United States,” American Immigration Council, June 14, 2022.
Notes: STEM = Science, technology, engineering, and mathematics. STEM occupations are defined by the American Immigration Council according to the list of STEM occupations from the U.S. Census Bureau. The American Immigration Council report is based on data from the American Community Survey.

attracting and retaining top scientists, Washington’s hostility toward Beijing is driving some of the top talent out of the United States.⁵⁶ Recent research found that nearly 1,500 U.S.-trained Chinese engineers and scientists dropped their U.S. academic or corporate affiliations and exchanged them for Chinese affiliations in 2021, which represents a more than 20 percent increase from the prior year.⁵⁷ This trend accelerated due to the Trump administration’s so-called “China Initiative,” which the Justice Department intended to use to counter espionage and national security threats from China.⁵⁸ Yet it became apparent that many of the cases were weak and those were quickly dismissed. Additionally, there were charges of racial profiling, which led the Biden administration to drop the program in 2022.⁵⁹ Indeed, there is recent evidence that Washington’s hostility toward China is pushing scientists away from the United States and toward China.⁶⁰ If this trend continues it risks undermining the asymmetrical advantage the United States has over China: the ability to attract and retain talented foreigners.

Policymakers should reverse course and liberalize immigration, particularly for high-skilled immigrants. Specific ideas to attract and retain top-notch foreign talent include exempting STEM graduates from green card caps, providing Chinese nationals who hold college degrees with work permits or green cards without numerical caps,

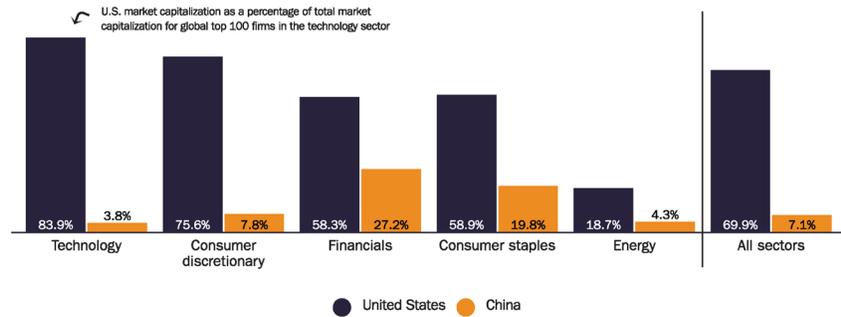
creating a start-up entrepreneur visa, and prioritizing visa applications in high-tech sectors.⁶¹

Over the long term, immigration restrictionism would lead to a less dynamic and innovative economy and undercut the United States vis-à-vis China. A recognition of the positive-sum results of liberalizing immigration would spur innovation from nonimmigrants, bolster our technology sector, and reduce the number of talented workers and innovators in China. It is a no-brainer.

Tech Optimism and Light-Touch Regulation

A primary goal for both Washington and Beijing is to set standards and dominate the commanding heights of technology. As noted, U.S. policymakers’ concerns about China’s embrace of industrial policies—focused on alternative energy vehicles, information technology, telecommunications, robotics, and artificial intelligence—are understandable. Yet U.S. trade and immigration policy have become increasingly hostile to the very American firms that are pushing the envelope in terms of research and development (R&D) and high-tech products. Simply put, populist outrage toward superstar technology firms may be smart politics, but it is no way to “outcompete China.”

Figure 4
When measuring the percent of total market capitalization for the top 100 global firms, the United States outcompetes China in every sector, especially technology



Source: “Global Top 100 Companies by Market Capitalisation,” PricewaterhouseCoopers, November 18, 2022.

Specifically, lawmakers in Congress and lawyers at the Department of Justice are increasingly skeptical of major U.S. technology firms simply because of their size and not for any anti-consumer concerns. They are looking at using antitrust tools to crack down on them, including by upending a century of predictable rules that center on consumer welfare. Antitrust is beyond the scope of this analysis, but it is worth considering the geopolitical and economic implications of severely cracking down on America's leading technology firms given the ongoing struggle with China over technological supremacy.

“Kneecapping America’s most influential and successful technology companies will not only dim their R&D intensity but will also benefit Chinese competitors like Tencent and Alibaba.”

With its historically more-liberal regulatory policy, dedication to the rule of law, and embrace of openness, the United States has led the way in creating the type of environment necessary to cultivate technological innovation. In 2022, four of the top five global firms based on market capitalization were American technology firms (Apple, Microsoft, Amazon, and Alphabet [the parent company of Google]). Further, 63 of the top 100 global firms based on market capitalization were American firms. Of the total market capitalization of the top 100 firms, 70 percent is U.S.-based. In 2021, China was second, with 11 of the top 100 firms based on market capitalization, including tech giants Tencent and Alibaba. As Figure 4 shows, U.S. firms hold a higher share of total market capitalization than Chinese firms across all sectors, especially technology.⁶²

A recent report from the Progressive Policy Institute (PPI) highlights how six of the largest American tech firms—Amazon, Alphabet, Intel, Facebook, Microsoft, and Apple—are driving large-scale investments in research and technology. The Progressive Policy Institute estimates that these six firms made nearly \$90 billion in private investment in 2020, which was up about 6 percent over 2019.⁶³ That is remarkable given that the economy in 2020 was lagging because of the outbreak

of COVID-19. Cracking down on U.S. tech firms will mean less investment in R&D in cutting-edge technologies.

The American tech giants already face heavily subsidized foreign competition and discriminatory treatment abroad, particularly from China. Despite this, the American technology industry pushes the envelope on exactly the types of R&D that policymakers should welcome: those current and next-generation technologies the United States will need to outcompete Beijing. Kneecapping America's most influential and successful technology companies will not only dim their R&D intensity but will also benefit Chinese competitors like Tencent and Alibaba.

The U.S. technology industry is the envy of the world. That is why China, the European Union, and others are trying to mimic it through subsidies and discrimination. Yet those policies are simply no match for a relatively free and dynamic economy fostered by economic openness and light-touch competition policies. Making the United States less efficient and less dynamic through misguided efforts at targeting high-performing American tech companies is a nonsensical way to counter China's economic rise.

Smarter Tax Policies

Finally, policymakers should bolster U.S. competitiveness by improving the tax treatment of R&D investment and capital-intensive manufacturing in the United States. As part of the Tax Cut and Jobs Act (TCJA), which passed in 2017, domestic firms making investments in R&D are currently allowed to deduct those costs from their tax liability for the year in which the investments occur instead of amortizing those deductions over many years. This is a potent incentive for economic growth.

Unfortunately, that provision began to be phased out at the end of 2022 and it phases out entirely by 2026, returning firms to amortizing over a period of years. Likewise, the tax code requires firms to amortize deductions for nonresidential buildings, such as manufacturing facilities, over a 39-year period. Because of inflation and the time value of money, a dollar today is worth a lot more than a dollar in 5—or 39—years from now. Over time, this will raise the cost of R&D, resulting in less innovation and fewer new technologies. This is a recipe for slower growth, lower productivity, and lower wages—and a less competitive

economy vis-à-vis China. Instead, policymakers should make the immediate expensing of R&D permanent and expand it to include structures in order to ensure that the United States remains the best place in the world to innovate and create.

CONCLUSION

Policymakers are rightly concerned about Chinese policies that distort international trade and investment. But copying these policies won't ensure that American companies

outcompete their Chinese counterparts in the years to come. The policies laid out in this analysis will.

Policymakers need to understand that many of Beijing's decisions are beyond Washington's control and, moreover, will be self-defeating for China in the long run. Rather than mimicking Chinese interventionism, policymakers should trust America's traditional strengths: openness to international trade and immigration and a devotion to dynamic market-based innovation. A reembrace of these policies will ensure that America's next 50 years are as prosperous and harmonious as the last.

NOTES

1. Greg Ip, "Has America's China Backlash Gone Too Far?," *Wall Street Journal*, August 28, 2019.
2. Lingling Wei, "Xi Jinping Aims to Rein In Chinese Capitalism, Hew to Mao's Socialist Vision," *Wall Street Journal*, September 20, 2021.
3. Alexandra Stevenson and Cao Li, "China Evergrande Defaults on Its Debt. Now What?," *New York Times*, December 9, 2021.
4. International Monetary Fund, "People's Republic of China: 2022 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the People's Republic of China," IMF Country Report no. 23/67, February 3, 2023.
5. Jason Douglas, "China's Economy Returns to Growth Mode as Covid-19 Lockdowns Lift," *Wall Street Journal*, June 30, 2022.
6. Roland Rajah and Alyssa Leng, "Revising Down the Rise of China," Lowy Institute, March 14, 2022.
7. Carl Minzner, "China's Doomed Fight against Demographic Decline," *Foreign Affairs*, May 3, 2022; and Chelsea Follett, "Neo-Malthusianism and Coercive Population Control in China and India: Overpopulation Concerns Often Result in Coercion," Cato Institute Policy Analysis no. 897, July 21, 2020.
8. "ARCHIVE: U.S.-China Strategic Competition in Technology: Analysis and Prospects (Chinese Language)," U.S.-China Perception Monitor, February 6, 2022.

9. Donald J. Trump, "Presidential Memorandum for the United States Trade Representative," White House, August 14, 2017.
10. Office of the U.S. 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," March 22, 2018.
11. Office of the U.S. 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," pp. 153, 168.
12. International Monetary Fund, "People's Republic of China: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the People's Republic of China," IMF Country Report no. 22/21, January 28, 2022, p. 21.
13. Office of the U.S. 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," pp. 19, 32.
14. Office of the U.S. 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," pp. 41-43, 48.

15. Office of the U.S. 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," pp. 65, 147.
16. Chad P. Bown, "US-China Trade War Tariffs: An Up-to-Date Chart," Peterson Institute for International Economics, April 22, 2022.
17. Pablo D. Fajgelbaum and Amit K. Khandelwal, "The Economic Impacts of the US-China Trade War," *Annual Review of Economics* 14 (August 2022): 206–7.
18. Jeanna Smialek and Ana Swanson, "American Consumers, Not China, Are Paying for Trump's Tariffs," *New York Times*, updated December 31, 2020.
19. Mary Amiti, Stephen J. Redding, and David E. Weinstein, "New China Tariffs Increase Costs to U.S. Households," *Liberty Street Economics* (blog), Federal Reserve Bank of New York, May 23, 2019; and Mary Amiti, Sang Hoon Kong, and David E. Weinstein, "The Investment Cost of the U.S.-China Trade War," *Liberty Street Economics* (blog), Federal Reserve Bank of New York, May 28, 2020.
20. Rachel Layne, "Trump Trade War with China Has Cost 300,000 U.S. Jobs, Moody's Estimates," *CBS News*, updated September 12, 2019.
21. Chad P. Bown, "US-China Phase One Tracker: China's Purchases of US Goods," Peterson Institute for International Economics, July 19, 2022.
22. Eric Martin and Daniel Ten Kate, "U.S. Trade Chief Says New Focus Needed as China Hasn't Changed," Bloomberg, March 30, 2022.
23. U.S.-China Economic and Security Review Commission, *2021 Report to Congress of the U.S.-China Economic and Security Review Commission* (Washington: Government Printing Office, 2021).
24. Bob Davis and Lingling Wei, "Who Won the U.S.-China Trade War?," *Wall Street Journal*, May 20, 2022.
25. David Steinberg and Yeling Tan, "Public Responses to Foreign Protectionism: Evidence from the US-China Trade War," Peterson Institute for International Economics Working Paper 22-10, June 2022.
26. Scott Lincicome and Huan Zhu, "Questioning Industrial Policy: Why Government Manufacturing Plans Are Ineffective and Unnecessary," Cato Institute White Paper, September 28, 2021.
27. Scott Lincicome and Inu Manak, "Protectionism or National Security? The Use and Abuse of Section 232," Cato Institute Policy Analysis no. 912, March 9, 2021.
28. "Price History: Tables and Charts," SteelBenchmarker, report no. 397, October 24, 2022.
29. Scott Lincicome, "'Dumping' Doesn't Mean What You Think It Means," *The Dispatch*, February 16, 2022.
30. Gary Clyde Hufbauer, Megan Hogan, and Yilin Wang, "For Inflation Relief, the United States Should Look to Trade Liberalization," Peterson Institute for International Economics Policy Brief no. 22-4, March 2022.
31. Clark Packard, "Trump's Real Trade War Is Being Waged on the WTO," *Foreign Policy*, January 9, 2020.
32. *Hearing on U.S. Tools to Address Chinese Market Distortions, Before the U.S.-China Economic and Review Security Commission, (2018)* (testimony of Jennifer Hillman, professor from practice, Georgetown University Law Center); and James Bacchus, "How the World Trade Organization Can Curb China's Intellectual Property Transgressions," *Cato at Liberty* (blog), Cato Institute, March 22, 2018.
33. James Bacchus, Simon Lester, and Huan Zhu, "Disciplining China's Trade Practices at the WTO: How WTO Complaints Can Help Make China More Market-Oriented," Cato Institute Policy Analysis no. 856, November 14, 2018.
34. Peter A. Petri and Michael G. Plummer, "The Economic Effects of the Trans-Pacific Partnership: New Estimates," Peterson Institute for International Economics Working Paper 16-2, January 2016.
35. "Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors," U.S. International Trade Commission, USITC Publication no. 4607, May 2016.
36. Daniel J. Ikenson et al., "Should Free Traders Support the Trans-Pacific Partnership? An Assessment of America's Largest Preferential Trade Agreement," Cato Institute Working Paper no. 39, September 12, 2016.
37. Inu Manak, "Unpacking the IPEF: Biden's First Big Trade Play," Council on Foreign Relations, June 8, 2022.
38. "Neal Opening Statement at Hearing on the Biden Administration's 2022 Trade Policy Agenda," Office of Representative Richard Neal, press release, March 30, 2022.
39. Jason Douglas, "Manufacturers Move Back to China as

- Renewal of U.S. Trade Deal Is Delayed," *Wall Street Journal*, March 17, 2023.
40. Dan Anthony and Steve Lamar, "How Antitrade Sentiment Helps China," *Wall Street Journal*, December 16, 2022.
41. Colin Grabow, Inu Manak, and Daniel J. Ikenson, "The Jones Act: A Burden America Can No Longer Bear," *Cato Institute Policy Analysis* no. 845, June 28, 2018.
42. Richard N. Haass, "Economic Sanctions: Too Much of a Bad Thing," *Brookings Institution Policy Brief* no. 34, June 1, 1998.
43. "Huawei Outhustles Trump by Hoarding Chips Vital for China 5G," *Bloomberg*, October 22, 2020.
44. Stuart Anderson, "Immigrants and America's Comeback from the COVID-19 Crisis," *National Foundation for American Policy Policy Brief*, July 2020.
45. Rana Foroohar, "Immigration Is Back in the US," *Financial Times*, April 17, 2023.
46. Pierre Azoulay et al., "Immigration and Entrepreneurship in the United States," February 18, 2021; and Sari Pekkala Kerr and William R. Kerr, "Immigrant Entrepreneurship," *Harvard Business School Working Paper* 17-011, June 2016.
47. Chris Morris, "10 Iconic US Companies Started by Immigrants," *CNBC*, June 13, 2017.
48. Kimberly Clausing, *Open: The Progressive Case for Free Trade, Immigration, and Global Capital* (Cambridge, MA: Harvard University Press, 2019), p. 181.
49. Scott Lincicome, "Five Market-Oriented Policies to Help the U.S. Semiconductor Industry," *Cato at Liberty* (blog), *Cato Institute*, May 5, 2022; and Scott Lincicome, "How to Boost American AI in One Easy Step," *Cato at Liberty* (blog), *Cato Institute*, April 13, 2021.
50. Scott Lincicome, "We'll Do Anything for American Innovation, But We Won't Do That," *Cato at Liberty* (blog), *Cato Institute*, July 20, 2020.
51. Giovanni Peri, Kevin Shih, and Chad Sparber, "STEM Workers, H-2B Visas, and Productivity in US Cities," *Journal of Labor Economics* 33, no. S1 (July 2015): S227.
52. Jennifer Hunt and Marjolaine Gauthier-Loiselle, "How Much Does Immigration Boost Innovation?," *American Economic Journal: Macroeconomics* 2, no. 2 (April 2010): 31–56.
53. Kimberly Clausing, *Open: The Progressive Case for Free Trade, Immigration, and Global Capital* (Cambridge, MA: Harvard University Press, 2019), p. 182.
54. David J. Bier, "Visualizing a 4-Year Assault on Legal Immigration: Trends Biden Must Reverse," *Cato at Liberty* (blog), *Cato Institute*, December 11, 2020.
55. Remco Zwetsloot, "Winning the Tech Talent Competition," *Center for Strategic and International Studies*, October 28, 2021, p. 2.
56. Sha Hua and Karen Hao, "U.S.-China Tensions Fuel Outflow of Chinese Scientists from U.S. Universities," *Wall Street Journal*, September 22, 2022.
57. Yu Xie et al., "Caught in the Crossfire: Fears of Chinese-American Scientists," 2022.
58. Sha Hua and Karen Hao, "U.S.-China Tensions Fuel Outflow of Chinese Scientists from U.S. Universities," *Wall Street Journal*, September 22, 2022.
59. Aruna Viswanatha and Sha Hua, "The U.S. Pursued Professors Working with China. Cases Are Faltering," *Wall Street Journal*, December 20, 2021; and Josh Gerstein, "DOJ Shuts Down China-Focused Anti-Espionage Program," *Politico*, February 23, 2022.
60. David J. Bier, "Abandoning the U.S., More Scientists Go to China," *Cato at Liberty* (blog), *Cato Institute*, April 11, 2023.
61. Remco Zwetsloot, "Winning the Tech Talent Competition," *Center for Strategic and International Studies*, October 28, 2021, p. 2.
62. "Top 100 Companies—By Market Capitalization," *PricewaterhouseCoopers*, March 2022.
63. Michael Mandel and Elliott Long, "Investment Heroes 2021: Capital Spending during the Pandemic," *Progressive Policy Institute*, June 2021.

China's Economic Headwinds

Overestimating China's economic strength and future growth prospects leads to overreaction and poor policymaking.

OCTOBER 10, 2023 • PUBLICATIONS

By **Clark Packard**

- ◆ Beginning in the late 1970s, China's experimentation with market liberalization helped supercharge China's economy. It is estimated that this change in policy lifted approximately 800 million people out of grinding poverty.
- ◆ In recent years, China has abandoned its commitment to market liberalization and instead embraced a return to Maoist command and control of its economy.
- ◆ Beijing faces several short-term and long-term headwinds that will almost certainly limit its economic potential—and the supposed threat it poses to the United States.

The bipartisan consensus emerging in policymaking circles around Washington, DC, is that China is an economic juggernaut, inexorably poised to overtake the United States as the world's leading economy. To many policymakers, Beijing's increasingly interventionist and mercantilist policies—high-tech, 21st-century industrial policy—have supercharged its economy and that unless Washington matches China's interventionism, the United States' days as a global economic superpower are numbered.

Proponents of this consensus about China's economic rise argue that the United States naively welcomed Beijing into the rules-based trading system to pad the profits of multinational corporations at the expense of average American workers—all on a Panglossian belief about the ability of freer markets to facilitate democracy and peace. This development, critics allege, allowed China to dramatically increase its wealth, which it is leveraging to strengthen its military and adopt a revisionist foreign policy.

This consensus is rife with problems. First, China's rise has a lot more to do with its abandonment of central planning decades ago than it does with today's re-embrace of protectionism, industrial policy, and **Maoist socialism**. Second, China faces several headwinds that will constrain future growth. Indeed, overestimating China's economic strength and future growth prospects leads to overreaction and poor policymaking. To be clear, many of China's commercial practices are legitimately concerning and do pose significant challenges to the United States and the rules-based trading system. To meet these challenges, however, policymakers need a sober assessment of China's economy and prospects for future growth.

Chinese Reforms Boost the Economy

Between the establishment of the People's Republic of China in 1949 and the early 1970s, China's economy was centrally planned, and it had little foreign trade. Beginning in the late 1970s, **China began to liberalize** its economy and experiment with private markets under the leadership of

Deng Xiaoping. Among the policies enacted, “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,” says Douglas Irwin in *Clashing over Commerce: A History of US Trade Policy*. Indeed, as part of the process that granted China a spot in the World Trade Organization (WTO), Beijing cut tariffs substantially—from an average of 25 percent to 9 percent—phased out import quotas, eliminated several nontariff barriers, and made a commitment to respect and enforce intellectual property rights.

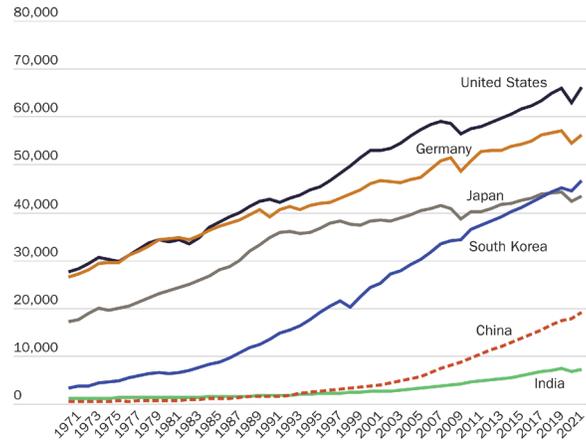
China’s economic liberalization dramatically improved the lives of average citizens. Between 1980 and 2016, China’s national poverty rate, as judged by the World Bank’s poverty line, fell from about 90 percent to 4 percent, which implies 800 million fewer Chinese *living in poverty*. Global trade played a critical role in this advancement. Even according to David Autor, David Dorn, and Gordon Hanson, authors of the famous *China Shock* papers, Beijing’s own domestic internal reforms—especially tariff liberalization (and thus access to imports)—were responsible for much of its gains in global export competitiveness in the late 1990s and 2000s.

The Chinese People Are Still Relatively Poor

Despite the rapid growth following China’s market-oriented economic reforms, the average Chinese citizen remains poor relative to the individuals in the developed world because its economic growth began from a very low, communism-induced baseline. Figure 1 shows per capita gross domestic product (GDP) based on purchasing power parity (PPP) among the major economies in the world. As the chart shows, per capita GDP adjusted for PPP in the United States was about \$66,000 in 2021 compared to just over \$19,000 in China.

Figure 1

Despite making much progress since the 1970s, China remains a relatively poor country
 GDP per capita, constant 2020 international dollars, PPP



Source: The Conference Board, "GDP per Capita, 2020 International Dollars, PPP, 1950-2021," Human Progress.
 Notes: GDP = gross domestic product; PPP = purchasing power parity; the international dollar is an artificial currency used to eliminate differences in purchasing power when comparing countries. Data adjusted for PPP.

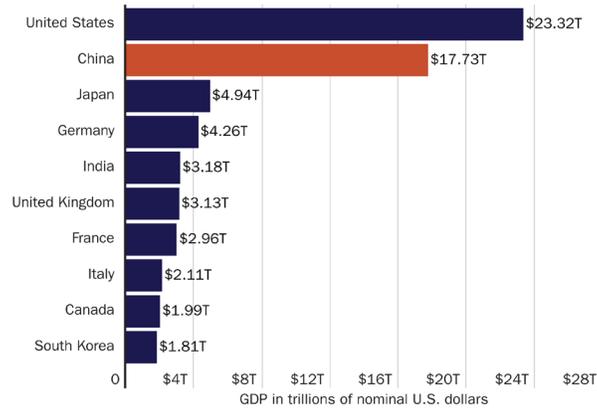
China's influence in the global economy thus comes more from its massive population than from Chinese individuals' productivity and wealth.

China's Growing Clout in the Global Economy

Nevertheless, China is the second-largest economy in the world—trailing only the United States. In 2021, its **GDP** was about \$17.7 trillion compared to about \$23.3 trillion for the United States. In fact, both countries dwarf their closest competitors economically as Figure 2 demonstrates. Japan is the third-largest economy in the world, but its **GDP in 2021** was only about \$5 trillion, **while Germany**, the fourth-largest economy, was about \$4.3 trillion.

Figure 2

China is the second-largest economy in the world, trailing only the United States



Source: "GDP (Current US\$)," The World Bank.

And, with about 1.4 billion people (about 18 percent of the world's total population), China has a massive consumer market that most multinational corporations want to access. On top of that, the country is a major trading nation and central to many supply chains, especially in Asia. Indeed, China's share of **world goods exports** was negligible in 1980, but it rose to 14.68 percent in 2020.

Thus, even if several American-allied countries in the region share U.S. concerns about Beijing's commercial practices, the reality is that China's market size, trade relationships, and geographical positioning are such that many foreign governments and multinational corporations will desire to maintain ties to the Chinese market, even amid growing geopolitical risk.

Nevertheless, China's influence and economic strength now and in the future should not be oversold—especially to justify radical shifts in Western governments' domestic and international economic policy. Indeed, China faces both short-term problems and long-term headwinds that will at best diminish the country's once-bullish economic and investment prospects and at worst severely weaken China's economy and government in the decades ahead.

Short-Term Problems

Despite some undeniable economic successes, policymakers in Beijing, particularly under the leadership of Xi Jinping, have moved in an illiberal direction. As a result, China faces several short-term concerns that will likely weigh on growth in the coming years.

The tech sector, once a dynamic and thriving industry, has been paralyzed by Xi's re-embrace of Maoist socialism. Likewise, Beijing's crackdown on education platforms and its general antipathy toward private-sector firms continues to fuel youth unemployment in China. *The Economist* recently noted that China's **urban youth unemployment rate** is above 20 percent.

Likewise, China's open embrace of industrial policy in the late 2000s generated backlash in the global business community and developed country governments, heightening geopolitical tensions and fomenting trade conflicts (or, at the very least, giving Western politicians an excuse to favor their own national industries). Thus, for example, the United States imposed expansive export controls on semiconductors and semiconductor manufacturing equipment to China in late 2022, followed by Japan and the Netherlands, two major players in the semiconductor production supply chain, shortly thereafter. Given the ubiquity of semiconductors in virtually everything produced today, these efforts will hurt China's technology and manufacturing capacities in the short and intermediate term.

The real estate sector is increasingly overinflated while property developers fail to deliver on promised residential units leading to a large middle-class **boycott of mortgage payments** in 2022. Evergrande, a major Chinese property developer, **defaulted on its debt** in late 2021. Investment in property development fell by **nearly 6 percent** in the first quarter of 2023. As a result of real estate struggles, local government coffers, largely reliant on land sales to fund public services, are drying up. A *Wall Street Journal* story about the **Guizhou province** is illustrative of this problem. For a while, the southwestern province was one of the fastest-growing regions in China owing to debt-fueled infrastructure development that was financed by local banks that lent heavily to local governments. As the *Wall Street Journal* notes, "Chinese authorities largely stood aside over the past two years as the country's largest property developers slid into financial distress, causing losses for investors and many businesses and depressing the land sales that were a big source of revenue for many local governments," including Guizhou. As Tianlei Huang, a research fellow at

the Peterson Institute for International Economics told the newspaper, "It is challenging the problems in the real economy to the financial sector and eventually could pose a threat to financial stability." Indeed, two-thirds of local governments in China are "now in danger of breaching unofficial debt thresholds set by Beijing to signify severe funding stress."

It's not just economic policies that increasingly make China a less desirable country in which to invest and with which to trade. Beijing's handling of COVID-19 and its disastrous Zero-COVID strategy is giving multinational corporations second thoughts about investments in China. The country also recently began **cracking down** on economic consulting firms, which is drawing criticism. Moreover, China is increasingly relying on forced labor and repression toward Uyghur Muslims in the Xinjiang region. Likewise, Beijing has turned its back on the "One Country, Two Systems"—meaning a great deal of autonomy and self-governance—promise to Hong Kong, which was effectively annexed with the passage of the national security law in 2020. Beijing's hostility to inquiries into the origins of COVID-19 has increasingly alienated countries in the Indo-Pacific region, such as Australia, which led to a **simmering trade war** between the two countries.

In other words, Beijing's belligerence is adding to growing geopolitical risk and uncertainty. Foreign direct investment into China fell by nearly 50 percent in 2022 compared to 2021 as foreign firms are increasingly wary of China's deteriorating relations with other countries and firms. All told, **growth is suffering** and will continue to suffer unless these policies are reversed or at least mitigated.

Long-Term Headwinds

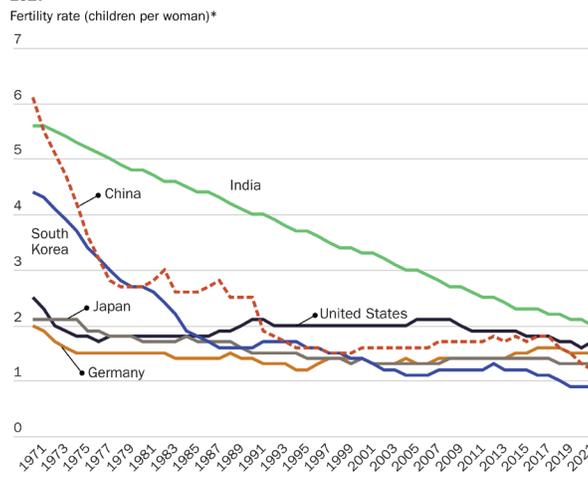
China's short-term problems may be surmountable, but its long-term headwinds pose a much bigger challenge for Chinese economic growth and global influence.

China's Demographic Problems

First, China's rapidly aging population and a shrinking workforce will weigh on economic output, suppress innovation, and stress government services. The United Nations recently announced that **India will overtake China** as the world's largest population in 2023. An essay in *Foreign Affairs* noted,

"In 1978, the median age of a Chinese citizen was 21.5 years. By 2021, it had risen to 38.4, surpassing that of the United States." In the 30-year period between 1949 and 1979, China's population grew from 540 million to nearly 970 million. Beginning in the 1970s, however, China began a series of policies aimed at curbing population growth, and fertility rates began to drop precipitously—"from 5.8 births per woman in 1970 to 2.7 in 1978." Today, China's fertility continues to fall; in 2020, for example, the fertility rate of **1.3 births per woman** is below the replacement rate of 2.1 births per woman. Data from China's National Bureau of Statistics in 2021 show that the birth rate in the country **fell for the fifth consecutive year** with a fertility rate of 1.15 births per woman, one of the lowest percentages in the world (Figure 3).

Figure 3
The decline in China's fertility rate has outpaced that of other major economies since 2017



Source: United Nations, "Fertility Rate: Children per Woman," Our World in Data.
Note: Total fertility rate defined as "the number of children that would be born to a woman if she were to live to the end of her childbearing years and give birth to children at the current age-specific fertility rates."

In 2016, Beijing reversed course and lifted its brutal One Child Policy. As of May 2021, the limit is three children. Despite this about-face, what explains China's demographic headwinds? For starters, women have seen increased educational and employment opportunities, which **has been**

linked to lower birth rates in other countries, including the United States. Likewise, China has a severe imbalance in the ratio of men to women owing to the One Child Policy that favored males. In most of the world, the sex at birth ratio is 1.06 males for every 1 girl, but in China, it is **1.2 males for every 1 female**, and in some provinces, the ratio is 1.3 males for every 1 female. Other possible drivers include the fact that the population has gotten used to having smaller families, rising costs associated with having a child, and a decrease in marriage rates.

Given the significant downturn in the Chinese economy in 2022, early indications are that the **birth rate will drop again**. Indeed, marriages in 2021 were down to their lowest levels since the mid-1980s, when Beijing began keeping records of annual registrations, and initial data suggest a further decline in 2022. Yi Fuxian, a scientist in obstetrics and gynecology at the University of Wisconsin-Madison and author of *Big Country with an Empty Nest*, a book on China's demographic troubles, projected that China's Zero-COVID policies would lead to a significant drop in marriages in 2020 and 2021 and would lead to a drop of about a million births in 2021 and 2022. Though there are legitimate questions about the veracity of Chinese demographic data, government officials are now acknowledging publicly that the country faces serious challenges. In August 2022, China's National Health Commission wrote in an essay for the Communist Party's journal, "Low births and aging amid negative population will become the norm."

Low birth rates, a rapidly aging population, and a shrinking workforce will almost certainly inhibit China's future GDP growth, but it will also inhibit productivity, dynamism, innovation and risk-taking, all leading to a weaker social safety net. Yet China's long-term structural problems do not end there.

Talent Is Fleeing China

In theory, China should be leading the way in the high growth sectors of the global economy. Yet on top of low birth rates and a rapidly aging population, China also faces a serious exodus of young, talented, highly educated citizens.

The Organisation for Economic Co-operation and Development's (OECD's) Programme for International Student Assessment (PISA) measures international educational outcomes by administering a cross-national exam

every three years to 15-year-old students in about 80 high- and middle-income countries. Each participating country selects a representative sample of between 4,000 and 8,000 students and administers the exam. Due to the outbreak of COVID-19, 2018 was the last time the OECD administered the **PISA exam**. Based on those results, China ranked first in reading, science, and mathematics. Meanwhile, the United States ranked 13th in reading, 37th in mathematics, and 18th in science.

China's success extends to undergraduate education as well. The country awards "more science and engineering undergraduate degrees than the U.S., Britain, France, Germany, Japan and South Korea combined." Between 2000 and 2015, "the number of science and engineering undergraduate degrees granted **per year in China** more than quadrupled"—from about 360,000 annually to more than 1.7 million.

These smart, talented individuals, however, aren't staying in China. Take artificial intelligence (AI). Of the top-tier **AI researchers globally**, nearly one-third received their undergraduate degree from a university in China, yet the overwhelming majority do not stay in China. In fact, 56 percent come to the United States, and about one-third stay in China. As Macropolo, a project of the Paulson Institute at the University of Chicago, notes, "After completing graduate studies in the United States, a full 88% of those Chinese researchers chose to stay and work in the country, while only 10% headed back to China. (This sample includes a combination of recent graduates, mid-career researchers, and veteran researchers to reflect average stay-rates across all these groups.)"

Generally, about 70 percent of international science, technology, engineering, and math (STEM) graduates from **U.S. Ph.D. programs** stay in the country, but among Chinese graduates, the rate is significantly higher—about 85 percent stay here.

Not only is China failing to keep a large quantity of its highly talented AI researchers, but it also struggles to attract foreign advanced STEM talent. An October 2021 study from the **Center on Strategic and International Studies** notes, "Only about 10 percent of international scientists and engineers seemed open to moving to China, compared to nearly 60 percent for the United States." This is despite China's decades-long global recruitment efforts.

So why does China struggle to retain and attract talent? As a February 2022 report from **Peking University Institute of International and Strategic**

Studies argues, this is largely due to the “relatively relaxed and innovative scientific research environment” in the United States compared to China. **Other reasons include** China’s “authoritarian political system and restricted freedom” and “language barriers, pervasive internet censorship, and environmental quality.”

Yet instead of capitalizing on China’s woes in attracting and retaining top scientists, Washington’s hostility toward Beijing is driving some top talent **out of the United States**. Recent research found that nearly 1,500 U.S.-trained **Chinese engineers and scientists** dropped their U.S. academic or corporate affiliations for Chinese affiliations in 2021, which represents a more than 20 percent increase from the prior year. This trend accelerated due to the Trump administration’s so-called China Initiative, which the U.S. Justice Department intended to use to counter espionage and national security threats from China. Yet it became apparent that many of the cases were weak and were quickly dismissed, and there were **charges of racial profiling**, which led the Biden administration to **drop the program in 2022**. Indeed, there is recent evidence that if the trend of Washington pushing scientists away from the United States and **toward China** continues, it risks undermining the asymmetrical advantage the United States has over China: the ability to attract and retain talented foreigners.

China’s Declining Business Dynamism and Slowing Productivity

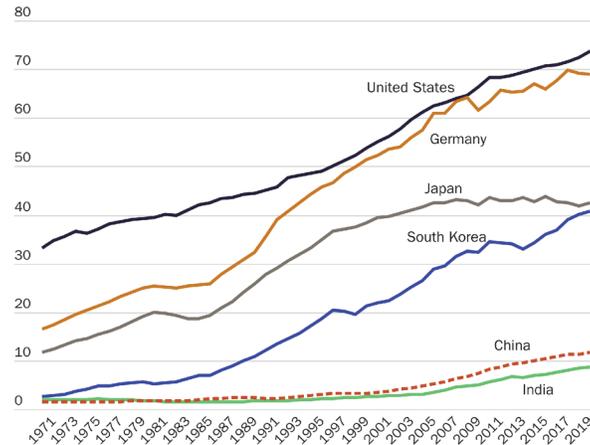
A nation’s **economic growth and global influence** generally stems from two things: the size of its population and the productivity of its workforce. China could thus increase global power by, theoretically, offsetting a declining population with strong productivity growth. In reality, however, productivity is a significant challenge for China’s economy that will increasingly hamper growth unless policies are radically transformed.

Beginning in the late 1970s and early 1980s—shortly after Deng’s market-oriented reforms—China experienced a rapid increase in productivity growth, but much of this was due to **catch-up growth** given that the country had a very low starting point. Indeed, China’s annual productivity growth averaged about 4 percent during this period. Today, however, there is mounting evidence that **productivity growth** is slowing in China—an even sharper decline than worldwide productivity trends (Figure 4).

Figure 4

After decades of growth, China's productivity appears to be stalling

Real GDP per hour worked, in constant 2017 international dollars, PPP



Source: Penn World Table, "Productivity: Output per Hour Worked," Our World in Data.
 Notes: GDP = gross domestic product; PPP = purchasing power parity.

What are the primary causes of China's productivity slowdown?

Demographic challenges and brain drain as documented above are certainly contributors. In addition, China's increasing reliance on top-down economic planning (industrial policy) and **state-owned enterprises (SOEs)** is a major contributing factor. It is estimated that China's SOEs are about **20 percent less productive** than private firms operating in the same sector.

This is a relatively new phenomenon. Between 1998 and 2005, the International Monetary Fund (IMF) estimates that the **share of SOEs** in industrial output fell from about 50 percent to about 30 percent and that this "transition coincided with rapid aggregate productivity growth, which came in part from the growth of the private sector at the expense of less productive SOEs." Yet the role of SOEs in China's economy is growing. As the **IMF noted** in early 2023 in its review of China's economy in 2022, "SOEs are being tasked to make advances in strategically important sectors and technologies affected by growing geoeconomic fragmentation, further burdening them with responsibilities." Indeed, the IMF noted in 2022 that "the decline in business dynamism is particularly pronounced in sectors and regions with large SOE presence."

China's shift from economic liberalization toward central planning has also taken a toll on Chinese innovation and productivity. It is estimated that about 70 percent of China's subsidies flow to less productive SOEs, and the **government increasingly subsidizes** non-SOEs—to their detriment. A December 2022 paper found, for example, that between 2007 and 2018, direct government subsidies to companies listed on China's stock exchange increased by about seven-fold—from about \$4 billion to \$29 billion. Examining firm-level data about the relationship between firm productivity and **government subsidies**, authors of the study found that the latter tended to *undermine* the former:

We find little evidence that the Chinese government picks winners—if anything, the evidence suggests that direct subsidies tend to flow to less productive firms rather than more productive firms. In addition, we find that, overall, the receipt of direct government subsidies is negatively correlated with subsequent firm productivity growth over the course of our data window, 2007 to 2018. Even subsidies given out by the government in the name of R&D and innovation promotion or industrial and equipment upgrading do not show any statistically significant evidence of positive effects on subsequent firm productivity growth.

Likewise, a November 2022 National Bureau of Economic Research (NBER) paper found “little statistical evidence of productivity improvement or increases in R&D expenditure, patenting and profitability” of China's major industrial policy program known as “**Made in China 2025**,” which is the crown jewel for Beijing's goal of indigenous innovation and technological supremacy as a bulwark for future economic and military strength. Finally, another NBER paper found that beginning in 2008, China's industrial policy began heavily subsidizing local firms with many patents. As a result, more patents were awarded, but the **quality declined** and led to less innovative firms buying patents to receive subsidies. In total, it was a large welfare loss once accounting for the subsidy cost.

Debt continues to plague both the corporate and government sectors, which hurts growth. As the IMF noted, “Government and household debt-to-GDP ratios are estimated to have increased to new highs of 108 and 62 percent in the second quarter of 2022, respectively, while corporate debt is hovering around a very elevated 125 percent.” The *Wall Street Journal* reported that by June 2022, **debt in China reached** about \$52 trillion, “dwarfing outstanding debt in all other emerging markets combined.” The same story reported that between 2012 and 2022, debt in China grew by \$37 trillion—nearly one and a half times the amount in the United States, a

larger economy. Much of this debt is the result of the massive subsidies China provides on industrial policy projects, the overwhelming majority of which did not create leading-edge companies. In short, Chinese “state capitalism” may have generated a few notable successes in industries like electric vehicles. But as long as Beijing pursues its economic goals through government-influenced SOEs and costly industrial policy, surging debt and sagging productivity will combine with demographic decline to severely hamstring the country’s economic growth—and its global influence.

Conclusion

China’s experiment with market-oriented reforms between about 1980 and 2012 propelled the country to increasing wealth and rising living standards for average citizens. In recent years, Chinese leaders have unfortunately turned back toward illiberalism through heavy-handed state intervention in the economy and repressive human rights practices. These policies are starting to show signs in the data. Since 2011—the last year before Xi Jinping became president—China has seen foreign direct investment drop precipitously as tensions mount between Beijing and the West. In 2011, foreign direct investment was about 4 percent of China’s GDP; today, it’s 1 percent. As economist [Noah Smith](#) recently noted, foreign direct investment in China from G7 countries declined from \$35.4 billion in 2014 to \$16.3 billion in 2020.

Policies emanating from Beijing are the primary culprit for this decline and will generate more of it in the future—an outcome that would be tremendously unfortunate for not only the hundreds of millions of Chinese people who have yet to escape relative poverty but also for the global economy overall.

But China’s future is not yet written, and Beijing should reverse course again in the years ahead and re-embrace the types of reforms that drove the country’s rapid economic growth in the past. This might not be the most likely future, but it’s the one we should all hope for.

ABOUT THE AUTHOR



Clark Packard

Research Fellow, Cato Institute



This work is licensed under a [Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License](https://creativecommons.org/licenses/by-nc-sa/4.0/).



122 C Street N.W., Suite 700, Washington, DC 20001

**TESTIMONY OF
BRYAN RILEY**

**DIRECTOR
NATIONAL TAXPAYERS UNION'S FREE TRADE INITIATIVE**

**HEARING ON
"SAFEGUARDING THE HOMELAND: EXAMINING CONFLICTS OF INTEREST IN
FEDERAL CONTRACTING TO PROTECT AMERICA'S FUTURE"**

**BEFORE THE
SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE**

SEPTEMBER 24, 2024

Founded in 1969, National Taxpayers Union (NTU) is the oldest taxpayer group in the United States. We serve as the “Voice of America’s Taxpayers” and strive to represent their best interests before governments at all levels. Thank you for the opportunity to comment on federal contracting policy and related issues.

NTU supports legitimate measures to protect U.S. national security. However, history shows that unless they are carefully crafted, such measures can be abused to unduly restrict the economic freedoms that have helped make our country great. For example, the United States restricts imports of steel and aluminum produced by friendly countries including Israel and the UK based on far-fetched national security grounds. Such restrictions weaken our security more than they strengthen it.

- With respect to federal contracting and its impact on our country’s future, NTU encourages Congress to modernize Buy American laws to make the best use of taxpayer dollars and to strengthen ties with our friends and allies.

As President Dwight Eisenhower observed, it is unfair to the taxpayer for the government to pay a premium on its purchases.¹ Economists at the Peterson Institute for International Economics calculated that our various Buy American laws cost taxpayers \$97 billion in 2017.² Since then, the Trump and Biden administrations have each added costly new Buy American restrictions, including the “Buy American and Hire American” executive order issued by President Donald Trump³ and the “Executive Order on Ensuring the Future Is Made in All of America by All of America’s Workers” from President Joe Biden.⁴

- Removing barriers to the use of affordable goods and services provided to the government by U.S. allies would strengthen our national security ties, and, by promoting a more efficient use of taxpayer dollars, would help control federal spending. The security benefits of reducing waste and inefficiency should be

¹ President Dwight D. Eisenhower, “Special Message to the Congress on Foreign Economic Policy,” March 30, 1954.

<https://www.presidency.ucsb.edu/documents/special-message-the-congress-foreign-economic-policy>.

² Gary Clyde Hufbauer and Euijin Jung, “Buy American’ and Similar Domestic Purchase Policies Impose High Costs on Taxpayers.” Peterson Institute for International Economics, August 6, 2020.

<https://www.piie.com/research/piie-charts/buy-american-and-similar-domestic-purchase-policies-impose-high-costs>.

³ President Donald Trump, “Presidential Executive Order on Buy American and Hire American,” April 21, 2017.

<https://trumpwhitehouse.archives.gov/presidential-actions/presidential-executive-order-buy-american-hire-american/>.

⁴ President Joe Biden, “Executive Order on Ensuring the Future Is Made in All of America by All of America’s Workers,” January 25, 2021.

<https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/25/executive-order-on-ensuring-the-future-is-made-in-all-of-america-by-all-of-americas-workers/>.

especially clear in a year in which the federal government is projected to spend more on interest payments than on the military for the first time in U.S. history.

- Currently, Section 38 of the Arms Export Control Act (22 U.S.C. 2778) authorizes the President to control the export of defense articles and services. The proposed Time to Choose Act of 2024 (S. 3810) would restrict the ability of certain firms that have contracts with China or other covered entities to contract with the U.S. government.⁵

This appears to be a very broad criteria that fails to adequately require a demonstration of national security concerns resulting from the delivery of services provided by such firms. It would expand the costly “Buy American” principle in federal contracting to “Buy American, and only with firms that don’t do business in China.”

- Such legislation could represent a slippery slope leading to further restrictions. For example, China is the largest export market for U.S. agricultural producers. This does not mean that it would be wise for the government to require farmers to choose between contracting with the government to provide food for school lunch programs or continuing to export to China.

Furthermore, this type of legislation could open the door to similar restrictions being placed on U.S. firms that do business with countries that have policies viewed unfavorably by the president. For instance, an American company could conceivably be penalized for doing business in a country with different environmental, labor, or social policies.

- If federal policymakers want to curtail interactions with China, they should first look at the practices of the federal government, which has contracted with China to make interest payments on \$776.5 billion in Treasury securities. These transactions should not be treated more permissively than those conducted by private businesses.
- The federal government already has gone too far in micromanaging the way that private companies do business. More laws and regulations could especially burden small businesses included in the hundreds of thousands of business entities covered by the North American Industry Classification System categories specified in the bill.

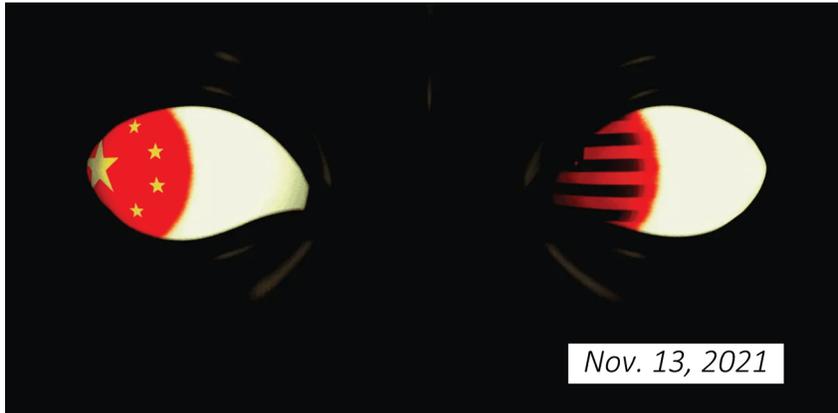
⁵ S.3810, Time to Choose Act of 2024. <https://www.congress.gov/bill/118th-congress/senate-bill/3810/text>.

- At a time when some politicians and policymakers are seeking to reduce the U.S.-China trade deficit, it should be noted that restricting U.S. firms from providing goods or services to China also would increase the deficit.

In conclusion, the federal government can promote our economic and national security interests by prioritizing the procurement of goods and services based on which firms are able to provide the best value for taxpayers' dollars.



Advising both Chinese state companies and the Pentagon, McKinsey & Co. comes under scrutiny





DEPARTMENT OF THE AIR FORCE
 HEADQUARTERS AIR FORCE INSTALLATION AND
 MISSION SUPPORT CENTER
 JOINT BASE SAN ANTONIO LACKLAND TEXAS

August 20, 2024

Adele M. Hopkins
 Chief, Information Access Branch
 FOIA, Privacy & Civil Liberties
 2261 Hughes Ave Ste 133
 JBSA Lackland TX 78236-9853



Dear [REDACTED],

This is a corrected response letter to our letter dated July 2, 2024 regarding your June 6, 2023 Freedom of Information Act (FOIA) request and assigned case number 2023-05453-F, where you seek the following:

OSD document referral 23-F-0950 I am requesting a copy of the following contract between DARPA and McKinsey & Co. as well as any conflict of interest disclosures or conflict mitigation plans submitted by McKinsey in connection with this contract: Contract FA701421F0042. Start date 1/25/21. I am unable to submit this to DARPA as specified on their website and no one answers any phone number listed on their site. Hopefully you can assist with this request.

Our review included consideration of the "Foreseeable Harm Standard." We reviewed 27 pages of which 23 pages are fully releasable and 4 pages are partially releasable in accordance with the following FOIA Exemptions.

FOIA Exemption 4, 5 U.S.C. §552(b)(4) protects "trade secrets and commercial or financial information obtained from a person [that is] privileged or confidential."

FOIA Exemption 6, 5 U.S.C. §552 (b)(6), protects information about individuals in "personnel and medical files and similar files" when the disclosure of such information "would constitute a clearly unwarranted invasion of personal privacy."

[Added] The request also asked for the OCI/Mitigation plan for the subject contract. To the best of their knowledge, McKinsey provided a conflict of interest disclosure or mitigation plan in connection with the contract. However, the OCI/Mitigation plan could not be located during the search, therefore we provide a no records response to this portion of your request.

If you disagree and interpret this response as an adverse action, you may write to the Secretary of the Air Force in care of (c/o): HQ AFIMSC/A33F, 2261 Hughes Avenue, Suite

133, JBSA-Lackland, TX within 90 calendar days from the date of this letter. Include in the appeal your reasons for reconsideration and attach a copy of this letter. You may also submit your appeal online at the Air Force's Public Access Link: <https://efoia.cce.af.mil/app/Home.aspx/>.

If you are dissatisfied with the servicing of this request and/or this final response from this office, you may contact the Air Force FOIA Public Liaison Officer, Mr. Robert Bivins, concerning this final response at Air Force FOIA Public Liaison Office, 1800 Air Force Pentagon, Washington, DC 20330-1800, DAF.FOIA@us.af.mil, or (703) 614-8500. You may also seek dispute resolution services from the Office of Government Information Services and can find information on this Office at <https://www.archives.gov/ogis/mediation-program/request-assistance>. Using the dispute resolution services will not affect your appeal rights.

The FOIA provides for the collection of fees based on the costs of processing a FOIA request and your fee category. In this case, we assessed no fees for processing this request.

Direct questions to AFIMSC.FOIA.Workflow@us.af.mil and reference above FOIA case number.

Sincerely,

X *Adele M. Hopkins*

ADELE M. HOPKINS, GS-14, DAF
Chief, Information Access Branch
Signed by: HOPKINS.ADELE.MARIE.1021816783

1 Attachment:

1. Responsive Records (27 Pages)