

Emerging Issues in Economic Diplomacy

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HARVARD Kennedy School

BELFER CENTER

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Participants attend the G20 Finance Ministers and Central Bank Governors Meeting Saturday, June 8, 2019, in Fukuoka, western Japan.

AP Photo/Eugene Hoshiko



Introduction

Economic diplomacy has long been integral to the implementation of U.S. foreign policy goals. From deploying development aid and establishing multilateral institutions that facilitate global commerce, to levying economic sanctions and erecting trade barriers, U.S. policymakers have wielded various carrots and sticks to promote national objectives.

Today, economic diplomacy has taken on a more complex and vital character. The Trump Administration has made it central to its foreign policy, using coercive economic tools to gain concessions on a wide range of policy issues. Since taking office, the Administration has added over 3,000 people and entities to the sanctions list, a marked increase from predecessors. It has placed export restrictions on Huawei, ZTE, and various Chinese supercomputing firms. It has also imposed worldwide tariffs on steel and aluminum imports, in addition to engaging in a trade war with China.

At the same time, more nations have gained the capacity to project economic power, and the interconnectedness of the global economy has created new economic pressure points for the U.S. Whereas the U.S. once enjoyed economic hegemony, China can now respond with its own set of tariffs, deploy foreign investment that surpasses what the U.S. has to offer, and establish rival multilateral institutions. Where U.S. sanctions were once a death sentence, the European Union and others have begun to explore alternate arrangements to circumvent U.S. oversight. With the integration of supply chains and the global flow of capital and talent, the U.S. must weigh measures to protect critical domestic industries, against its long-standing commitment to open markets.

For the next Administration, developing a clear strategy for maintaining and projecting American economic power will be critical. At the Belfer Center's Economic Diplomacy Initiative, we define three key objectives for a U.S. economic diplomacy strategy. Against each of these objectives, our students have identified a range of pressing issues that the next Administration must address. The objectives and associated issues are:

- **Promoting U.S. competitiveness in critical economic sectors**, including protecting America's leadership in AI, building U.S. competitiveness in 5G, evaluating the track record of the Committee of Foreign Investment in the U.S. (CFIUS), and defining federal data privacy regulation.
- **Setting a clear vision for the international economic order**, including maintaining the dominance of the U.S. dollar as the global reserve currency, updating the governance of multilateral institutions like the World Trade Organization (WTO), and countering China's economic diplomacy strategies in the Indo-Pacific.
- **Demonstrating American leadership in addressing transnational challenges**, including deploying economic aid to address the migration challenge and developing a global health security strategy.

The nine issue papers contained in this report were proposed and written by graduate students at the Belfer Center for Science and International Affairs at Harvard Kennedy School. They present fact-based, nonpartisan analysis to help focus the next Administration on the key policy debates that must be resolved. And, they aim to create a platform for our students to engage with the most pressing policy issues of the day as they continue their careers in public service.

—**Aditi Kumar**, Executive Director, Belfer Center



A telecommunications tower undergoing maintenance in High Ridge, Missouri, May 2017.

AP Photo/Jeff Robertson



1. Maintaining American AI leadership

Bo Julie Crowley

Issue Overview

As Artificial Intelligence (AI) drives relentless operational efficiency in the public and private spheres, it creates new economic winners and losers, introduces security opportunities and risks, and generates public concern about the safe and ethical use of technology. AI refers to computer systems capable of perceiving their environment and making decisions, such as processing a complex set of data and predicting outcomes or taking an action in response. Machine learning (ML) is often used interchangeably with AI, but is a subfield of AI that enables a computer to learn and improve on its own without being explicitly programmed for a particular outcome.

Recent breakthroughs in ML have enabled AI researchers to surpass human records in specialized skillsets, like chess and poker, and to mirror human linguistics and behavior with software. Combined with sensors and robotics, AI/ML solutions bridge the physical world with the virtual, leading to innovations like improved drone targeting and autonomous vehicles.

U.S. policymakers must maximize AI-powered economic opportunity while mitigating job replacement and inequality, establish international norms, address public concerns over the use of AI in warfare and surveillance, and navigate U.S.-China competition for global AI leadership.

Background

When AI is applied to a particular problem or task, the core components are algorithms and data. A learning algorithm allows the computer to identify patterns in a data set, build a predictive model, and make a decision

without being pre-programmed for that exact scenario. AI can be broken down into four waves of development that are maturing at different rates:¹

1. *Internet AI*: algorithms that use internet behavior data (e.g., sites visited, products purchased) to build a user profile and tailor content (e.g., ads, suggested Netflix shows).
2. *Business AI*: algorithms that use proprietary data (e.g., lifestyle and financial risk) to inform complex business processes (e.g., an applicant's likelihood of repaying a loan).
3. *Perception AI*: algorithms that process physical data (e.g., the number of eggs in the fridge, voice commands) to make decisions (e.g., to order more groceries, to play a song).
4. *Autonomous AI*: algorithms that use data generated from multiple sensors (e.g., visual and audio feeds) to navigate the world on their own (e.g., in self-driving cars).

Despite continuous advancement, most sectors have not realized the majority of benefits from AI. The technology & communications, automotive, and financial service industries report the widest use of AI, but the adoption rate remains below one third across each industry. Large segments of manufacturing and retail remain offline; only 1% of cars sold in 2016 had basic autonomous capabilities, and only 10% of total sales in the U.S. and Western Europe occur online.²

Key Topics

AI represents enormous opportunity potential and is predicted to add \$15+ trillion to the world economy by 2030.³ It also poses significant policy challenges around international competitiveness, worker displacement, the future of warfare, and data privacy. While this memo focuses on

1 Lee, Kai-Fu. "The Four Waves of A.I." Medium, Medium, 2 Nov. 2018, medium.com/@kaifulee/the-four-waves-of-a-i-46e7e627c054.

2 "Is the Solow Paradox Back?" McKinsey & Company, June 2018, www.mckinsey.com/business-functions/mckinsey-digital/our-insights/is-the-solow-paradox-back.

3 "PwC's Global Artificial Intelligence Study: Sizing the Prize." PwC, 2017, www.pwc.com/gx/en/issues/data-and-analytics/publications/artificial-intelligence-study.html.

the economic and national security implications of AI, ethical issues, such as algorithmic bias, surveillance state AI tools, and artificial general intelligence (AGI) are also contested topics.

U.S.-China competition

The U.S. and China far outpace other regions of the world in AI research and application. Some experts believe the exponential pace of AI development creates a winner take all model where the most advanced country will concentrate insurmountable advantages. The McKinsey Global Institute estimates that leading countries will capture 20-25% of net economic benefits from AI.⁴

While the U.S. maintains an advantage in AI research over China, this lead is declining. The majority of AI conference researchers study in the U.S. (44% compared with 11% in China),⁵ but China recently surpassed the U.S. in number of annual AI research publications and patents.⁶ The U.S. maintains a lead in AI company valuations; American high-tech unicorns (startups valued above \$1 billion) account for 40% of global high-tech unicorns compared to 14% within China.⁷ This gap will decrease, however, as Chinese AI companies rival their American peers in creativity and profitability and no longer depend on IP theft or copycat business models to drive growth. It is more difficult to compare financial investment in AI: U.S. figures account for direct investment in R&D while China also includes indirect investment, like construction costs for AI office parks and universities, in its investment totals. Chinese local governments, however, offer a range of AI investment and incentive programs, such as subsidies for AI companies, AI economic zones, and regulatory support

4 "Notes from the AI Frontier: Modeling the Impact of AI on the World Economy." McKinsey & Company, Sept. 2018, www.mckinsey.com/featured-insights/artificial-intelligence/notes-from-the-ai-frontier-modeling-the-impact-of-ai-on-the-world-economy.

5 Castro, Daniel. "Who Is Winning the AI Race: China, the EU or the United States?" Center for Data Innovation, 30 Aug. 2019, www.datainnovation.org/2019/08/who-is-winning-the-ai-race-china-the-eu-or-the-united-states/.

6 Deng, Iris. "China's AI Industry Gets the Most Funding, but Lags US in Key Talent." South China Morning Post, 19 July 2018, www.scmp.com/tech/china-tech/article/2155600/chinas-ai-industry-gets-most-funding-lags-us-key-talent-says.

7 Lee, Georgina. "China's Share of Hi-Tech Unicorns Tiny Compared to US Start-Ups." South China Morning Post, 26 Mar. 2019, www.scmp.com/business/companies/article/3003248/china-no-match-us-unicorns-ai-big-data-and-robotics-it-continues.

for applications like autonomous vehicles. Nevertheless, global investment studies consistently report greater funding for U.S. AI startups, with U.S. venture capital and private equity firms investing over \$16 billion in AI in 2017 compared to \$13 billion in China.⁸

AI leadership will allow countries to concentrate economic gains and project foreign influence in unprecedented ways. China's AI-enabled exports, like facial recognition software, mirror its Belt and Road infrastructure investments, with Chinese AI companies dominating parts of Southeast Asia, Africa, and Latin America. Analysts estimate that China exports AI-enabled surveillance technology to 50+ countries around the world.⁹ For example, Ecuador used part of a \$250 million loan from China to purchase a statewide network of Chinese "smart" cameras and response centers.¹⁰

These private sector relationships establish new communication channels between China and foreign governments. They also advance Chinese norms around the use of AI to monitor domestic dissent, empower state surveillance, and restrict movement. For example, Megvii, one of China's leading surveillance technology companies, provides facial recognition software to police departments across China. Independent reporting revealed that Megvii helped create software to identify Uighur muslims, a minority group interned in China's northwest Xinjiang region. Last year, Megvii reported over 100% annual growth in international revenue and plans to open offices across Asia and the Middle East.¹¹

Impact on jobs and wages

AI's unintended consequences include worker displacement and growing inequality. AI's net impact on overall employment may be low: McKinsey

8 Castro, Daniel. "Who Is Winning the AI Race: China, the EU or the United States?."

9 Feldstein, Steven. "China Is Exporting AI Surveillance Technology to Countries around the World." *Newsweek*, 23 Apr. 2019, www.newsweek.com/china-ai-surveillance-technology-world-1403762.

10 Romaniuk, Scott and Tobias Burgers. "How China's AI Technology Exports Are Seeding Surveillance Societies Globally." *The Diplomat*, 19 Oct. 2018, thediplomat.com/2018/10/how-chinas-ai-technology-exports-are-seeding-surveillance-societies-globally/.

11 Simonite, Tom. "Behind the Rise of China's Facial-Recognition Giants." *Wired*, *Conde Nast*, 4 Sept. 2019, www.wired.com/story/behind-rise-chinas-facial-recognition-giants/.

estimates that AI-driven job displacement could impact up to 25% of the U.S. workforce, but AI will create new opportunities to offset the majority of this loss. The study notes that technology has historically been a net job creator. At the same time, AI will transform the nature of work. An estimated 3% of the global workforce will need to change occupations by 2030, with physical, manual, and repetitive labor needs declining 30% and managerial, technological, and advanced analytics needs increasing 8% - 55%.¹² AI is also not a silver bullet for the economy; U.S. productivity growth rates are predicted to decline from 2.5% annually in the 2000s to 2% annually in the next decade.¹³

More worryingly, studies show economic benefits from AI accrue to a small number of researchers and executives while median wages stagnate. Even within Silicon Valley, a 2017 study found that wages for 90% of workers (all workers excluding the top 10%) were lower in 2017 than 1997 after adjusting for inflation.¹⁴ Middle income workers in the 50th and 60th percentiles saw wages decline 14% after adjusting for inflation, despite the fact that per capita economic output increased 74% overall. In contrast, the top 10% enjoyed a wage increase. Without policy intervention, AI innovation and gains will be restricted to a small number of highly specialized individuals.

Impact on national security

Maintaining AI competitiveness is critical to the U.S.'s defense posture. The FY19 National Defense Authorization Act¹⁵ and DoD AI Strategy¹⁶ increased funding and support for defense AI applications and public-private sector partnerships to improve the Department of Defense's

12 "AI, Automation, and the Future of Work: Ten Things to Solve For." McKinsey & Company, June 2018, www.mckinsey.com/featured-insights/future-of-work/ai-automation-and-the-future-of-work-ten-things-to-solve-for.

13 "Is the Solow Paradox Back?" McKinsey & Company, June 2018.

14 Boitnott, John. "Why Silicon Valley Income Inequality Is Just a Preview of What's to Come for the Rest of the U.S." *Inc.com*, Inc., 18 Oct. 2018, www.inc.com/john-boitnott/why-silicon-valley-income-inequality-is-just-a-preview-of-whats-to-come-for-rest-of-us.html.

15 H.R. 5515 — 115th Congress: John S. McCain National Defense Authorization Act for Fiscal Year 2019." www.GovTrack.us. 2018. March 29, 2020, <https://www.govtrack.us/congress/bills/115/hr5515>.

16 Summary of the 2018 Department of Defense Artificial Intelligence Strategy. DOD, Feb. 2019, media.defense.gov/2019/Feb/12/2002088963/-1/-1/1/SUMMARY-OF-DOD-AI-STRATEGY.PDF.

capabilities. While AI has increased the accuracy, efficiency, and lethality of defense technology, there remains considerable opportunity to improve capabilities like intelligence collection and analysis, logistics, cyber operations, and autonomous vehicles.¹⁷ U.S. rivals are actively incorporating AI into military systems.¹⁸ China aims to become a global leader in AI by 2030 and is focused on using AI to improve national security decision making, while Russia is primarily focused on military use cases for AI and robotics. Barriers to AI adoption in national security include integration with legacy systems, maintaining interoperability with allies, applying commercially-trained AI to military environments with different conditions (e.g., poor map data), and obtaining the cloud computing power needed to run AI algorithms.

Although the DoD is not currently developing fully autonomous weapons systems, technology companies and civil society groups have opposed defense projects on ethical grounds that “killer robots” pose a threat to society. Regardless of DoD policy, AI and robotics technology is not advanced enough to deploy lethal robots that could pose an existential threat to society.

Data privacy

Data privacy regulation will directly impact AI research and competitiveness. Some studies suggest access to large quantities of training data is the greatest factor on AI development. U.S. states and the European Union have stricter privacy regimes than China, which may curtail U.S. companies’ access to training data. With over 750 million internet users (nearly three times as in the U.S.), China’s AI companies enjoy greater access to live consumer data. This advantage, however, may be overstated.¹⁹ While Chinese officials highlighted the country’s database of over 1 billion facial images, the FBI alone maintains a database of over 640 million facial

17 U.S. Congressional Research Service. Artificial Intelligence and National Security (R45178; Nov. 21, 2019), by Kelley M. Sayler. Text in: <https://fas.org/sgp/crs/natsec/R45178.pdf>.

18 Simonite, Tom. “Artificial Intelligence Fuels New Global Arms Race.” *Wired*, Conde Nast, 2 Feb. 2018, www.wired.com/story/for-superpowers-artificial-intelligence-fuels-new-global-arms-race/.

19 “China Has Nearly 3 Times the Number of Internet Users as the US, and the Gap Will Only Widen.” *CircleID Master*, July 2018, www.circleid.com/posts/20180710_china_has_nearly_3_times_the_number_of_internet_users_as_the_ust.

images.²⁰ U.S. companies like Microsoft and Alphabet are also investing in artificial training data, which may reduce China's advantage in data access.

²⁰ Vanian, Jonathan. "What People Get Wrong About China and Artificial Intelligence: Eye on A.I." *Fortune*, 14 Jan. 2020, fortune.com/2019/07/09/china-data-artificial-intelligence/.

2. Competing in 5G

Raina Davis and Matthew Shackelford

Issue Overview

Fifth Generation (5G) wireless telecommunications networks will increase the bandwidth, capacity, and reliability of mobile communications. This latest evolution will provide critical support to a number of emerging technologies—including autonomous vehicles, augmented and virtual reality, remote healthcare, the internet of things (IoT)—that depend on reliable, low-latency,²¹ high-throughput²² connections to transfer large quantities of data. These networks have the potential to generate vast wealth and social benefits for the U.S., but also introduce certain risks.

Supply-chain integrations and technological challenges accentuate these risks. U.S. companies continue to dominate 5G component manufacturing, but the U.S. relies exclusively on foreign suppliers for telecommunications systems.²³ The more interconnected and technologically-dependent U.S. infrastructure becomes, the greater its vulnerability to cyberattacks that cause physical, psychological, or financial harm. Two Chinese firms, Huawei and ZTE, dominate a substantial share of the 5G market. Reliance on their equipment generates national security concerns due to the firms' close ties to the Chinese Communist Party (CCP) and legal obligation to comply with state intelligence requests. Several countries, including the U.S., have placed restrictions on the use of Huawei and ZTE equipment.

U.S. policymakers need to grapple with the opportunities and challenges that 5G presents to American consumers, businesses, and society. Engaging on a forward-thinking basis with 5G technology will drive American economic growth and prosperity in the coming decades, but important

21 Latency refers to the delay in transmitting and processing data and is one of the contributing factors to the perceived “speed” of internet or mobile connections, along with bandwidth.

22 Through-put is a measure of the amount of data that transmits over a given period of time.

23 The last American producer, Lucent, went out of business in 2006. James Andrew Lewis, Senior Vice President and Director, Technology Policy Program, Center for Strategic and International Studies (CSIS) <https://www.judiciary.senate.gov/imo/media/doc/Lewis%20Testimony1.pdf>.

questions must be answered regarding the security and privacy threats posed by the incorporation of data and network technology into all aspects of daily life. As American businesses try to catch up with foreign competitors in technology development and deployment, innovative government policies can catalyze their growth and leadership. 5G calls for clear, well-developed, and values-driven leadership from policymakers to enable optimal outcomes for the U.S. and its citizens.

Background

Technological Developments

Since the first cellular network launched in the U.S. in 1982, a new generation of communications technology has entered the market each decade. The first generation (1G) supported basic speech; the second generation (2G) introduced digital transmission over the air, enabling mobile data use such as text and picture messaging; the third generation (3G) added data overlay capabilities such as GPS and video conferencing; and the fourth generation (4G) led to the transition from content download to wide-scale streaming. While most Americans today rely on recent 4G evolutions, 2G and 3G continue to be used in rural areas that lack 4G coverage.

5G will transform mobile networks through the integration of new technology and legacy equipment to support ultra-low latency and high-throughput connections. Unlike previous generations that utilize low-band radio frequencies, 5G networks will transmit and receive data across low-, medium-, and high-band radio frequencies.²⁴ Broad-spectrum use will decrease wireless traffic congestion and increase perceived network speed. To compensate for the shorter transmission and lower penetration rates of medium- and high-band frequencies, 5G systems will relay data through a network of smaller, non-traditional deployments, such as small

²⁴ Radio frequencies range from 3 kHz to 300 GHz. Low-Band Frequencies are below 1 GHz, Mid-Band Spectrum spans from 1 GHz to 6 GHz, and High-Band, also known as Millimeter Wave, ranges from 24 GHz to 30 GHz. <https://www.wired.com/story/wired-guide-5g/>

cells and micro-cells.²⁵ These miniature and small cellular towers transmit short-range radio signals and will need to be deployed across cities on street lights, street signs, vehicles, and buildings.

The 3rd Generation Partnership Project (3GPP), a leading standard and regulatory body, divides future 5G demand into three categories based on radio-band frequency: Enhanced Mobile Broadband (eMBB) (low-band); Ultra-Reliable Low-Latency Communications (URLLC) (medium-band); and Massive Machine Type Communications (mMTC) (high-band). With download speeds up to 20x faster than current standards, eMBB supports data-driven applications over large areas, like augmented/virtual reality, as well as traditional mobile connectivity and broadband. Autonomous vehicles, smart grids, tactical feedback in remote medical procedures, and other time-sensitive applications that require high reliability will utilize URLLC (end-to-end latency of <5ms and uptime of 99.999%). mMTC will connect tens of billions of low-complexities, low-power devices in the IoT domain.

The 5G network in the U.S. launched in a limited capacity beginning in 2018,²⁶ reaching over 30 U.S. cities as of July 2019,²⁷ but widespread domestic availability faces technical and physical challenges that cannot currently be overcome by U.S. firms alone. Even as the U.S. expands its reliance on foreign equipment, China races to end its dependence on U.S. technology and has invested heavily to develop an end-to-end domestic supply chain.

The 5G Marketplace

Important 5G companies can be divided into three functional categories: Network Infrastructure, Mobile Equipment, and Telecom Operators. Network Infrastructure companies focus on developing software or hardware solutions for the core or periphery of 5G networks. As an example, Intel is a leading provider of specialized software called Network Functions

25 Devices in range will still be able to connect directly to a base station (massive MIMO/Macro cells or small cells).


























26 As well as South Korea. China and a number of places in the Middle East also have limited capacity.

27 Samuel Contreras, "Here's every U.S. city with 5G coverage right now," *androidcentral*, July 19, 2020, <https://www.androidcentral.com/heres-every-us-city-5g-coverage-right-now>.

Virtualization (NFV) that enables the functionality of the network core, while Ericsson produces, among other things, the radio system that is deployed at the network periphery to communicate with mobile devices. Mobile Equipment companies produce 5G mobile phones or modems for 5G-enabled devices. Finally, the Telecom Operators are the firms that manage cellular networks.

Companies in all three verticals interact with each other regularly. Network Infrastructure firms need to ensure that their technology can communicate with the phones and modems being produced by the Mobile Equipment companies, and vice versa. Telecom Operators enter into contracts with Network Infrastructure firms to upgrade their networks to 5G and agree to sell the devices of Mobile Equipment companies for use on their networks.

Figure 1: The 5G Marketplace

	Network Infrastructure	Mobile Equipment	Telecom Operators
U.S.		 	   
China	  <small>HUAWEI 中兴通讯股份有限公司 ZTE CORPORATION</small>	  <small>HUAWEI 中兴通讯股份有限公司 ZTE CORPORATION</small>	   <small>中国移动 China Mobile 中国电信 China Telecom 中国联通 China Unicom</small>
Europe	  <small>ERICSSON NOKIA</small>		  <small>vodafone orange</small>
Japan/ South Korea		  <small>LG SAMSUNG</small>	    <small>kt SK telecom LG U+ NTT docomo</small>

Federal Legal & Regulatory Structure

The rollout of 5G in the U.S. and around the world will be gradual and incremental.

Systems and devices already operating on current networks, such as smartphones and infrastructure, will begin using 5G far quicker than those that require wide spectrum availability. Most devices will continue to utilize 4G, a hybrid of 4G/5G infrastructure, or Non-Stand-Alone (NSA) 5G Networks.²⁸ Stand-Alone (SA) 5G Networks are projected for rollout in

28 Also known as Non-standalone 5G NR, NSA combines LTE RAN and core with a 5G component carrier and will primarily support eMBB. Libby Allen, "Non-Standalone 5G NR vs. Standalone 5G NR," *RCR Wireless News*, November 27, 2018, (<https://www.rcrwireless.com/20181127/5g/non-standalone-standalone-5g-nr>).

2020²⁹ and widespread adoption in 2022.³⁰ Their deployment requires the finalization of 5G standards by international regulatory bodies, like the 3GPP and the International Telecommunications Union (ITU), and the release of broader spectrum by the FCC.³¹

U.S. 5G regulation is driven by the Department of Commerce, Department of Homeland Security, and Federal Communications Commission (FCC). The Department of Commerce works closely with industry stakeholders and international partners to develop 5G standards, promote innovation and competitiveness, and manage export controls and treaty compliance.³² The Federal Communications Commission (FCC) leads federal regulation of telecommunications technology and manages commercial spectrum use. Under its 5G FAST Plan, the FCC plans to auction 6,000 licenses for underutilized high-band spectrum (28-24 GHz) to communications companies. Finally, the Department of Homeland Security leads the federal government's 5G resilience and security efforts.

Security concerns have driven additional 5G-specific and communications supply chain regulations. The Federal Acquisition Supply Chain Security Act (FASCA) of 2018 (P.L. 115-390) established the interagency Federal Acquisition Security Council to mitigate, via "removal orders" and "exclusion orders," supply chain risk in federal information and communications technology (ICT) acquisition, including 5G. The 2018 National Defense Authorization Act (NDAA) prohibited federal agencies and contractors from purchasing or using certain telecommunications and surveillance products from Huawei, ZTE, and Chinese surveillance-equipment makers. Section 889 of the 2019 NDAA reiterated this ban.

29 Ibid.

30 Cybersecurity and Infrastructure Agency (CISA), *Overview of Risks Introduced by 5G Adoption in the United States* (Critical Infrastructure Security and Resilience Note) (Washington D.C.: CISA, July 2019): https://www.cisa.gov/sites/default/files/publications/19_0731_cisa_5th-generation-mobile-networks-overview_0.pdf.

31 "The FCC's 5G FAST Plan," *Federal Communications Commission*, <https://www.fcc.gov/5G>; CISA, *Overview of Risks*.

32 Through the National Institute of Standards and Technology (NIST), National Telecommunications and Information Administration (NTIA), and Bureau of Industry and Security (BIS).

Key Topics

5G Security

Director Christopher Krebs of DHS's Cybersecurity and Infrastructure Security Agency (CISA) categorizes the risks associated with U.S. 5G deployment as technical, physical, and logistical related vulnerabilities.³³ On the technical side, the current 5G rollout is overlaid on existing 4GLTE networks, making the network vulnerable to legacy exploits that previously enabled eavesdropping, location tracking, device fraud, or denial of service attacks.³⁴ As with any new technology, initial 5G equipment and protocols will likely contain exploitable backdoors, which will increase in consequence as 5G takes on mission-critical functions.

On the physical side, 5G expands the potential attack surface area of mobile infrastructure. The ubiquity of small cell sites will make the physical security of telecom hardware nearly impossible. However, such entry points are unlikely to provide widespread network access or allow for substantial data extraction.³⁵

Finally, 5G represents a significant shift from hardware to software-based telecom, giving more power to vendors. As with cellphones and computers, future telecom technology will maintain connection to manufacturers long after sale and require frequent software updates, which malicious actors could use to create backdoors or disrupt service.³⁶ Working with trusted companies and a diversity of vendors can help mitigate this risk.

33 According to the ICT Supply Chain Risk Management Task Force, CISA, Department of Homeland Security, "CISA Director Krebs Outlines 5G Security Issues, Remedies," *MeriTalk*, July 31, 2019, <https://www.meritalk.com/articles/cisa-director-krebs-outlines-5g-security-issues-remedies/>.

34 For example, NSA 5G radio will utilize a similar security protocol to the SS7, in which backdoors enabled interception and monitoring, geolocation, and remote tracking.

35 CISA, *Overview of Risks*.

36 James Andrew Lewis (Senior Vice President and Director, Technology Policy Program Center for Strategic and International Studies(CSIS)), "5G: The Impact on National Security, Intellectual Property, and Competition," Testimony before the Senate Committee on the Judiciary, *Hearing on 5G: The Impact on National Security, Intellectual Property, and Competition*, May 14, 2019, <https://www.judiciary.senate.gov/imo/media/doc/Lewis%20Testimony1.pdf>.

The Huawei, ZTE Threat

Two Chinese telecom companies, Huawei and ZTE, have been at the center of the 5G policy and security debate. Accusations of economic espionage and theft of trade secrets culminated in a Department of Justice (DOJ) indictment against Huawei in January 2018.³⁷ Concerns that Chinese telecom equipment will be exploited by Beijing for espionage, surveillance, or cyber-attacks, prompted many Western governments, including the U.S., to restrict or altogether ban Huawei equipment.³⁸ Lawsuits filed by the targeted corporations and an international lobbying campaign to portray Huawei as the only technologically viable 5G provider³⁹ have muddled the debate. How should governments assess the threat that Huawei and ZTE pose to 5G infrastructure security?

China has long pursued a strategy of cyber-enabled economic espionage and cross-border intellectual property theft to bypass lengthy and expensive R&D and strengthen its economic competitiveness, often to the private benefit of party leaders or PLA units. Chinese cyber espionage rose to unprecedented levels as part of President Xi's larger military modernization effort.⁴⁰ The 2019 Worldwide Threat Assessment of the U.S. Intelligence Community warned that "China presents a persistent cyber espionage threat and a growing attack threat to our core military and critical infrastructure systems." In addition, former Director of National Intelligence Dan Coats voiced "concern that Chinese intelligence and security services [may] use Chinese information technology firms as routine and systematic espionage platforms against the United States and allies." This warning echoed the findings of the 2012 House Permanent Select Committee on Intelligence's study on Huawei and ZTE, which concluded that China has the "means, opportunity, and motive to use telecommunications companies for malicious purposes," and supply-chain risks in our

37 For "theft of trade secrets conspiracy, attempted theft of trade secrets, seven counts of wire fraud, and one count of obstruction of justice." U.S. Department of Justice, "Chinese Telecommunications Device Manufacturer and its U.S. Affiliate Indicted for Theft of Trade Secrets, Wire Fraud, and Obstruction Of Justice," press release no. 19-13, January 28, 2019, <https://www.justice.gov/opa/pr/chinese-telecommunications-device-manufacturer-and-its-us-affiliate-indicted-theft-trade>.

38 U.S., New Zealand, Australia, UK, Germany, Canada, Germany, and the EU are investigating or publicly concerned about this issue.

39 Matt Schrader, "Huawei's PR Campaign Comes Straight From the Party's Playbook," *Foreign Policy*, June 6, 2019, <https://foreignpolicy.com/2019/06/06/huaweis-pr-campaign-comes-straight-from-the-partys-playbook/>.

40 Lewis, *Hearing on 5G*.

critical infrastructure from the use of Chinese telecom technology cannot be addressed by “mitigation measures” alone.⁴¹

Chinese telecom technology had often been used to pursue state objectives. In 2018, investigative journalists working for *Le Monde* identified unusual traffic leaving the African Union headquarters following the donation of a Huawei telecom system.⁴² Huawei denies any complicity, and Ren Zhengfei, CEO and founder of Huawei, has vowed to deny any request from the Chinese government to access user data.⁴³

Indeed, there is no “smoking gun” indicating that Chinese telecom companies have willingly given access or data to the government. Proven vulnerabilities in Huawei equipment⁴⁴ have been subsequently identified in a number of non-Chinese products, including from Cisco, Sony, and D-Link. Global 5G competition pressured companies to produce quickly, and it is difficult to ascertain if bugs in Huawei code are deliberate vulnerabilities or accidental mistakes.

Under China’s 2017 National Intelligence Law, which compels all Chinese companies to comply with Ministry of State Security requests, Huawei and other telecom companies can now be forced to assist the government in surveillance and espionage. As James Andrew Lewis, CSIS Senior Vice President, testified before Congress, “The issue is not whether one trusts the Chinese company, but whether one trusts the Chinese government.”⁴⁵

Other concerns related to Chinese telecoms include network hijacking and surveillance.

41 U.S. Congress, House, Permanent Select Committee on Intelligence, *Investigative Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE*, 112th Congress October 8, 2012, H. Rep., [https://stacks.stanford.edu/file/druid:rm226yb7473/Huawei-ZTE%20Investigative%20Report%20\(FINAL\).pdf](https://stacks.stanford.edu/file/druid:rm226yb7473/Huawei-ZTE%20Investigative%20Report%20(FINAL).pdf).

42 A. Dahir, “China Gifted the African Union a Headquarters Building and then Allegedly Bugged it for State Secrets,” *Quartz*, January 30, 2018, <https://qz.com/africa/1192493/china-spied-on-african-unionheadquarters-for-five-years/>

43 Arjun Kharpal, “Huawei CEO: No matter my Communist Party ties, I’ll ‘definitely’ refuse if Beijing wants our customers’ data,” *CNBC*, January 16, 2019, <https://www.cnbc.com/2019/01/15/huawei-ceo-we-would-refuse-a-chinese-government-request-for-user-data.html>.

44 In 2019, Vodafone identified back doors that gave Huawei remote access into parts of its European networks. Dr. Charles Clancy (Bradley Professor of Cybersecurity, Virginia Tech), Testimony before the Senate Committee on the Judiciary, *Hearing on 5G: The Impact on National Security, Intellectual Property, and Competition*, May 14, 2019, <https://www.judiciary.senate.gov/imo/media/doc/Clancy%20Testimony.pdf>.

45 Lewis, *Hearing on 5G*.

China has sufficient penetration into the Internet backbone to redirect or disrupt global traffic. In 2010, Chinese telecoms took over 15% of internet traffic for 18 minutes.⁴⁶ Domestically, China has doubled down on surveillance, deploying AI-enabled facial recognition technologies run on 5G networks to track individuals and identify ethnic minorities.⁴⁷ Huawei and ZTE are actively exporting these “smart city” surveillance systems to repressive regimes, including Mongolia, Ethiopia, Zimbabwe, Malaysia, and Ecuador.⁴⁸

Making U.S. Firms Competitive

To compete globally in an effective manner, U.S. companies need to overcome three key obstacles that currently prevent them from doing so. The first is the successful vertical integration of their 5G offering. Currently, no U.S. firm offers an end-to-end solution for telecom operators who seek to build a 5G network, while Huawei does,⁴⁹ making it difficult for U.S. firms to compete effectively. Second, U.S. firms are being out-competed on price. Firms from other nations, particularly Huawei, are undercutting the prices charged by U.S. companies by up to 30%, principally driven by manufacturing advantages for non-U.S. firms and alleged state subsidization for Chinese firms.⁵⁰ The third obstacle is the technological advantage possessed by non-U.S. firms in some specific 5G technologies. Experts believe that U.S. firms are 18-24 months behind competitors in the research of and rollout capacity for particular technologies,⁵¹ preventing U.S. companies from playing a larger role in the global 5G market.

46 Clancy, *Hearing on 5G*.

47 Zak Doffman, “China Is Using Facial Recognition To Track Ethnic Minorities, Even In Beijing,” *Forbes*, May 3, 2019, <https://www.forbes.com/sites/zakdoffman/2019/05/03/china-new-data-breach-exposes-facial-recognition-and-ethnicity-tracking-in-beijing/#6c495c6934a7>.

48 Clancy, *Hearing on 5G*; Robert L. Strayer (Deputy Assistant Secretary of State for Cyber and International Communications and Information Policy), Testimony before the Senate Committee on the Judiciary, *Hearing on 5G: The Impact on National Security, Intellectual Property, and Competition*, May 14, 2019, <https://www.judiciary.senate.gov/imo/media/doc/Strayer%20Testimony.pdf>.

49 Keith Johnson and Elias Groll, “The Improbable Rise of Huawei,” *Forbes*, April 3, 2019, <https://foreignpolicy.com/2019/04/03/the-improbable-rise-of-huawei-5g-global-network-china/>.

50 Charlie Campbell, “Inside the Controversial Company Helping China Control the Future of the Internet,” *TIME*, May 23, 2019, <https://time.com/5594366/5g-internet-race-huawei/>.

51 Ibid.

To support American growth and increase U.S. competitiveness, U.S. policymakers should implement two broad sets of actions: fostering actions to bolster U.S. businesses to compete in the 5G market and diminishment actions against foreign firms focused on leveling the playing field for U.S. companies. 5G supply chain integration creates challenges in pursuing a wholesale “decoupling” of U.S. firms from international markets, yet policymakers can strengthen U.S. firms and selectively work with U.S. allies to diminish the role of strategic adversaries. By focusing on overcoming the potential dominance of strategic adversaries, the U.S. could attain leadership in some 5G technology facets while maintaining a competitive edge in others.

3. Evaluating the Track Record of CFIUS

Allison Lazarus and Raina Davis

Issue Overview

The Committee on Foreign Investment in the United States (CFIUS) has largely kept a low profile over its 44-year history. CFIUS is an interagency committee charged with reviewing the national security implications of foreign investments in U.S. companies and was originally established in response to concerns about foreign direct investment by Organization of the Petroleum Exporting Countries (OPEC) in American portfolio assets in the 1970s. However, in recent years, the committee's activities have become newly visible to the American public amid concerns about growing Chinese investment in American companies, particularly in the technology sector.

This influx of Chinese investment revived interest in CFIUS and led, in the summer of 2018, to the bipartisan passage of the Foreign Investment Risk Review Modernization Act (FIRRMA). FIRRMA expanded CFIUS's jurisdiction to include a broader range of transactions, including joint ventures, and doubled the list of national security factors for CFIUS to consider in its risk reviews. However, further reform may be necessary to ensure that CFIUS is able to successfully meet its objectives. Current criticisms of CFIUS range from allegations of unfair targeting of Chinese investment and perversion of American free market principles to concerns that there are still too many loopholes for problematic foreign investment.

Background

CFIUS is chaired by the Secretary of the Treasury, and includes voting members from the Departments of Commerce, Defense, Homeland Security, Justice, State, and Energy, with several additional non-voting

members. The establishing language called for the committee to have responsibility for “monitoring the impact of foreign investment in the United States,” and for “coordinating the implementation of U.S. policy on such investment.”⁵² In its original iteration, CFIUS existed only to study foreign investment, but by 1988, fear of Japanese investment, particularly in the semiconductor industry, led Congress to pass the Exon-Florio Amendment, which allowed CFIUS to reject deals. The committee did not have a formal statutory basis until 2007, with the passage of the Foreign Investment and National Security Act (FINSIA), which also provided a broader oversight role for Congress but left the President as the only officer with the authority to suspend or prohibit actions under CFIUS.

The committee’s jurisdiction over ‘national security’ effects is wide: it can review any “covered transactions,” which are defined as mergers, acquisitions, and takeovers by or with a foreign entity that could result in foreign “control” of a U.S. business.⁵³ However, it generally focuses on transactions for which there is some fear that the technology involved might be transferred abroad inappropriately, especially related to critical infrastructure and defense. Companies involved in an acquisition by a foreign firm are required to notify CFIUS, but the committee can also review transactions of its own accord. CFIUS does not publicize which deals are under review, involve parties directly, or publicly announce its findings.

The committee’s process is fairly simple. The reviews begin with a 30-day period to authorize a transaction or begin an investigation. CFIUS considers 10 specific factors when analyzing the national security implications of a transaction (e.g., domestic production needed for projected national defense requirements, capability and capacity of domestic industries to meet national defense requirements). If it pursues an investigation, it has a 45-day decision period to either permit the acquisition or order divestment. This is potentially followed by a 15-day period for presidential review if CFIUS refers a transaction to the President for a decision. Most transactions are approved without a statutory investigation – in 2015, only

52 The Committee on Foreign Investment in the United States. The Treasury of the United States. <<https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius>>

53 Latham and Watkins, LLP. “Overview of the CFIUS Process.”

46% of the cases that had been noticed were investigated.⁵⁴ If CFIUS finds that a covered transaction poses national security risks, it can impose certain conditions before allowing the deal to proceed, including a mitigation agreement to address these risks. Some parties opt to withdraw the deal rather than executing a mitigation plan or waiting for referral to the President.

However straightforward these guidelines, their application has varied significantly over recent decades. While largely inactive in earlier years, the committee's investigations increased beginning in 2008 and continuing until today.⁵⁵ High profile recent cases have included the 2012 ordered divestment of wind farm projects in Oregon by a Chinese company, the 2016 blockage of acquisitions by a Chinese company interested in gallium nitride, the 2017 blockage of a Chinese buyer for Lattice Semiconductor, the 2018 blockage of a Singaporean company from purchasing Qualcomm, and the 2019 requirement for divestment from Grindr by a Chinese company.⁵⁶ To date, only five transactions have been formally blocked through this process, though this number certainly understates CFIUS's true impact as many other transactions under investigation have been subject to stringent mitigation actions or withdrawn by the firms (who anticipate them being blocked if allowed to proceed).

In recent years, CFIUS has focused primarily on investment from China. Chinese investment in U.S. companies has quickly grown, tripling from 2015 to 2016 at a peak of \$46 billion.⁵⁷ Though there has been a recent fall-off in the level of investment given the Trump administration's trade policies, policymakers remain concerned that some of this investment may, though conducted by private firms, be centrally directed toward acquiring early-stage U.S. technology with potential military applications. This concern is reinforced by public Chinese documents, such as the "Made in China 2025" plan, which includes measures to provide domestic Chinese companies with preferential access to capital to support acquisition of

54 Jackson, James K. "The Committee on Foreign Investment in the United States." Congressional Research Service. <<https://fas.org/sgp/crs/natsec/RL33388.pdf>>

55 Jackson.

56 Gibson Dunn. "CFIUS Developments: Notable Cases and Key Trends." <<https://www.gibsondunn.com/cfius-developments-notable-cases-and-key-trends/>>

57 Wiseman, Paul. "China's investment in US drops 83% among growing mistrust." AP News. 8 May 2019.

technology from overseas.⁵⁸ These fears have been bipartisan, with the Obama White House publicly questioning Chinese investment in semiconductors, and the Trump administration doubling down on this skepticism. From 2016-2017, a full 20% of CFIUS's cases were related to Chinese investment.⁵⁹

In 2018, Congress passed FIRRMA, a reform to CFIUS, on a bipartisan basis. This Act gave CFIUS new powers over particular types of FDI, including real estate investing, minority investments, and joint ventures.⁶⁰ FIRRMA targeted these areas because they were widely perceived as gaps in CFIUS's authorities exploited by Chinese firms. The committee also gained more resources, the authority to lengthen review periods, and to request widened disclosure from involved parties. The rhetoric surrounding FIRRMA's passage was explicitly tied to concerns about Chinese investment. Though FIRRMA reformed CFIUS, it did not fundamentally change the committee's structure and did not impose a categorical ban on any type of foreign investment, potentially reflecting the ongoing consensus on FDI's value except in specific situations of concern.

Key Topics

Is CFIUS effectively balancing economic competitiveness and national security?

Historically, the U.S. has been intent on establishing an open and rules-based international economic system. This approach has maintained that, except in exceptional cases, FDI has positive net benefits for the U.S. and the global economy. CFIUS represents that small group of cases where this prevailing viewpoint is challenged. The Committee must balance, on the one hand, the maintenance of an open and efficient investment climate where U.S. firms are competitive, and on the other, the appropriate

58 McBride, James and Andrew Chatzky. "Is Made in China 2025 a Threat to Global Trade?" Council on Foreign Relations. 13 May 2019.

59 Jackson.

60 Zable, Stephanie. "The Foreign Investment Risk Review Act of 2018." Lawfare. 2 August 2018. <<https://www.lawfareblog.com/foreign-investment-risk-review-modernization-act-2018>>

protection of U.S. technology and other critical industries from foreign theft or injury.

There is limited evidence that CFIUS enforcement has hurt U.S. business on a macro scale. The global FDI position of the United States, or the cumulative amount of inward foreign direct investment, was recorded at around \$7.8 trillion in 2017, with the U.S. outward FDI position of about \$7.9 trillion.⁶¹ This is on par with recent years, despite an uptick in CFIUS activity beginning in the same period. However, CFIUS seems to have had an impact on the inflow of Chinese capital. Chinese investment in the tech sector dropped from \$18.7 billion across 107 deals in 2016, to \$2.2 billion across 80 deals in 2018.⁶² The numbers suggest that Chinese investors may be pursuing smaller deals in order to avoid CFIUS scrutiny.

FIRRMA also newly allowed for investors' nationalities to be considered directly during the review, which will further target CFIUS's attention on the highest perceived national security risks. Ultimately, the limited volume of cases investigated by CFIUS are unlikely to harm U.S. economic competitiveness overall, although the impact on specific sectors may be more significant. At an individual company level, however, the CFIUS process can create an "overhang" that negatively affects a firm's valuation and ability to access funding. If the scale of CFIUS activity were to increase substantially, these concerns might become more important for the evaluation of the committee's work.

Proponents and critics disagree on CFIUS's efficacy in addressing national security concerns. On one hand, by blocking investments into critical infrastructure and companies like Grindr that hold sensitive information on U.S. customers, CFIUS has protected key American assets. There is some evidence that CFIUS's greatest impact may be occurring outside of the formal process: the committee's most recent public report indicated

61 Jackson, James K. "U.S. Direct Investment Abroad: Trends and Current Issues." Congressional Research Service. 29 June 2017.

62 Danzman, Sarah and Geoffrey Gertz. "Why is the U.S. forcing a Chinese company to sell the gay dating app Grindr?" The Washington Post. 3 April 2019.

that CFIUS applied mitigation measures to 47 cases in the 2016-2017 period.⁶³

However, criticisms range from whether the process is unfairly targeting Chinese investors to a lax enforcement regime (e.g., 89% of the investment transactions notified to CFIUS from 2008 to 2015 ultimately took place).⁶⁴ For example, the voluntary disclosure that begins the process is nominally checked by CFIUS through a review of ongoing deals that might not have been reported. But, it is likely that, even with a well-intentioned, hard-working staff, the committee is not resourced appropriately to follow up on all investment flows into the United States. Often, foreign investors enter the U.S. market through complex investment structures, such as pooled investment funds managed by U.S. private equity firms, and detecting this activity would require a full investigative capability that the committee does not currently have.

If we conclude that CFIUS does not harm the economic situation of the U.S., but may be missing genuine security threats, there are several potential remedies. CFIUS could be modified to include a mandatory approval process for some transactions or to act as part of a larger industrial policy which actively protects and promotes certain target industries. Solutions nearer to the minimal end of this spectrum may be best positioned to ensure that the committee does not end up inadvertently harming broader foreign investment.

Is CFIUS structured in the right way to be effective?

Even if there is agreement on the balance between CFIUS' objectives, the committee's structure still influences whether it is able to achieve them. Would-be reformers of CFIUS might choose to focus on potential areas for improvement where the committee's structure currently stops it from being most effective.

63 Cooley, Shawn and Christine Laciak. "United States: CFIUS Review" The Antitrust Review of the Americas. 5 September 2018. <<https://globalcompetitionreview.com/insight/the-antitrust-review-of-the-americas-2019/1173803/united-states-cfius-review>>

64 Jackson.

The first of these areas is resourcing. Though FIRRMA designated more resources for the committee (including the piloting of a fee-financing structure) and added positions at Treasury focusing specifically on this issue (e.g., Assistant Secretary for Investment Security), CFIUS must be resourced appropriately for the duties that it is assigned. Current voluntary reporting as the main source of information for the committee on ongoing deals means that it may miss deals of real concern, so the committee may need to invest in a more robust investigative capacity. Moreover, understanding which technologies may have national security implications for the U.S. requires deep functional expertise which the committee may not currently be resourced to provide. Finally, FINSA authorized CFIUS to evaluate the compliance of firms that have entered into a mitigation agreement – another duty that is critical to the committee’s success as an institution but likely to require significant manpower.

Another area of potential reform is specialization. CFIUS does not affect all industries equally: 43% of foreign investment transactions notified to CFIUS from 2008 to 2015 were in the manufacturing sector (especially within computer and electronic parts).⁶⁵ Investments in the finance, information, and services sectors accounted for another 31% of the total notified transactions. However, the committee is ostensibly structured to be equally applicable across industries. Future reformers might consider specializing CFIUS in such a way as to be capable of operating across sectors but more knowledgeable about those few which will make up the vast majority of its work.

Finally, CFIUS might be more effectively structured for its interaction with the companies and investors that it investigates. Much of the committee’s work with them (e.g., informal discussions, creation of mitigation plans) was not envisioned when the statute was drafted. Mitigation agreements can include steps like ensuring only authorized persons have access to technology, establishing a Corporate Security Committee, establishing governance structures, particularly if investors must give up Board seats or other decision-making authority during the course of the investigation, or other security protocols. These agreements, despite their broad nature, often have little basis in statute and have not been tested in court.

⁶⁵ Jackson.

Therefore, going forward, it would be helpful both for private investors and the committee to better understand the bounds of these mitigation agreements and the potential actions that can be included within them. Such reforms might also help to mitigate past criticism that CFIUS's process can feel like a black box subject to politicization.

Ultimately, these areas represent some potential reforms that could enable CFIUS to function more effectively, but the real work for a future administration will be in determining their ideological stance on weighing national security concerns against broader economic interests. The committee should then be structured to support this consensus.

4. Developing Data Privacy Regulation

Angela Winegar

Issue Overview

Large data breaches at Equifax, CapitalOne, Facebook, and a host of other companies have ignited a policy debate about data privacy and security. These incidents highlight the significant risk to consumers of allowing online social media providers, data brokers, and others to collect their personal data. First, consumers may not have given proper consent for personal data to be collected, signing complex terms and conditions of free services without a thorough understanding of their contents. Second, consumers may know their data is being collected, but the data may be stored in a way that is sub-optimal and susceptible to hacks by bad actors, as in the case of the Equifax breach. Third, as the Cambridge Analytica scandal illustrated, companies may intentionally use consumer data in inappropriate ways, in this case to influence votes in the 2016 election.

While consumer data protections have already been proposed or enacted in China and the European Union, and various U.S. states have proposed their own versions, U.S. policymakers have yet to outline a national data privacy policy. In addition to the benefits of consumer protection, these policies must weigh a number of risks. First, regulation should consider how data privacy policy will impact tech business models, and thus impact access to services and cost to consumers. Facebook, Google, LinkedIn and other tech giants offer free services to consumers because of their ability to profit from targeted advertising. Eliminating this opportunity could threaten the free nature of many products and services, disadvantaging the lowest income consumers, as well as potentially harm innovation by smaller tech players.

Second, data privacy regulation will have direct impacts on the development of the U.S. tech industry, and particularly the artificial intelligence (AI) sector. Many AI and ML solutions require consumer data to train the

algorithm, and how a data privacy policy mandates data collection, usage, and storage of this consumer data will have massive implications for the industry. Thus, the specifics of any national consumer data regulation must balance consumer protection while still encouraging key types of technological innovation.⁶⁶

Background

While the U.S. has yet to develop a national consumer data privacy policy, similar policies have been proposed or adopted by foreign jurisdictions, notably the E.U.'s General Data Protection Regulation (GDPR); by U.S. states, notably the California Consumer Privacy Act (CCPA); and within specific economic sector like the Health Insurance Portability and Accountability Act (HIPAA) and the Family Educational Rights and Privacy Act (FERPA).

GDPR was passed in the E.U. in 2016 and went into effect in 2018. It is applicable to any company processing the personal data of individuals residing in the E.U., regardless of the company's physical location. GDPR enables the E.U. to fine companies the greater of €20 million or up to 4% of annual global revenue should the company not meet GDPR's robust data standards. GDPR also includes a number of consumer-friendly stipulations, including: no longer allowing companies to use long, indiscernible terms and conditions; requiring users to give consent before their data can be used by advertisers (effectively pursuing an opt-in model); requiring ease for withdrawal of that consent; requiring mandatory breach notifications; protecting the right of consumers to access their data in a commonly used, machine-readable format with understanding of why it is being processed; and mandating the right to delete data (the right to be forgotten), among others.⁶⁷

⁶⁶ It is worth noting that while interrelated, data privacy policy differs from several other tech policies that have been proposed, including those that address concerns about uncompetitive behavior and algorithmic biases. For example, in June 2019 Senators Cory Booker (D-NJ) and Ron Wyden (D-OR) proposed the Algorithmic Accountability Act of 2019 ("Act"), with Rep. Yvette Clarke (D-NY) sponsoring an equivalent bill in the House. Though both of these are enabled by data collection and would no doubt be impacted by a data privacy policy, they are inherently separate policy issues.

⁶⁷ GDPR, <https://gdpr-info.eu/>

Just one month after GDPR went into effect, the California State Legislature, led by Governor Jerry Brown, signed the California Consumer Privacy Act (CCPA), which went into effect on January 1, 2020. CCPA is similar to GDPR for California residents, with a few key distinctions. It only applies to certain companies, based on revenue, data type, and how revenue is generated, and has a broader definition of “personal information”, extending to households what GDPR classifies as individual-only. CCPA also includes: the right for consumers to know what personal information a business has collected, where it was sourced from, and what it is being used for; the right to opt out of allowing a business to sell their personal information to third parties; the right to delete personal data used by companies; and the right to receive equal service and pricing from a business.⁶⁸

Following passage of the CCPA, Vermont passed its own data privacy legislation in December 2018, followed shortly by Maine and Nevada. Hawaii, North Dakota, New York, Texas, and others are currently considering similar measures. Big Tech companies have been lobbying the federal government for a national policy since the introduction of CCPA, to avoid implementing and managing adherence to fifty different policies.

Similar data protection policies have long been effective in specific sectors. In the healthcare sector, HIPAA outlines national standards for processing electronic healthcare transactions at the national level, as well as standards for how healthcare providers and insurers must treat confidential consumer data. Similarly, FERPA protects the privacy of student education records, by stipulating how schools and school districts must treat student data.

Currently, Congress is considering several bills to establish a federal data privacy policy. Bills range from those weaker in data privacy protection to proposals that are even stricter than CCPA, GDPR, and other similar policies. In the Senate, Marco Rubio has introduced the American Data Dissemination Act and Senator Marsha Blackburn has introduced the Balancing the Rights of Web Surfers Equally and Responsibly Act.

⁶⁸ California Senate, Senate Bill No. 1121, https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB1121

Both were meant to pre-empt the implementation of the CCPA and offer less stringent protections; both have stalled in committee. In the House, Representative Suzan DelBene's Information Transparency and Personal Data Control Act was also meant to pre-empt the implementation of CCPA while offering slightly more protections than the two Senate bills. On the stricter end, Senator Catherine Cortez Masto introduced the DATA Privacy Act which is very similar to CCPA and GDPR, while Senator Ed Markey's Privacy Bill of Rights Act goes even further in protecting consumer privacy and punishing violations by tech companies, including the provision that consumers are able to sue. To date, none of these bills look likely to pass, paving the way for a fragmented patchwork of state-level regulations.

Key Topics

Any national data privacy policy will need to weigh the tradeoffs between consumer protection and impacts to economic development, specifically the future of America's AI industry.

Consumer protection

From a consumer protection standpoint, a data privacy policy will need to address obvious concerns about consumer harm: for example, because Equifax didn't take the necessary precautions in storing consumer data, roughly half of all American's social security numbers were leaked. Similarly, the Cambridge Analytica scandal demonstrated how users' personal data could be used without their consent or knowledge for political advertising.

Perhaps less intuitively, data protection is also about reducing different forms of consumer bias, for example, preventing companies from deciding who sees a job advertisement based on race, religion, gender, income, or other factors, or colleges from collecting enough data to identify and admit the likely highest income earners to maximize their endowments. This is particularly relevant when consumer data is an input to machine learning algorithms, which is increasingly the case. A clear data privacy policy must

not only protect consumers from theft and misuse of their data, but also from discriminatory practices and biased algorithms.

U.S. competitiveness

Moreover, data privacy policy proposals must also consider impacts on the U.S. tech industry. For example, the introduction of GDPR necessitated changes to business models, particularly in the digital marketing sector.⁶⁹ Global advisory firm Ernst & Young estimated that Fortune 500 companies spent \$7.8 billion⁷⁰ simply to comply with GDPR before the law took effect, in addition to the ongoing costs of compliance. While larger firms may have the resources to comply with this, many small businesses have been unable to compete and simply ceased operations in Europe⁷¹. If the U.S. were to implement a similar policy, one potential risk is disproportionate impacts on small businesses that are unable to manage compliance costs, with the effect of reducing overall competition.

In addition, proposed data privacy policies must evaluate the impact on AI development in the United States. AI is expected to add over \$15 trillion to the world economy by 2030⁷², with gains anticipated to accrue disproportionately to leading U.S. firms. A data privacy policy that hampers data use in the AI sector could risk U.S. competitiveness, particularly relative to Chinese developers. Some recent studies find that the E.U.'s lack of competitiveness in the AI sector can be attributed, in part, to GDPR,^{73,74} specifically because AI development requires exceptionally large datasets. GDPR prohibits use of certain consumer data in these datasets, or requires

69 Ross Benes, "Five Charts: Yes, the GDPR Is Shaking Up Digital Marketing" <https://www.emarketer.com/content/five-charts-the-gdpr-is-shaking-up-digital-marketing>

70 Jeremy Kahn, Stephanie Bodoni, and Stefan Nicola, "It'll Cost Billions for Companies to Comply With Europe's New Data Law," <https://www.bloomberg.com/news/articles/2018-03-22/it-ll-cost-billions-for-companies-to-comply-with-europe-s-new-data-law>

71 Ivana Kottasová, "These Companies are Getting Killed By GDPR," <https://money.cnn.com/2018/05/11/technology/gdpr-tech-companies-losers/index.html>

72 Frank Holmes, "AI Will Add \$15 Trillion To The World Economy By 2030," <https://www.forbes.com/sites/greatspeculations/2019/02/25/ai-will-add-15-trillion-to-the-world-economy-by-2030/#3b49a5571852>

73 Daniel Castro, Michael McLaughlin, and Eline Chivot, "Who Is Winning the AI Race: China, the EU or the United States?" <https://www.datainnovation.org/2019/08/who-is-winning-the-ai-race-china-the-eu-or-the-united-states/>

74 Nick Wallace and Daniel Castro, "The Impact of the EU's New Data Protection Regulation on AI," <http://www2.datainnovation.org/2018-impact-gdpr-ai.pdf>

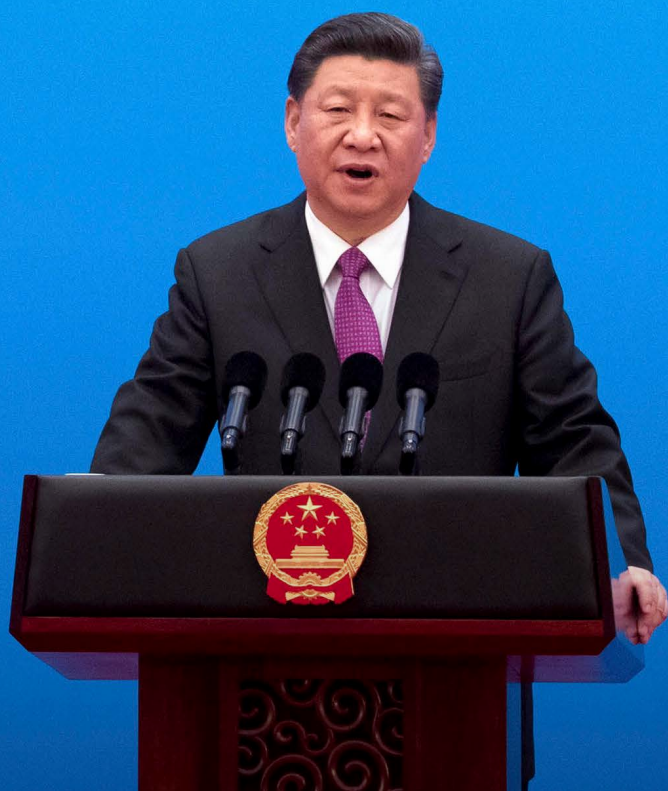
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4月25-27日 中国·北京

Chinese President Xi Jinping speaks during a press conference at the closing of the Belt and Road Forum at Yanqi Lake on the outskirts of Beijing, Saturday, April 27, 2019.

AP Photo/Mark Schiefelbein

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the structuring of it in a certain way (to allow for right to delete, etc.) limiting the ways in which private companies can leverage these datasets to create AI and machine-learning algorithms. By contrast, it is believed that China leads in the facial recognition field because of its large population and limited privacy requirements, allowing both government and private sector to leverage data, such as camera footage, to develop these algorithms.⁷⁵ As such, it is important to collaborate with the private sector and those developing AI-related products to ensure a data privacy policy does not hamper economic competitiveness in this space.

In conclusion, data privacy policies must carefully consider the long-term repercussions on consumer protection and economic competitiveness.

⁷⁵ Yuan Yang and Madhamita Murgia, "How China cornered the facial recognition surveillance market," <https://www.latimes.com/business/story/2019-12-09/china-facial-recognition-surveillance>

5. Protecting U.S. Dollar Dominance

John Michael Cassetta

Issue overview

Since the end of the Second World War, the U.S. has been the system operator of the international financial system. The world uses the U.S. dollar (USD) and dollar-backed assets as a de facto reserve currency, and the U.S. financial system is central to global commerce.

This position endows the U.S. with unique power and responsibility in at least three critical areas: (1) a position of leadership in the global coordination of economic policies, such as among G7/G20 nations, (2) the ability to sanction and therefore influence any state engaged in dollar-based global commerce, and (3) the paradoxical effect that, because USD securities such as U.S. government debt are “safe harbor” assets, the USD and U.S. government debt strengthen in global economic crises, even those originating at home.

A strong dollar, buoyed by global demand, also presents challenges. In supplying the world with sufficient dollar liquidity, the U.S. runs a large trade deficit: it imports goods and exports dollars. Because world demand for dollars is strong, the dollar is often overvalued relative to other currencies, inflating the cost of U.S. exports and harming American exporters (although some argue a weaker dollar could indirectly do greater harm to the U.S. economy by slowing the global economy). Foreign countries and companies reinvest dollar savings earned from exports to the U.S. back into the U.S. economy. China alone holds 4.6% of U.S. government debt, for example, and accounts for 15.7% of foreign holdings of U.S. government debt.⁷⁶

76 U.S. Department of the Treasury, “Major Foreign Holders of Treasury Securities,” March 16, 2020, <https://ticdata.treasury.gov/Publish/mfh.txt>; U.S. Department of the Treasury, “U.S. Treasury Securities Held by Foreign Residents,” January 1, 2020, <https://ticdata.treasury.gov/Publish/slt3d.txt>

When put to productive use, this “easy credit” allows the U.S. to finance spending cheaper than other countries; when put to unproductive use, this credit can fuel bubbles such as in the subprime mortgage market that triggered the Great Financial Crisis. Cognizant of the power the dollar-based system gives the U.S. over their economies, China and Russia, but also the E.U., are exploring alternative non-dollar systems, though with limited success to date.

The current debates focus on the tension between the U.S. using its advantage to prioritize unilateral aims. This tension plays out in three major policy areas:

1. How aggressively should the U.S. use secondary sanctions to achieve foreign policy goals, and should it do so unilaterally?
2. How seriously should the U.S. be concerned about attempts by other states to create non-dollar systems? How should it respond?
3. Should the U.S. devalue the dollar to support exporters and American jobs, or will a weaker dollar harm the global economy in a way that ultimately harms the U.S.?

Background

America emerged from WWII as the leader of the international economic system. In what came to be known as the Bretton Woods system, the victorious nations agreed to fix world currencies to the U.S. dollar, which would be backed by and redeemable in gold at \$35 per ounce (i.e., the gold standard).⁷⁷

While in the 1950s and early 1960s the U.S. became a major exporter to foreign countries, especially Europe flush with aid from the Marshall Plan, by the late 60s the trend reversed as war-ravaged economies grew and began exporting to the U.S. The U.S. ran a trade deficit, importing goods and exporting dollars to the world. To finance government expenditures,

⁷⁷ The Economist, “What was decided at the Bretton Woods summit,” July 1, 2014, <https://www.economist.com/the-economist-explains/2014/06/30/what-was-decided-at-the-bretton-woods-summit>.

especially the Vietnam War and President Johnson's Great Society programs, the U.S. increased the supply of dollars. As a result, the global supply of dollars (claims on U.S. gold deposits) held by foreigners grew beyond the gold reserves of the U.S.⁷⁸

Then, two developments shaped the modern monetary system. In August 1971, in the face of downward market pressure on an overvalued dollar and threats from foreign countries to redeem their dollars for gold, President Nixon took the U.S. off the gold standard. Despite attempts to set new fixed exchange rates, notably in the 1971 Smithsonian Agreement, market pressure forced another dollar devaluation. G-10 countries agreed to allow European Community currencies to float against the dollar, and eventually most world currencies, rather than being fixed to the dollar, would float with market forces.⁷⁹

Second, a wave of "balance of payment crises" swept the developing world in the 1980s and 90s, convincing central banks to hold significantly more dollars reserves. The Asian Financial Crisis of 1997-8, for example, occurred when Asian countries who had pegged their currencies to the dollar and borrowed heavily from foreign creditors faced sharply rising borrowing rates as creditors grew doubtful about their ability to repay. Lacking a stockpile of dollars to defend their currencies, countries such as Thailand devalued their currencies, stifling imports and domestic growth, while spreading a global economic contagion.⁸⁰

Today, the dollar represents 88% of global currency transactions.⁸¹ Much of world trade is conducted in USD, particularly trade in commodities such as oil, even by adversaries of the U.S. To guard against such crises, many central banks now hold significantly greater foreign exchange holdings,

78 International Monetary Fund, "The end of the Bretton Woods System (1972–81)," <https://www.imf.org/external/about/histend.htm>.

79 U.S. Department of State, "Nixon and the End of the Bretton Woods System, 1971–1973," <https://history.state.gov/milestones/1969-1976/nixon-shock>; Elwell, Craig K., Congressional Research Service, "Brief History of the Gold Standard in the United States," June 23, 2011, <https://fas.org/sgp/crs/misc/R41887.pdf>.

80 Michael Carson and John Clark, Federal Reserve Bank of New York, "Asian Financial Crisis," November 22, 2013, https://www.federalreservehistory.org/essays/asian_financial_crisis.

81 Bank for International Settlements, "Triennial Central Bank Survey: Global foreign exchange market turnover in 2019," December 8 2019, https://www.bis.org/statistics/rpfx19_fx_annex.pdf.

62% of which are in dollars (Figure 1).⁸² To earn interest on their dollars, foreigners invest dollars in dollar assets, primarily U.S. Treasury bonds: 39% of U.S. government debt held by the public is held by foreigners, including China which holds 4.6%, or over \$1 trillion. (See Figure 2.)⁸³

Three major factors prop up the dollar's popularity. First, the dollar is the preeminent medium of exchange. World trade is settled in dollars largely because the dollar is a liquid asset everyone can agree everyone else wants. As balance of payment crises are ultimately about trade, central banks hold dollar assets to prop up their currencies and service their dollar-denominated sovereign debt in times of crisis.

Second, the dollar is a store of value. Other countries are confident that U.S. institutions will set prudent policies (such as the Federal Reserve Bank which controls value-eroding inflation). Central banks store dollars and dollar assets because of their prominence as a medium of exchange, but also because they believe the dollar will hold its value over time. Both factors rely, however, on the choices of other nations: were other countries to doubt the dollar's strength or its acceptability to other countries, they might abandon it for alternative currencies.

Third, structural features of the system make it difficult to divest dollar assets. No other currency market is as liquid or as large ("deep") as the dollar markets. The market for U.S. government debt markets is nearly twice as large as the second biggest, Japan's. (See Figure 3.) Were large countries such as China to divest their dollar holdings, they'd struggle to find alternative assets in which to park their value. Similarly, many countries and firms frequently turn to dollar markets to issue debt rather than their own currencies, increasing the supply of dollar-denominated debt for those who hold dollars to invest in.

82 International Monetary Fund, "Currency Composition of Official Foreign Exchange Reserves (COFER)," October 1, 2019, <https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09E-C4E62A4>

83 U.S. Department of the Treasury, "Major Foreign Holders of Treasury Securities," March 16, 2020, <https://ticdata.treasury.gov/Publish/mfh.txt>; U.S. Department of the Treasury, "U.S. Treasury Securities Held by Foreign Residents," January 1, 2020, <https://ticdata.treasury.gov/Publish/slt3d.txt>

Nations, firms and individuals who use dollars must inevitably interact with the U.S. financial system, making U.S. banks and institutions central to the plumbing of international finance. U.S. policies that affect the domestic financial system therefore ultimately affect the global financial system. Dollar holders, searching for investments to earn interest on their dollars, also increase the demand for dollar-denominated assets such as bonds. The increase in savings as populations age and prepare for retirement through personal investments or pension funds (the “global savings glut”) has increased this demand. At best, this demand makes it cheaper and easier for the U.S. government, firms and individuals to borrow money. At worst, it can fuel asset bubbles, such as the subprime mortgage bubble that precipitated the global financial crisis. Nonetheless, the prominence of the dollar in the global economy endows the U.S. with a leadership role in shaping global economic policy.

Key Topics

Secondary sanctions

Primary sanctions prohibit U.S. entities from transacting with foreign third-parties, such as those in Iran or North Korea. Secondary sanctions threaten entities, such as banks, with being cut off from the U.S. financial system if they transact with parties under primary sanctions. For entities such as banks or multinational corporations, losing access to the U.S. financial system is a death sentence. Secondary sanctions are therefore a powerful tool to compel non-U.S. entities to cease economic activity with adversaries of the U.S.

In 2017, for example, the Treasury’s Financial Crimes Enforcement Network (FinCEN) sanctioned the Chinese Bank of Dandong, which laundered money for North Korea. As a result, Bank of Dandong could no longer facilitate transactions for its clients in the United States.⁸⁴ Leading

⁸⁴ U.S. Department of the Treasury, “FinCEN Further Restricts North Korea’s Access to the U.S. Financial System and Warns U.S. Financial Institutions of North Korean Schemes,” November 2, 2017, <https://www.treasury.gov/press-center/press-releases/Pages/sm0205.aspx>.

up to the Joint Comprehensive Plan of Action (JCPOA), the U.S. in coordination with other nations put financial sanctions in place against Iran. As a result of congressional legislation passed in 2012 authorizing the president to sanction SWIFT—the Belgian-based system nearly all banks use to transact with each other across borders—for providing services to Iranian banks, the service severed ties with Iran’s financial sector.⁸⁵ Following the U.S.’s unilateral withdrawal from the JCPOA, U.S. financial sanctions have prevented European banks, which rely on access to the U.S. dollar system, from transacting with Iranian entities, to the ire of European politicians.

One perspective holds that the U.S. should use these tools aggressively. The Obama administration considered broadening its sanctions against Chinese companies that transacted with North Korea. In spite of European resistance, SWIFT again ejected Iranian banks from its network following pressure from the Trump administration.⁸⁶ And the Trump administration has since formally withdrawn waivers that allowed Chinese oil companies to continue transacting with Iran, causing China to reduce its purchases of Iranian oil.⁸⁷

The opposing perspective holds that aggressive use of secondary sanctions without multilateral support encourages other countries, particularly allies, to find alternatives to the dollar. Europe in particular is searching for alternatives: politicians call for an end to the dollar’s dominance and have established Instrument in Support of Trade Exchanges (“INSTEX”) to facilitate marginal trade in humanitarian goods with Iran without transacting in dollars.⁸⁸ Furthermore, critics argue that were the U.S. to impose secondary sanctions on a systemically important institution—for example, central banks or multinational banks in Europe or China, or global payments infrastructure such as SWIFT—it would cause a global financial crisis.

85 Rick Gladstone and Stephen Castle, *The New York Times*, “Global Network Expels as Many as 30 of Iran’s Banks in Move to Isolate Its Economy,” March 15, 2012.

86 Peel, Michael. *The Financial Times*, “Swift to comply with U.S. sanctions on Iran in blow to E.U.,” November 5, 2018,” <https://www.ft.com/content/8f16f8aa-e104-11e8-8e70-5e22a430c1ad>

87 Schott, Jeffrey, Peterson Institute for International Economics, “Will Trump Throw Oil Sanctions on the Fire of US-China Relations?,” September 23, 2019, <https://www.piie.com/blogs/realtime-economic-issues-watch/will-trump-throw-oil-sanctions-fire-us-china-relations>.

88 Andrew England, Najmeh Bozorgmehr & Michael Peel, *The Financial Times*, “European nations prepare to launch delayed Iran payments channel,” June 27, 2019, <https://www.ft.com/content/14a-3c2ea-98ee-11e9-8cfb-30c211dcd229>.

Threat of Alternative Currencies

While the dollar is still the most used currency by a wide margin, it is losing ground. Central banks have been slowly decreasing their dollar holdings. And Europe, Russia and China have made prominent attempts to create alternatives to dollar payment systems.⁸⁹ China, perceiving its need to use dollars to purchase oil (nearly all of which it imports) as a strategic weakness, has engaged in “barter” transactions in commodities (mainly oil) rather than dollars. It has also extended as much as \$50 billion of official loans to Venezuela that are guaranteed by or expected to be paid in oil rather than dollars.⁹⁰

To date, however, efforts to replace the dollar on a wide scale have not been successful. In 2018, China and Russia committed to developing the capability to settle their bilateral trade in rubles and yuan. Yet only 10-12% of bilateral trade between the two countries, which increased by 25% y/y in 2018, was settled in yuan or rubles.⁹¹ Middle East countries, many of which peg their currencies to the dollar, prefer global oil trade to be conducted in dollars.⁹² Although nine European nations now participate in INSTEX, it has largely been ineffective, and European banks and multinationals remain wary of doing business with Iran for fear of U.S. sanctions.⁹³ The yuan remains, at 2.0%, the fifth most held currency by central banks. Analysts argue that China’s tight controls on cross-border currency flows and its long policy of running a trade surplus prevent the yuan from being a sufficiently global and liquid market to serve as a reserve currency. China similarly lacks political transparency relative to the issuers of other major global currencies.

Many policymakers and observers agree that the U.S. draws important benefits from the dollar as a reserve currency. However, they disagree on the extent

89 Henry Foy, Demetri Sevastopulo, *The Financial Times*, “Kremlin throws weight behind EU effort to boost Iran trade,” July 18, 2019. <https://www.ft.com/content/3aa3e7ee-a8b7-11e9-984c-fa-c8325aaa04>.

90 Page, Jeremy, *The Wall Street Journal*, “China Counts the Costs of Its Big Bet on Venezuela,” Feb 1, 2019. <https://www.wsj.com/articles/china-counts-the-costs-of-its-big-bet-on-venezuela-11549038825>.

91 Ma, Josephine, *South China Morning Post*, “Russia, China keen to increase use of yuan, rouble in trade settlement, ambassador Andrey Denisov says,” April 20, 2019. <https://www.scmp.com/news/china/diplomacy/article/3006988/russia-china-keen-increase-use-yuan-rouble-trade-settlement>.

92 David Dollar, Samantha Gross, *Brooking Institute*, “China’s currency displacing the dollar in global oil trade? Don’t count on it,” April 19, 2018. <https://www.brookings.edu/blog/order-from-chaos/2018/04/19/chinas-currency-displacing-the-dollar-in-global-oil-trade-dont-count-on-it/>.

93 Deutsche Welle, “EU-Iran Instex trade channel remains pipe dream,” January 31, 2020. <https://www.dw.com/en/eu-iran-instex-trade-channel-remains-pipe-dream/a-52168576>.

to which the U.S. can use that advantage to its benefit at the expense of other nations before the other nations conspire to develop credible alternatives.

On one hand, some argue that failed efforts by foreign countries to develop dollar alternatives prove the U.S. should not be concerned. Small declines in dollar holdings by central banks are still a long way from threatening the dollar's dominance. On the other hand, transitions between reserve currencies have historically been a slow process. The British Pound, for example, was replaced by the dollar over the course of decades, and did not fully cease to be a reserve currency until long after the American economy had overtaken the British economy. Although China's new yuan settlement scheme, the Cross-border Interbank Payments System (CIPS), handled less transactions in all of 2018 than SWIFT handles in a day, China's attempts to onboard other countries to its global non-dollar payment systems should be taken seriously,⁹⁴ as should efforts by other countries to weaken the dollar's standing regardless of their limited initial success. Policymakers should work to build multilateral consensus before deploying tools such as secondary sanctions, as the Obama administration did in the run-up to the signing of the JCPOA with Iran.

Balancing Domestic and Global Priorities in Trade Policy

Recently, the most nuanced debate over how the U.S. should use the advantage of the U.S. dollar and its centrality in the global economic system has focused on trade. By running a trade deficit—importing goods and exporting dollars—the U.S. supplies the world with the dollar liquidity required of a reserve currency. However, the deficit represents potential losses for American firms and workers.

One argument holds that the U.S. should devalue the dollar to improve its trade position. A cheaper dollar would make exports more competitive, boosting the profit of U.S. exporters and leading to more jobs at home. China, proponents of this view point out, in 2019 allowed its currency to weaken below 7 RMB-per-dollar for the first time since 2010 to offset the

94 The Economist, "America's aggressive use of sanctions endangers the dollar's reign," January 18, 2020. <https://www.economist.com/briefing/2020/01/18/americas-aggressive-use-of-sanctions-endangers-the-dollars-reign>.

effects of tariffs.⁹⁵ By objective metrics the dollar has been overvalued in recent years.⁹⁶ Therefore, proponents of this view argue, the U.S. should either devalue the dollar unilaterally (with Treasury intervening in currency markets) or through agreements with other economic powers to jointly devalue (as in the 1985 Plaza Accords amongst the G5).

Opponents of this view argue it will harm the U.S. for at least three reasons. First, a devalued dollar would have wide-spread negative effects on the global economy which would ultimately harm the U.S. Central banks would see the value of their currency reserves decline. Governments may tighten policy in response, leading to a worldwide slowdown in GDP, decreasing demand for U.S. exports and harming U.S. industry and workers.

Second, because currency reserves at central banks would be less valuable, their ability to fight balance of payment crises by defending their own currencies would be diminished (i.e., by selling dollars and buying their currency). If their “financial firepower” were to fail, countries would be more likely to turn to the IMF (which is funded in part by the U.S.) for support, or rely on alternatives, such as direct lending from China, that risks eroding American relationships with those countries.

Third, opponents argue that other countries would be inclined to devalue their own currencies in response, offsetting the benefits of a cheaper dollar. Currency wars, where all nations devalue their currencies and make each worse off, could lead to global economic turmoil.

Ultimately, these factors would hasten the erosion of the dollar as a reserve currency and deprive the U.S. of the advantages afforded it. U.S. policies should therefore consider the needs of global constituents who use the dollar to ensure it remains a reserve currency. Furthermore, the U.S. could use its advantages to benefit domestic constituents in other ways, for example by channel demand for dollar-denominated bonds (which lowers interest rates) into productive uses such as infrastructure investment.

95 Joanne Chiu, Steven Russolillo, the Wall Street Journal, “China’s Yuan Breaches Critical Level of 7 to the Dollar, Prompting Trump Critique,” August 5, 2019. <https://www.wsj.com/articles/chinas-yuan-falls-past-key-level-of-7-to-the-dollar-11564977948>.

96 Morgan Stanley, “Is the Mighty Dollar Losing Its Smile?,” May 3, 2019. <https://www.morganstanley.com/ideas/us-dollar-weakness-2019>.

Figure 1: Percent of reported central bank FOREX holdings by currency as of Q3 2019 (Source: IMF)

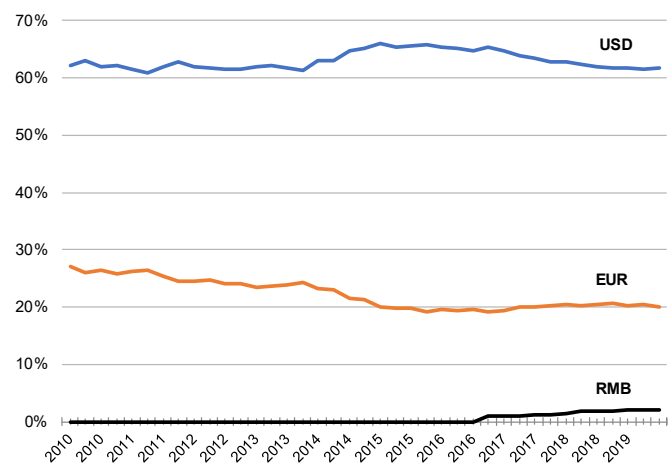


Figure 2: Percent of U.S. Government debt held by foreigners, as of Jan. 2020 (Source: U.S. Treasury)

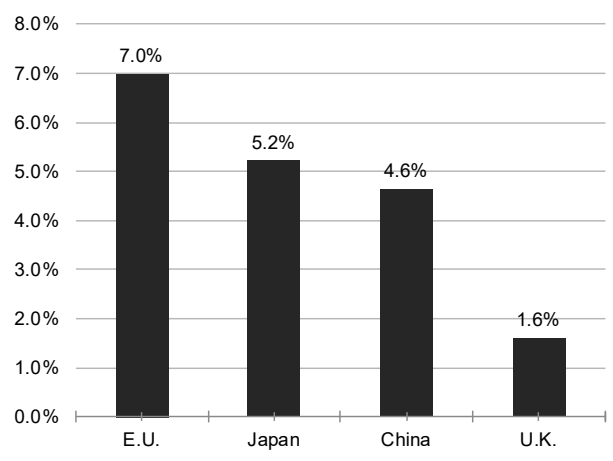
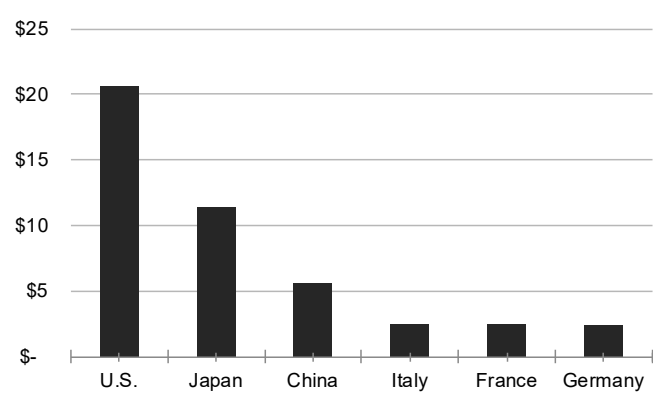


Figure 3: Total sovereign debt outstanding by country as of 2017, \$trillion (Source: IMF)



6. Reforming the WTO

Aaron Huang

Issue Overview

The perceived unfair trade practices that the People's Republic of China (PRC) has engaged in over decades and the recent aggressive tactics the United States has used on eliminating its trade deficits have reignited the discussion on reforming the World Trade Organization (WTO). The WTO requires reform in the areas of state-owned enterprises (SOEs), forced technology transfers, subsidies, intellectual property (IP), transparency and reporting, and special treatment for developing countries. The PRC disagrees with the West (namely, the United States, the European Union, and Japan) on these issues, and it has put forth its own proposal for what the future WTO should look like, that is, a WTO that protects developing countries.

Beijing is finding few allies in the developed world for its plan, however, as developed countries seek to (1) end China's perceived systematic cheating of global trade norms and (2) strip China of its "developing country" status at the WTO. Summarized by Peter Navarro, the White House Office of Trade and Manufacturing Policy Director, the sentiment and resolve to achieve these two goals are strong: "As soon as one bad actor like China massively cheats, they win at the expense of us; they win at the expense of Europe, and over time, it threatens the entire integrity of the global financial system and the global trading system."⁹⁷

⁹⁷ Solman, Paul, "What is the Trump trade doctrine? His economic adviser explains," *PBS*, August 25, 2016, <https://www.pbs.org/newshour/economy/trump-trade-doctrine-economic-adviser-explains>.

Background

Founded over 25 years ago in 1995, the World Trade Organization (WTO) is an international organization with the purpose of “open trade for the benefit of all.”⁹⁸ It was designed to serve four principal functions: operate a global system of trade rules; act as a forum for negotiating trade agreements; settle trade disputes between its members; and support the needs of developing countries.

Since its inception, the WTO has been successful in reducing trade barriers in both goods and services among its member states.⁹⁹ However, the organization is now in dire need of reform to address an evolving set of issues and areas of potential dispute. (See table on next page.)¹⁰⁰

The WTO Appellate Body’s inability to discipline China’s SOEs is an example of how WTO rules must be updated in order to address modern global trade disputes.¹⁰¹ However, many of the structural reforms the WTO needs require unanimous consensus, and Beijing disagrees with developed countries on the issues of government subsidies, SOE discipline, competition neutrality, technology transfer, and IP protection.¹⁰² China, resolved to preserve its state-capitalist economic system, is standing against the West’s liberalization proposals and offering its own vision for the WTO to compete against the United States in determining the future of trade norms.^{103, 104}

98 “The WTO,” *WTO*, https://www.wto.org/english/thewto_e/thewto_e.htm.

99 McBride, James, “What’s Next for the WTO?,” *Council on Foreign Relations*, March 23, 2018, <https://www.cfr.org/background/whats-next-wto>.

100 Rashish, Peter S., “The United States, Germany, and WTO Reform: An Answer to the Rise of China?,” *AICGS*, March 28, 2019, <https://www.aicgs.org/2019/03/the-united-states-germany-and-wto-reform-an-answer-to-the-rise-of-china/>.

101 Rashish, “The United States, Germany, and WTO Reform: An Answer to the Rise of China?”

102 Singh, Antara Ghosal, “China’s Evolving Strategy for WTO Reforms,” July 31, 2019, <https://thediplomat.com/2019/07/chinas-evolving-strategy-for-wto-reforms/>.

103 Singh, Antara Ghosal, “What Does China Want From WTO Reforms,” *The Diplomat*, May 21, 2019, <https://thediplomat.com/2019/05/what-does-china-want-from-wto-reforms/>.

104 Miles, Tom, “China says U.S. policies are causing existential damage to the WTO,” *Reuters*, May 13, 2019, <https://www.reuters.com/article/us-usa-trade-wto-china/china-says-u-s-policies-are-causing-existential-damage-to-the-wto-idUSKCN1SJI1QI>.

Issue	Description
State-owned enterprises (SOEs)	Government-funded national champions, through subsidies, have flooded global markets and unfairly driven out businesses around the world, and the current WTO can do little to identify these murky subsidies and enforce its SOE reporting regulations on violating countries. ¹⁰⁵
Forced technology transfers	For years, Beijing has illegally forced foreign firms that wish to do business in China to reveal and share their proprietary technologies, and the present WTO takes over years to settle a dispute of this kind between countries. ¹⁰⁶
Subsidies	Countries are arguing that the WTO's anti-subsidy rules do not take into account the many ways that China supports its industries and SOEs and that other WTO countries have a poor track record of complying with the Organization's subsidy notification requirements. ¹⁰⁷
Intellectual property (IP)	Critics, such as the United States, are accusing the WTO of failing to enforce IP rules and effectively impose WTO countries' "affirmative obligation" to protect IP rights. ¹⁰⁸
Transparency and reporting	Many WTO members are not meeting their obligations to submit information about their trade regimes, and the WTO at the moment does not punish these countries for failing to be transparent. ¹⁰⁹
Special and differential treatment (S&DT)	The WTO gives developing countries special rights, including "longer time periods for implementing agreements and commitments, measures to increase trading opportunities for these countries, provisions requiring all WTO members to safeguard the trade interests of developing countries, and support to help developing countries build the infrastructure to undertake WTO work, handle disputes, and implement technical standards." ¹¹⁰ However, countries that have since flourished, such as China and Singapore, still hold on to the "developing country" status to continue to benefit from these special treatments. ¹¹¹

105 Katz, Sherman, "Why the WTO Should Constrain the Power of China's State-Owned Enterprises," *Harvard Business Review*, December 11, 2017, <https://hbr.org/2017/12/why-the-wto-should-constrain-the-power-of-chinas-state-owned-enterprises>.

106 Miles, Tom, "U.S. and China clash over 'technology transfer' at WTO," *Reuters*, May 28, 2018, <https://www.reuters.com/article/us-usa-trade-china/u-s-and-china-clash-over-technology-transfer-at-wto-idUSKCN1IT11G>.

107 Ljunggren, David, and David Lawder, "WTO member group vows to reform rules on subsidies, dispute settlement," *Reuters*, October 25, 2018, <https://www.reuters.com/article/us-usa-trade-wto-canada/wto-member-group-vows-to-reform-rules-on-subsidies-dispute-settlement-idUSKCN1MZ2CL>.

108 Tran, Hung, "The WTO may be beyond saving," *Atlantic Council*, March 27, 2019, <https://www.atlanticcouncil.org/blogs/new-atlanticist/the-wto-may-be-beyond-saving/>.

109 Tran, Hung, "The WTO may be beyond saving."

110 "Special and differential treatment," *World Trade Organization*, https://www.wto.org/english/tra-top_e/dda_e/status_e/sdt_e.htm.

111 Embury-Dennis, Tom, "China refuses to give up 'developing country' status at WTO, despite Trump administration pressure," *Independent*, April 10, 2019, <https://www.independent.co.uk/news/world/asia/china-wto-developing-nation-country-trump-administration-trade-war-tariffs-a8863746.html>.

Key Topics

China's WTO Reform Priorities and Strategies

On May 13, 2019, Beijing formally submitted its WTO reform proposal.¹¹² In it, China outlines three fundamental principles that the WTO should follow: 1) uphold the organization's core values of nondiscrimination and opening, 2) protect development interests of developing members and address their difficulties in integrating into economic globalization, and 3) follow the mechanism of decision making by consensus.¹¹³ Flowing from these principles come four of Beijing's WTO priorities:^{114 115}

1. **Tackle the essential and pressing issues threatening the organization's existence:** China wants to change WTO rules so that countries, such as the United States, can no longer, without punishment, block the appointment of Appellate Body members (those who settle disputes), erect trade barriers using the national security exception as a pretext, and impose unilateral measures inconsistent with WTO rules, such as secondary sanctions.
2. **Increase WTO relevance in international economic governance:** Beijing seeks to reform what it sees as agricultural rules that disadvantage developing countries and trade remedy guidelines that discriminate against enterprises with public interests (i.e. SOEs). It also aims for the WTO to establish e-commerce rules, particularly ones that protect internet sovereignty.
3. **Improve the organization's operating efficiency:** China wants
 - i) developed members to better comply with notification (of each country's trade actions and environment) obligations, ii)

112 "China's Proposal on WTO Reform," *World Trade Organization*, May 13, 2019, https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=254127&CurrentCatalogueIdIndex=0&FullTextHash=371857150&HasEnglishRecord=True&HasFrenchRecord=False&HasSpanishRecord=False.

113 Chengcheng, "China supports necessary WTO reforms: MOFCOM," *Xinhua News*, November 23, 2018, http://www.xinhuanet.com/english/2018-11/23/c_137627374.htm.

114 "China submits WTO reform proposal, identifying 4 priorities," *Xinhua News*, May 14, 2019, http://www.xinhuanet.com/english/2019-05/14/c_138058140.htm.

115 "China's Proposal on WTO Reform."

developing members to receive technical assistance to “endeavour to improve” their notification compliance, and iii) more representation of developing members in WTO subsidiary bodies.

4. **Increase the multilateral trade mechanism’s inclusiveness:** China is asking developed members to respect developing members’ “developing country” status and give them the full S&DT entitled to them under WTO rules. Moreover, Beijing demands that countries halt their discriminatory practices against SOEs, that they be treated as any other enterprise, and that they not be labelled as ‘public bodies.’

In short, the PRC argues that its proposal is needed now to counter the “rising unilateralist and protectionist practices,” suggesting that the United States is the reason the WTO is in an “existential crisis.”¹¹⁶

To implement its priorities, China is pursuing the following strategy: First, it wants to resolve “easy” problems with WTO members and put aside difficult disagreements on principles.¹¹⁷ These easy issues include transparency, routine work, fishery subsidies, e-commerce, and investment facilitation. Second, Beijing seeks to explore where it could be flexible in the reforms. For example, China has said that it may be willing to eliminate its trade distortions and subsidies more quickly.¹¹⁸ Both the first and second components help serve the third component: coalition building within the WTO.¹¹⁹ Beijing has been aiming to unite countries on the development agenda by working with India, Malaysia, and other less-developed countries on joint research and positioning within the WTO. China has also been communicating with the E.U. on WTO reforms, hoping that Brussels could be a conduit between Beijing and Washington. By working with both developed and developing countries, China aims to establish itself as a bridge between the two worlds, thereby making itself the key player and decision maker in the WTO reform process.

116 Zhong, Nan, and Xiao-jin Ren, “China submits proposal for WTO reform,” *China Daily*, May 15, 2019, <http://www.chinadaily.com.cn/a/201905/15/WS5cdb46b5a3104842260bb9a0.html>.

117 Singh, “China’s Evolving Strategy for WTO Reforms.”

118 Singh, “China’s Evolving Strategy for WTO Reforms.”

119 Singh, “China’s Evolving Strategy for WTO Reforms.”

The West is United Against Unfair Chinese Practices at the WTO

However, because of the state subsidies issue, the E.U. is more aligned with the United States and Japan than China, a grouping that is of special concern to Beijing.¹²⁰ Both the E.U. and Japan agree more with America's view that (1) China has a non-market economy, (2) China's economic system is not compatible with the WTO, and (3) China is no longer a developing country and thus not entitled to the WTO's S&DT.¹²¹ The three parties have formed a "united front" of sorts on reforming the WTO in order to systematically stop China (and other countries) from dumping products, forcing technology transfers, stealing IP, subsidizing industries, and advantaging SOEs.¹²²¹²³ Just last year, then E.U. Commissioner for Trade Cecilia Malmstrom declared that "the E.U. is focused on how we can find a way to make sure that China [increasingly] plays by the rules."¹²⁴

China is Unwilling to Give Up its "Developing Country" Status

Beijing counters, though, by claiming that it is still a developing country and deserves the S&DT within the WTO framework. China finds it unfair and unreasonable that these developed countries are attempting to force it to trade without tariffs, market barriers, and subsidies (also known as "three zero trade").¹²⁵ Beijing has conceded only by suggesting that in the potential WTO S&DT reform, it could have an open mind toward equivalence and reciprocity on certain matters and "make trade-offs based on its own level of development."¹²⁶ Yet many countries (e.g. E.U. states) and international organizations already do not recognize China as a developing

120 Elmer, Keegan, "China looks to Europe on WTO reform as pressure builds from 'united front,'" *South China Morning Post*, September 28, 2018, <https://www.scmp.com/news/china/diplomacy/article/2166244/china-looks-europe-wto-reform-pressure-builds-united-front>.

121 Singh, "What Does China Want From WTO Reforms."

122 Wemer, David A., "Europe ready to help with WTO reform," *The Atlantic Council*, January 10, 2019, <https://www.atlanticcouncil.org/blogs/new-atlanticist/europe-ready-to-help-with-wto-reform/>.

123 Elmer, "China looks to Europe on WTO reform as pressure builds from 'united front.'"

124 Wemer, "Europe ready to help with WTO reform."

125 Singh, "What Does China Want From WTO Reforms."

126 Singh, "China's Evolving Strategy for WTO Reforms."

country. Tokyo is asking the Asian Development Bank to reduce the low-interest loans it provides to Beijing, while the World Bank President David Malpass is indicating that the Bank will decrease its lending to China given its “robust capital markets.”¹²⁷

A Way Forward

Moving forward, to stop China’s WTO violations and strip it of its “developing country” status, the United States can pursue two strategies. One, it could promise developing countries new WTO trade benefits conditioned on their support to pressure China off of its “developing country” status. In this way, the dispute would no longer be between developed and developing countries, but WTO members versus the isolated Beijing. Two, amid the deadlock in the WTO, Washington could cooperate with like-minded European and Asian partners and agree on a new rules treaty that is layered over the WTO system, one that addresses the six aforementioned problems with the WTO.¹²⁸ These countries would enjoy new trade benefits from each other and give China this choice: either change its behavior to join this new economic community or trade on less favorable terms with over half of the global economy.¹²⁹

127 Singh, “What Does China Want From WTO Reforms.”

128 Campbell, Kurt M., and Jake Sullivan, “Competition Without Catastrophe: How America Can Both Challenge and Coexist With China,” *Foreign Affairs*, October 2019, <https://www.foreignaffairs.com/articles/china/competition-with-china-without-catastrophe>.

129 Campbell, Sullivan, “Competition Without Catastrophe: How America Can Both Challenge and Coexist With China.”

7. Assessing China's ASEAN Strategy

Brian Mongeau

Issue Overview

Southeast Asia is the ground-zero test bed for China's economic diplomacy, easily reachable as China's "near abroad" and representing tremendous commercial opportunities. Xi Jinping has presented the goals of the People's Republic of China (PRC) as building trust and "good neighborliness" through "win-win cooperation." This in turn is intended to provide mutual benefit, through China's development, as part of a "common destiny" for the PRC and the region.^{130, 131} Conversely, the Trump Administration contends that Beijing seeks to overturn international laws, remake commercial norms, spread its influence via "predatory economics," and force states to choose between their own sovereignty or economic stability.^{132, 133} China's primary economic diplomacy strategies in the region are the Asian Infrastructure Investment Bank, the Digital Silk Road, and the Belt and Road Initiative.

Background

In 2008, China and the U.S. had comparable trade relationships with the Association of Southeast Asian Nations (ASEAN), with China-ASEAN two-way goods trade totalling \$196 billion, and U.S.-ASEAN trade totalling \$186 billion. Since then, Chinese exports to the region have grown by 133%, compared to a mere 11% increase in U.S. exports. Chinese imports

130 Xi Jinping. Speech to Indonesian Parliament. 02 October 2013. http://www.asean-china-center.org/english/2013-10/03/c_133062675.htm.

131 Stromseth, Jonathan. *The Testing Ground: China's Rising Influence in Southeast Asia and Regional Responses*. Brookings Institute. November 2019. 3.

132 U.S. Department of State. *A Free and Open Indo-Pacific: Advancing a Shared Vision*. 04 November 2019. 21-23.

133 U.S. Department of Defense. *Indo-Pacific Strategy Report: Preparedness, Partnerships, and Promoting a Networked Region*. 01 June 2019.

have grown by 64%, compared to a 39% increase in U.S. imports. In 2018, the overall value of ASEAN trade in goods with China stood at \$441 billion, compared to \$234 billion with the U.S. This makes China ASEAN's largest trading partner and the U.S. its third.¹³⁴

As China outpaces the U.S. in trade volume, Beijing's relative political influence in the region has also increased. In a recent survey of ASEAN business, government, and academic leaders, 73% of respondents reported China was the most economically influential state in the region, whereas only 8% selected the U.S.; 45% said China was the most politically and strategically influential in Southeast Asia, compared to 30% selecting the U.S.¹³⁵

Southeast Asia's strategic importance is in part due to its economic potential, bolstered by young populations, rapidly growing economies, and some of the most digitized societies in the world. Overall, ASEAN is expected to be the fourth-largest global economic bloc by 2030. This is partly due to ASEAN representing the most engaged population of mobile internet users in the world, evaluated by daily hours spent on the mobile internet. The number of mobile users has grown from 260 million to 360 million from 2015-2019, and is expected to grow further as 150 million Southeast Asians turning 15 years of age over the next 15 years enter the mobile internet ecosystem.¹³⁶ Internet transactions are projected to triple between 2019 and 2025 to \$300 billion.¹³⁷ Beyond the digital economy's exponential growth and associated opportunities, 50% of the world's merchant fleet is hosted at Malacca, demonstrating the region's centrality to global shipping.¹³⁸ The region also has geopolitical importance. As the global focus continues to shift towards prioritizing the Indo-Pacific region, Southeast Asia is the nexus at which the Indian and Pacific Oceans converge, making it central to the U.S.'s and China's futures.

134 ASEAN *Statistical Yearbook 2018* (Jakarta: The ASEAN Secretariat). December 2018.

135 Prince, Rohana. "Southeast Asia – It's All in the Numbers," CSIS. 14 February 2019.

136 Google & Temasek / Bain, *e-Conomy 2019*. 2019.

137 Lee, Yoolim. "Southeast Asia's Internet Economy to Top \$100 Billion This Year," *Bloomberg*. 03 October 2019.

138 Kaplan, Robert. *Monsoon* (New York: Random House, 2010).

Chinese interests

The PRC's interests align with that of a rising power naturally looking to extend its economic strength. Access to foreign markets is crucial to China's continued economic growth, which has slowed domestically to the lowest levels in 27 years, largely due to significant drops in trade stemming from the US-China trade war.¹³⁹ The fallout from COVID-19 also raises concerns of economic contraction for the first time since 1976.¹⁴⁰ In this uncertain environment, Southeast Asia presents Beijing with an opportunity to take advantage of new economic growth opportunities in its "near abroad," while simultaneously building goodwill among regional populations from commercial benefits. Chinese energy demands are also likely to grow in the near and long term. 85% of China-bound oil passes through the Strait of Malacca, and Beijing recognizes the benefits of a friendly neighborhood in securing its passage through this vital chokepoint.¹⁴¹

Chinese scholar Zhang Yunling argues that Southeast Asia is "strategically indispensable in supporting China's rise to Great Power status," serving as both a testing ground for strategy and a springboard for further power projection.¹⁴² Increased Chinese economic influence can be used to project Beijing's regional power by empowering friendly governments. This can bring countries into Beijing's orbit by promoting shared governance values and Chinese policy objectives. Cambodia offers a case study; after receiving \$2.7 billion in loans and grants from Beijing in 2012, Prime Minister Hun Sen blocked ASEAN measures against Chinese claims in the South China Sea and ceded 20% of Cambodia's coastline to Chinese-owned companies.^{143, 144} Beijing touts its growing links with the region as a natural

139 Bradsher, Keith. "China's Economic Growth Hits 27-Year Low as Trade War Stings," *The New York Times*. 14 July 2019.

140 Bradsher, Keith. "Coronavirus Could End China's Decades-Long Economic Growth Streak," *The New York Times*. 16 March 2020.

141 Kaplan.

142 Stromseth, 3.

143 Blackwill, Robert and Harris, Jennifer. *War By Other Means: Geoeconomics and Statecraft* (Cambridge: Harvard University Press, 2016). 114.

144 Edel, Charles. "Cambodia's Troubling Tilt Toward China: And What It Means for Washington's Indo-Pacific Strategy," *Foreign Affairs*. 17 August 2018.

outgrowth of its development, in line with “win-win cooperation” and benefiting the entire “neighborhood.”¹⁴⁵

American interests

American interests reflect that it has traditionally been the region’s center of economic and military power since WWII. The U.S. has five bi-lateral defense agreements in or surrounding Southeast Asia, with Thailand, the Philippines, Japan, South Korea, and Australia/New Zealand.^{146, 147} Thailand and the Philippines are both regional American defense allies, and the US has expanded its relations over the last decade with multiple other states.^{148, 149} The region is central to Washington’s Indo-Pacific strategy outlined in the most recent National Defense Strategy.¹⁵⁰

Despite the attempted “pivot” to Asia under the Obama administration, however, U.S. attention has rarely extended beyond the increased movement of military hardware to the region. The US answer to the proposed \$1 trillion Belt and Road Initiative is illustrative, with only \$60 billion in the BUILD Act to spur private-sector investments. As a direct comparison, Chinese projects in Southeast Asia are valued at \$255 billion.¹⁵¹ The failure of the Trans-Pacific Partnership (TPP) tells a similar story.¹⁵² The US reaps domestic benefits from its relations with ASEAN, however, with an estimated 500,000 American jobs in 2016 directly linked to trade with the region.¹⁵³

145 Li Keqiang. Speech at the 22nd ASEAN Plus China, Japan, and ROK Summit. 05 November 2019. https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1713331.shtml.

146 U.S. Department of State. “U.S. Collective Defense Arrangements.” Archived, 20 January 2009 – 20 January 2017. Accessed 23 March 2020. <https://2009-2017.state.gov/s/l/treaty/collectivedefense/index.htm>.

147 U.S. Embassy Bangkok. “Joint Vision Statement 2020 for the U.S. – Thai Defense Alliance.” 17 November 2019. <https://th.usembassy.gov/joint-vision-statement-2020-for-the-thai-u-s-defense-alliance/>.

148 U.S. Department of State. “U.S. Relations with Thailand.” 21 October 2019. <https://www.state.gov/u-s-relations-with-thailand/>.

149 U.S. Department of State. “U.S. Collective Defense Arrangements.”

150 US Department of Defense. *Summary of the 2018 National Defense Strategy of the United States of America*. January 2018.

151 Edel, Charles. “How to Counter China’s Influence in the South Pacific,” *Foreign Affairs*. 13 November 2018.

152 Blackwill, Harris, 190-191.

153 Armbrecht, Arwen. “How do ASEAN nations view the United States?” *World Economic Forum*. 15 February 2016.

Southeast Asian countries are generally more supportive of the U.S. than other developing areas. In a recent survey, 77% of Filipino respondents preferred that the U.S. remain the leading global power, compared to 12% expressing support for China supplanting it. In a country with less of a historically robust relationship with America, 43% of Indonesians expressed support for the U.S. staying the global power, compared to 22% supporting China.¹⁵⁴ Majorities of respondents in the Philippines and Vietnam also expressed concern that China's growing military strength will have adverse implications for their countries.¹⁵⁵ Washington asserts that Beijing's use of economic support is used both to soften concern over its "revisionist" rise via more benign efforts than pure military projections and to serve as a coercive tool to "persuade other states to comply with its agenda."¹⁵⁶

Key Topics

China's primary economic diplomacy strategies in the region are the Asian Infrastructure Investment Bank, the Digital Silk Road, and the Belt and Road Initiative.

Asian Infrastructure Investment Bank (AIIB)

The Asian Infrastructure Investment Bank (AIIB) is a notable element of growing Chinese economic influence through financial policy. Started in 2016 and headquartered in Beijing, the AIIB serves as an alternative to American-led development financing efforts, such as the World Bank and Asian Development Bank (ADB). Despite the U.S. and Japan deciding not to join the AIIB, the organization has expanded rapidly—it is now the second largest global multilateral development bank (MDB) after the

154 Delaney, Robert. "United States or China as world leader? Asians overwhelmingly prefer the US, Pew study finds," *South China Morning Post*. 13 October 2018.

155 China Power Team. "How are global views on China Trending?" China Power Project. 15 February 2016. Updated 29 March 2019. <https://chinapower.csis.org/global-views/>.

156 U.S. Department of Defense. *Indo-Pacific Strategy Report: Preparedness, Partnerships, and Promoting a Networked Region*. 9.

World Bank and includes 14 G-20 states.^{157, 158} Critics contend that the AIIB gives Beijing greater power, via a 26.6% voting share, to shape development projects in Southeast Asia to best benefit its geopolitical strategy and diplomacy, while simultaneously ensuring contracts are awarded to Chinese construction firms.¹⁵⁹

The AIIB additionally does not hold recipients to the same governance, accountability, or environmental standards as its Western counterparts.¹⁶⁰ American diplomats have raised concerns that the AIIB is ultimately an attempt to weaken American alliances in the region and to decrease resistance to Chinese territorial claims by bringing economic benefits to developing countries.¹⁶¹ The AIIB is also criticized as a Chinese tool to facilitate “debt diplomacy” as part of the Belt and Road Initiative (BRI).¹⁶²

Countering this criticism, proponents of the AIIB assert that it can clear projects for member countries in only six months, compared to the minimum of three years with the ADB, and that it will not hold countries to onerous standards of MDBs led by already-developed states.¹⁶³ For developing Southeast Asian countries, the AIIB offers an attractive alternative to Western MDBs with the speed and flexibility it delivers in financing projects, even with the additional risks of debt diplomacy. This dynamic can be seen with the AIIB announcing in September that it will invest in six BRI-associated projects in Southeast Asia worth over \$1 billion. This is on top of the \$1 billion the AIIB has invested in six ASEAN countries over the last four years, compared to a total of \$8.5 billion in approved loan projects for all AIIB members since 2016.¹⁶⁴

157 Sims, Kearnin. “Cooperation and contestation between the ADB and AIIB,” *East Asia Forum*. 24 October 2019.

158 Blackwill, Harris, 115.

159 Sims.

160 Horta, Korinna. *The Asian Infrastructure Investment Bank (AIIB): A Multilateral Bank where China sets the Rules*. Heinrich Boell Stiftung Publication Series on Democracy, Volume 52. March 2019.

161 Blackwill, Harris, 115.

162 “China led AIIB could overtake ADB as major financier of infra projects,” *The Economic Times*. 13 June 2019.

163 Ibid.

164 “AIIB to invest 1.09 bln USD in ASEAN countries to boost interconnectivity,” *XinhuaNet*. 09 September 2019.

Digital Silk Road (DSR)

Chinese companies with government subsidization and direct support are increasingly and subtly pushing into Southeast Asian economies and displacing American technology companies. One such example of Chinese digital economic expansion is Alibaba operating the Singapore-based e-commerce Lazada Group, which accounts for the highest number of monthly active users in Thailand, Malaysia, Vietnam and the Philippines. Didi Chuxing and Tencent have both made heavy investments that have knocked Uber off the top perch of ride share services in the region. Aggressive Ant Financial M&A and partnership moves in Thailand, Indonesia, and the Philippines have also extended Chinese influence into the financial and fintech realm. After decades of dominance, Samsung has been overtaken by Chinese mobile manufacturers Oppo, Huawei, and Vivo.^{165, 166, 167} Beyond services, Chinese state-supported firms have been heavily involved in information and communications technology (ICT) infrastructure, most notably with Huawei and ZTE. Huawei Marine, for example, has completed over a dozen regional undersea cable projects, and has 20 more under construction, mostly in Indonesia and the Philippines. Beijing also views Southeast Asia as the primary test market for rolling out 5G and cloud computing services central to Xi Jinping's Made in China 2025 strategy.¹⁶⁸

DSR has led to concerns that Chinese-manufactured equipment may be used by the PRC to increase digital surveillance through data localization policies. By working with DSR, ASEAN countries can significantly reduce costs of new digital infrastructure projects. The downside, critics contend, is that they may be forced into data localization policies utilizing Chinese equipment, in turn increasing concerns of digital surveillance. Vietnam, for one, has shown a willingness to accept increased surveillance risks for lower costs. It has embraced Beijing's views on data localization and

165 Harding, Brian. "China's Digital Silk Road and Southeast Asia," *Commentary*. Published by the Center for Security and International Studies. 15 February 2019.

166 Hao, Chan Jia. "China's Digital Silk Road: A Game Changer for Asian Economies," *The Diplomat*. 30 April 2019.

167 "Local Acquisitions – Alibaba and Ant Financial's choice of expansion in Asean," *ASEAN Today*. 31 December 2017.

168 Harding.; Hao.

collection by requiring international companies to begin storing internet users' data on local servers for at least 36 months at a time.¹⁶⁹

Chinese firms' control of ICT infrastructure and software also increases surveillance risks through control of data. Alibaba Cloud, for example, has built data centers in Singapore, Malaysia, and Indonesia, each of which is promoting national digitization policies. Huawei has even been able to launch a 5G test bed in Thailand, though the kingdom is the U.S.'s oldest ASEAN ally. Even with concern of Chinese surveillance through such ICT expansion, Thai officials have explicitly viewed this threat as secondary to the benefits of low-cost Chinese investment. With Huawei, Alibaba, and TenCent all offering cheap (state-subsidized) products, Thailand is willing to accept the risks of espionage if it can attract FDI – which has been lacking – for its \$45 billion Eastern Economic Corridor.¹⁷⁰ American attempts to convince Southeast Asian states to ban Huawei have also failed, with only Singapore cooperating with U.S. policy.¹⁷¹

DSR is also directly connected to BRI through the “Information Silk Road”, a concept spelled out in a joint white paper by the National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the PRC in March 2015. The paper describes the goals of DSR as strengthening internet infrastructure, deepening space cooperation, and developing technology standards among BRI countries.¹⁷² To this end, it seeks to use digital economic gains to challenge areas of economic hegemony in the region. One example is the push by Chinese firms to promote and develop BeiDou-2, a Chinese-constructed and operated global satellite navigation system planned to consist of 35 satellites by 2020 and an alternative to the US government-owned GPS. Success in this endeavor will have profound second-order effects in such diverse fields as shipping navigation and military communications. Laos, Brunei, and Thailand have all already adopted BeiDou-2.¹⁷³

169 Boudreau, John and Nguyen. “Vietnam Says Google and Facebook May Have Year to Meet Cyber Law,” *Bloomberg*. 2 November 2018.

170 Reuters. “Thailand launches Huawei 5G test bed, even as US urges allies to bar Chinese gear,” *CNBC*. 08 February 2019.

171 Siti Rahil. “U.S. ban on Huawei largely ignored in Southeast Asia,” *The Japan Times*. 19 August 2012.

172 National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the PRC. Visions and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road.” 28 March 2015. https://en.ndrc.gov.cn/newsrelease_8232/201503/t20150330_1193900.html.

173 Hao.

Countering criticism, DSR represents for many developing ASEAN countries an opportunity to attract FDI and accelerate digital economy transitions. Many regional countries are willing to accept Chinese internet norms and potential espionage if the upshot is rapid economic growth. Myanmar shows such a dynamic at work. In 2012, less than 1% of its population had any internet connectivity; it is now working with Huawei to launch 5G by 2025, leapfrogging mobile network generations of other regional states, such as Singapore and Malaysia.¹⁷⁴

Belt and Road Initiative (BRI)

Many high-profile BRI projects have taken place across the region, most notably Kyakpyu port in Myanmar, a high-speed railway in Laos, and rail and pipeline projects in Malaysia.¹⁷⁵ Many of these projects, however, have raised concerns of “debt trap” diplomacy by Beijing. BRI has also come under criticism for undermining regional states’ sovereignty, prioritizing environmentally harmful resource extraction, and failing to employ local populations. Critics, including American Secretary of State Mike Pompeo, contend that the BRI represents an attempt by Beijing to impose its economic might on Southeast Asia in order to increase its political influence and reach.¹⁷⁶ The railway project in Laos, for example, has burdened the country with a project cost that is equal to half of its GDP and significantly contributed to a debt level owed to Beijing that the Council on Foreign Relations indexes at 19.7% of Laos’ GDP.¹⁷⁷ For developing states with significant infrastructure funding shortfalls, however, the BRI offers an opportunity for needed projects that Western-led MDBs would likely reject. Beijing counters criticism by presenting the BRI as an opportunity to increase “connectivity” with “new drivers of shared development.”¹⁷⁸

174 Hao.

175 Harding.

176 Michael Pompeo. Speech at the Siam Society. “The U.S. in Asia: Economic Engagement for Good.” 02 August 2019. <https://www.state.gov/secretary-of-state-michael-r-pompeo-on-the-u-s-in-asia-economic-engagement-for-good/>.

177 Steil, Benn and Della, Benjamin. “Belt and Road Tracker.” Published by Council on Foreign Relations. 08 May 2019.

178 OECD (2018), “The Belt and Road Initiative in the global trade, investment and finance landscape”, in OECD Business and Finance Outlook 2018, OECD Publishing, Paris, https://doi.org/10.1787/bus_fin_out-2018-6-en.



A border patrol agent walks along a border wall separating Tijuana, Mexico, from San Diego, Wednesday, March 18, 2020, in San Diego.

AP Photo/Gregory Bull



Critics also contend that some BRI endeavors are heavy-handed power plays by the PRC, especially with energy projects in the South China Sea. Two primary examples of this phenomenon are in Chinese strong-arming of Vietnamese and Filipino energy projects. Since 2017, Beijing has pressured Hanoi repeatedly, and successfully, to abandon energy development projects in the Red Emperor (Ca Rong Do) area, which is internationally recognized as part of Vietnam's continental shelf. This has forced out FDI in Vietnam from BP, Chevron, ConocoPhillips, and Repsol, the last of which abandoned the project even after investing \$500M. The result has been a loss of 227,000 barrels of oil production a day in Vietnam with a decreased ability to attract FDI. The Philippines has faced a similar issue, as Xi Jinping threatened Rodrigo Duterte that any attempt to develop Reed Bank unilaterally would be interpreted as an act of war. The upshot is that the Philippines – a U.S. treaty ally – will be unable to tap into its best option to provide energy for its main island of Luzon once its current energy source, the Malampaya gas field, runs dry in 2024. This is notable, as The Hague ruled in 2016 that Reed Bank was an exclusively Filipino area as per the United Nations Convention on the Law of the Sea (UNCLOS). China contends, however, that these projects represent cooperative “joint development” of energy resources within its territory in the South China Sea.¹⁷⁹

Fears of “debt trap diplomacy” have caused recent pushback among ASEAN economies. Despite this concern, regional countries are still more likely to try to renegotiate BRI contracts than end them completely without a viable modernization alternative. Malaysian Prime Minister Mahathir bin Mohamad, for example, cancelled BRI projects worth \$22 million upon taking office but has since agreed to a new railway agreement through Kuala Lumpur with a reduced price tag.¹⁸⁰ Myanmar has taken the same approach with the Kyaukpyu port in Rakhine.¹⁸¹

179 Glaser, Bonnie and Poling, Gregory. “Vanishing Borders in the South China Sea: The U.S. Must Do More to Stop China’s Encroachments,” *Foreign Affairs*. 5 June 2018.

180 Sipalan, Joseph. “China, Malaysia restart massive ‘Belt and Road’ project after hiccups,” *Reuters*. 25 July 2019.

181 Nitta, Yuichi. “Myanmar cuts cost of China-funded port project by 80%,” *Nikkei Asian Review*. 28 September 2018.

8. Deploying Aid to Shape Migration Flows

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Issue overview

The United States is facing a migration crisis, but not an unmanageable one. While immigrants from Central America have long flocked to the U.S.'s southern border, in recent years, the U.S. has seen an unprecedented spike in forced migrants and asylum-seekers. Between 2012 and 2018, the U.S. had received half a million asylum-seekers and refugees from other Western Hemisphere countries.¹⁸² This new wave of migration, known as forced migration and coming primarily from the Northern Triangle countries of El Salvador, Guatemala, and Honduras, is defined by different driving factors than previous waves of migration. In addition to immigrants who are seeking better jobs and economic opportunities in the U.S., many are now fleeing the violence, extreme poverty, and political instability that has made their home countries unlivable. These new dimensions of migration to the U.S. require an updated policy approach.

U.S. development aid plays an important role in shaping migration flows and should be considered as one element of a well-rounded policy approach to migration. Used effectively, aid targeting drivers of forced migration, such as economic instability, corruption, weak institutions, lack of social services, and democratic backsliding, may have a positive impact on preventing new waves of asylum-seekers. For decades, the U.S. has given development aid to the Northern Triangle to help fight economic and political instability. The U.S. now has the potential to strengthen its aid relationship with the Northern Triangle by giving in more significant amounts and to more targeted programs.

¹⁸² Martinez, Joel, Dan Restrepo, and Trevor Sutton. "Getting Migration in the Americas Right: A National Interest-Driven Approach" *Center for American Progress*. June 24, 2019. <https://www.americanprogress.org/issues/security/reports/2019/06/24/471322/getting-migration-americas-right/>

The Trump administration has drastically changed the U.S. approach to deploying development aid in Central America, using aid as a bargaining chip in maintaining its hardline approach on immigration, rather than as a means by which to address migration. The administration has used threats of aid cuts to pressure El Salvador, Guatemala, and Honduras to harden their stances on migration. An updated policy on development aid and migration should use development aid as an investment that will shape the flow of migration and benefit both the U.S. and the Northern Triangle.

Background

Definitions

In order to discuss development aid's impact on migration, it is important to define a few key terms. A **refugee** is an individual who has been forced to leave his or her home due to fear of violence or persecution in his or her home country. An **asylum-seeker** is an individual who is seeking international protection from this violence.¹⁸³ Asylum-seekers fall under the broader category of **forced immigrants**, or individuals who have been coercively displaced from their homes. One key distinction is that a family from Central America who is forced to leave their home due to economic struggles would not qualify for asylum or refugee status under international law, but would be considered a forced immigrant.¹⁸⁴ Finally, a non-forced **immigrant** to the U.S. is an individual who makes a conscious decision to leave his or her home country and settle in the U.S. Through legal channels, this requires lengthy vetting processes in the U.S. and can take a decade or more.

183 In the U.S., an asylum-seeker is considered someone whose claim has not yet been decided on by U.S. officials. Individuals must apply for asylum, and if granted, the applicant becomes recognized as a **refugee** and is permitted to remain in the U.S. Seeking asylum in the U.S. can take a few months to a few years, and many cases are rejected.

184 Definitions taken from International Organization for Migration and International Rescue Committee at <https://www.iom.int/key-migration-terms> and <https://www.rescue.org/article/migrants-asylum-seekers-refugees-and-immigrants-whats-difference>
See also definitions from UNHCR Convention and Protocol Relating to the Status of Refugees

The economic relationship between aid and migration

The relationship between aid and migration is complicated. A large body of economic research on the subject shows that overall, development aid has a positive impact on migration, often illustrated by the “migration hump” relationship.¹⁸⁵ As households move from very poor to more moderate income, migration tends to increase steeply, and taper off as average income increases beyond a certain threshold (estimated at around \$7,000-\$8,000 annually)¹⁸⁶. Thus, smaller amounts of aid, aimed specifically at job-creation or similar programs, may actually increase migration. For the world’s poorest countries, however, reaching this threshold could take decades. Therefore, in the short-term, no realistic amount of aid will have much of an impact on improving economic opportunities enough to decrease migration.¹⁸⁷

More recent economic studies, including a 2018 study by Mauro Lanati and Rainer Thiele, indicate that development aid does have an impact on reducing migration, but only when it is aimed at the appropriate sectors.¹⁸⁸ Specifically, economic assistance is effective when it targets causes of forced migration by focusing on improving public services, such as education or healthcare, which are often lacking or non-existent in countries of origin. Further studies hold that development aid can be effective in decreasing forced migration when it is targeted at strengthening political stability, rule of law, and democratic and security institutions, although the causal impact of aid to these programs on migration numbers can be difficult to capture.¹⁸⁹ Further, to have an observable impact, aid must be in an amount that represents a significant amount of the receiving country’s GDP.

185 Angenendt, Steffen, Charles Martin-Shields, and Benjamin Schraven. “More Development – More Migration? The ‘Migration Hump’ and its Significance for Development Policy Co-operation with Sub-Saharan Africa.” German Institute for International and Security Affairs. October 2017. https://www.swp-berlin.org/fileadmin/contents/products/comments/2017C40_adt_et al.pdf

186 Angenendt, Steffen, Charles Martin-Shields, and Benjamin Schraven. “When and how can foreign aid slow migration?” The Washington Post, November 2, 2017. https://www.washingtonpost.com/news/monkey-cage/wp/2017/11/02/when-and-how-can-foreign-aid-slow-migration/?utm_term=.6d7d17e0c2a3

187 Whelan, Robbie. “Central American Migrants are ‘Voting With Their Feet’ Despite U.S. Threats.” The Wall Street Journal. July 19, 2019. <https://www.wsj.com/articles/central-american-migrants-are-voting-with-their-feet-despite-u-s-threats-11563528602>

188 Lanati, Mauro and Rainer Thiele. “The impact of foreign aid on migration revisited.” World Development, Volume 111, November 2018. Pages 59-74.

189 Martinez, Restrepo, and Sutton. Center for American Progress, 2019.

Migration between Central America and the U.S.

Large-scale migration from Central America to the U.S. dates back several decades. As of 2017, approximately 3.5 million Central American immigrants, 86% of whom originated from the Northern Triangle, resided in the U.S. Nearly half of these immigrants arrived prior to 2000. Many emigrated to the U.S. during the civil conflicts occurring across the Northern Triangle in the 1980's, or following a series of natural disasters in the region during the late 1990's and early 2000's. These events prompted the U.S. to designate Temporary Protected Status (TPS) to immigrants from the Honduras, Nicaragua, and El Salvador, granting them work authorization and protecting them from deportation.¹⁹⁰

While U.S. politics and media have emphasized major increases in Central American immigrants to the U.S. in recent years, in reality this number has grown relatively slowly. Between 2009-2017, migrants from the Northern Triangle living in the U.S. grew by just 1.9%.¹⁹¹ What has grown, however, is the number of refugees, asylum-seekers, and forced immigrants arriving to the southern U.S. border. In 2018, U.S. Customs and Border Protection apprehended over 38,000 unaccompanied minors and approximately 104,000 people traveling in families from the Northern Triangle.¹⁹² This indicates that nearly two thirds of all migrants apprehended on the U.S. southern border were forced migrants, an increase from just one tenth in 2012.¹⁹³

This trend of increased forced migrants indicates that the primary drivers of migration from the Northern Triangle are again changing. The majority of Central Americans arriving to the U.S. southern border are no longer coming willingly, seeking better economic opportunities, but rather are fleeing physical and economic insecurity in their home countries.

190 Batalova, Jeanne, Jessica Bolter, and Allison O'Connor. "Central American Immigrants in the United States." Migration Policy Institute. August 15, 2019. <https://www.migrationpolicy.org/article/central-american-immigrants-united-states>

191 Orozco, Manuel. "Recent Trends in Central American Migration." The Dialogue: Leadership for the Americas. 2018. <https://www.thedialogue.org/wp-content/uploads/2018/05/Recent-Trends-in-Central-American-Migration-1.pdf>

192 The number of asylum-seekers and forced immigrants arriving in U.S. is often illustrated by the number of families or unaccompanied minors arriving at the border.

193 Martinez, Restrepo, and Sutton. Center for American Progress, 2019.

Development aid relationship between U.S. and Central America

Over the past 20 years, the U.S. has given a total of \$21.65 billion in development aid across 25 countries in the Americas. For comparison, U.S. aid contributions to the individual countries of Pakistan and Egypt over the same 20-year period, amounted to \$23 billion and \$24.75 billion, respectively. In the last four fiscal years, the U.S. has spent \$2.6 billion in aid to the Northern Triangle countries, an amount that represents just .5% of the combined GDP of El Salvador, Guatemala, and Honduras during this same period.¹⁹⁴

U.S. aid delivery to the Northern Triangle has targeted areas known to have an impact on creating political and economic stability. Aid programs have primarily focused on security and violence prevention, followed by economic growth, border security, and good governance and institutional strengthening. Recently, the U.S. held up its work with El Salvador as evidence of a successful development aid partnership. *The Washington Post* reported that both U.S. development officials and Salvadorans were heralding the countries' joint efforts at strengthening Salvadoran security, civil society, and economic resiliency, as helping to slow the flow of migrants from El Salvador to the U.S. Between 2016 and 2018, the number of Salvadorans apprehended at the U.S. border fell by over 50%, from 72,000 to 32,000. While it is difficult to determine how much of this decrease can be attributed to U.S. aid efforts, experts claim it is highly likely that the absence of this aid would have exacerbated the problem.¹⁹⁵

194 Whelan, Wall Street Journal, 2019 and Martinez, Restrepo, and Sutton, Center for American Progress, 2019.

195 Sieff, Kevin. "U.S. officials said aid to El Salvador helped slow migration. Now Trump is canceling it." *The Washington Post*. April 1, 2019. https://www.washingtonpost.com/world/the_americas/us-of-ficials-said-aid-to-el-salvador-helped-slow-migration-now-trump-is-canceling-it/2019/04/01/5a-8ca570-540a-11e9-aa83-504f086bf5d6_story.html?utm_term=.3ea8886e24fe

Key Topics

A key pillar of Donald Trump's presidency has centered on decreasing illegal immigration by Central Americans into the U.S. The Trump administration has doubled-down on hardline policies to combat immigration and has leveraged development aid and other economic tools towards this agenda. However, the administration's approach is short-sighted. It relies on economic threats as negotiation tactics and does little to envision the impact of development aid and trade in helping to create the economic and political stability necessary to stem the flow of forced migration.

Cutting aid to the Northern Triangle

In March 2019, Trump announced that he would cut development aid to the Northern Triangle, as punishment for the failure by these countries to combat illegal immigration to the U.S. In June 2019, the administration made good on this promise, announcing a total of \$552 million in aid cuts from the FY2017 and 2018 budgets, and confirming that aid funding from 2019 forward would be contingent on the Northern Triangle's cooperation in fighting illegal immigration.¹⁹⁶ Following this aid freeze, numerous aid projects across all three countries were forced to halt, or even shut down, activities over the summer.

Results

The decision to cut aid has had some results in pushing the Northern Triangle to agree to stricter immigration measures, but its impact on immigration to the U.S. is still somewhat unclear. In October 2019, the administration declared that it would partially restart the flow of aid to the Northern Triangle. The announcement cited "dramatic steps" the three countries had taken to help reduce migration, likely referring to "safe third country" deals that the Trump administration has struck with all

¹⁹⁶ Montoya-Galvez, Camilo. "U.S. cuts millions in aid to Central America, fulfilling Trump's vow." CBS News. June 18, 2019. <https://www.cbsnews.com/news/us-cuts-millions-in-aid-to-central-america-fulfilling-trumps-vow/>

three countries.¹⁹⁷ The deals would allow the U.S. to send asylum-seekers who pass through either Guatemala, Honduras, or El Salvador, back to the country through which they passed, with the understanding that these three countries can provide adequate protection for refugees. Human rights organizations, including Human Rights First and the United Nations High Commission for Refugees, have condemned these deals, pointing out that many of the asylum-seekers the U.S. seeks to expel were originally fleeing from exactly these three countries.¹⁹⁸

Response

The administration's aid policy has faced bipartisan pushback, with both Democrats and Republicans arguing that cutting aid will exacerbate conditions in these countries, and that aid is a "strategic investment" for U.S.-Central America relations. Similarly, the Trump administration's partial reversal of this decision has been met with skepticism. Some lawmakers claim the move comes too little too late, as the Northern Triangle has already lost approximately \$400 million in U.S. aid contributions.¹⁹⁹ Further, experts and lawmakers are concerned that full resumption of aid will remain contingent on countries' adoption of hardline anti-immigration policies, such as the "safe third country" deals. These policies will not only hurt already vulnerable populations, but will likely prove impossible for the Northern Triangle to implement. Both outcomes could exacerbate forced migration to the U.S.

Considerations

In the longer term, a policy of cutting aid delivery is unlikely to deliver results consistent with Trump's aim of decreased immigration. First, while the amount of U.S. aid to the Northern Triangle may not be enough

197 Shesgreen, Deirdre. "In shift, Trump administration says it will restore some U.S. aid to Central America." *USA Today*. October 16, 2019. <https://www.usatoday.com/story/news/world/2019/10/16/trump-administration-restart-targeted-u-s-aid-central-america/4001294002/>

198 Da Silva, Chantal. "What will happen if the Trump administration is allowed to start sending asylum seekers to Guatemala?" *Newsweek*. October 29, 2019. <https://www.newsweek.com/guatemala-la-us-safe-third-country-asylum-seekers-us-mexico-border-1468341>

199 Ibid.

to decrease migration in itself, cutting this aid could directly result in increased forced migration by undermining economic stability. Second, cutting aid delivery to the Northern Triangle policy does not apply pressure in the right places. Aid is generally disbursed to NGOs or directly to grantee recipients, rather than to government officials. Indeed, those who have already been impacted by the Trump administrations aid freeze have been, for example, poor families receiving humanitarian relief aid or small-scale farmers benefitting from development grants.²⁰⁰ Therefore, cutting aid does not directly incentivize governments to change migration policies, but rather, incentivizes would-be aid beneficiaries to re-calculate the decision of whether or not to migrate in search of economic opportunity.

Threatening tariffs

The Trump administration has also used threats of tariffs as a pressure point to incentivize the Northern Triangle and Mexico to combat illegal immigration. In late May 2019, Trump threatened to levy tariffs on a wide range of Mexican imports to the U.S. Due to the large annual trade volume between Mexico and the U.S., the brunt of these tariffs would ultimately have been paid by U.S. taxpayers, slowing GDP growth by at least .7 percentage point, and costing the U.S. approximately 400,000 jobs.²⁰¹

In late July 2019, Trump again used threats of tariffs to pressure Guatemalan President Jimmy Morales into signing a “safe third country” deal, one that would be close to impossible for Morales to implement. Trump threatened tariffs on both Guatemalan goods and on remittances sent from the U.S. to Guatemala, to pressure Morales into agreement. In 2018, Guatemala received approximately \$9.5 billion in remittances sent from the U.S., far exceeding development aid and thereby making remittances an effective pressure point.

200 McDonnell, Tim. “Trump froze aid to Central America. Now programs are shutting down.” NPR. September 17, 2019. <https://www.npr.org/sections/goatsandsoda/2019/09/17/761266169/trump-froze-aid-to-guatemala-now-programs-are-shutting-down>

201 “The Economic Cost of Proposed 5% Tariffs on Imports from Mexico.” The Perryman Group. Jun 3, 2019. <https://www.perrymangroup.com/publications/report/the-economic-cost-of-proposed-5-tariffs-on-imports-from-mexico/> (these estimates are also cited in multiple news outlets)

Results and Response

In June 2019, Trump's threats appeared to lead Mexican President Andres Manuel Lopez Obrador to agree to an unprecedented ramp-up of security along Mexico's southern border.²⁰² For several months, Mexico increased the presence of its national guard on both the southern and northern borders and added new immigration agency checkpoints on highways in the south, among other efforts. In August 2019, arrests at the U.S.-Mexico border fell to approximately 51,000, a decrease in over 60% from the number detained in May 2019. In June 2019, Mexico had already detained over 29,000 migrants, a 200% increase over June 2018. However, it is too soon to tell whether these trends will endure, and some within the Trump administration are again calling for Mexico to increase its border security efforts.²⁰³

In Guatemala, the administration continues to move towards finalizing its "safe third country" deal. However, the deal still faces a number of hurdles, including requiring approval from Guatemala's Congress, before it can be implemented. Guatemala would become the first of the three Northern Triangle countries to have a finalized deal, and to begin receiving asylum-seekers. Threats of tariffs have proved successful in achieving Trump's negotiation aims, but it is too soon to assess whether these agreements will lead to desired migration outcomes.

Building a border wall

In late July 2019, the U.S. Supreme Court ruled in favor of allowing Trump to use up to \$2.5 billion in funding towards his proposed wall along the southern border of the U.S. with Mexico. The funding was originally

202 Miroff, Nick, David Nakamura, and John Wagner. "Trump announces migration deal with Mexico, averting threatened tariffs." *The Washington Post*. June 7, 2019. https://www.washingtonpost.com/politics/trump-could-decide-over-the-weekend-to-hold-off-on-tariffs-white-house-official-says/2019/06/07/6adb7d86-892d-11e9-98c1-e945ae5db8fb_story.html

203 Frederick, James. "How Mexico beefs up immigration enforcement to meet Trump's terms." *NPR*. July 13, 2019. <https://www.npr.org/2019/07/13/740009105/how-mexico-beefs-up-immigration-enforcement-to-meet-trumps-terms>
See also: Hesson, Ted. "Border chief: Mexico must step up immigration enforcement." *Politico*. September 9, 2019. <https://www.politico.com/story/2019/09/09/border-chief-mexico-immigration-enforcement-1716715>

approved by Congress to be used towards important defense initiatives including military salaries and pensions, chemical-weapons disposal, and support to U.S. allies in Afghanistan. The proposed wall has been decried across the political spectrum as a destined failure and an inefficient use of taxpayer dollars, illustrated by studies from both the Center for American Progress and the Cato Institute.²⁰⁴

204 Martinez, Restrepo, and Sutton. Center for American Progress, 2019, and Bier, David. "Why the Wall Won't Work." Cato Institute. May 2017. <https://www.cato.org/publications/commentary/why-wall-wont-work>

9. Defining the Role of Strategic Health Diplomacy

Erin Gregor

Issue Overview

Strategic health diplomacy increases goodwill and national security by supporting health, prosperity, and stability, all of which are key to economic diplomacy²⁰⁵. The link between health and the economy has become extremely clear with the spread of COVID-19, or the novel coronavirus, and its shocking impact on the global economy. The U.S. Government is the largest global health donor in the world with FY2019 funding of \$11 billion. However, the FY2020 President's budget request proposed to reduce global health funding to \$8 billion²⁰⁶. While this is still far more in absolute terms than the next largest bilateral donor (the U.K at \$2.4 billion²⁰⁷), this cut would be detrimental to many health programs including those targeting AIDS and reduce U.S. influence and standing in global health and broader diplomatic settings.

Three major questions can help guide the future of strategic health diplomacy:

1. Which programs are delivering results and benefits to the U.S. and should be continued?
2. What is the best way to fund these programs?
3. What new areas pose threats or opportunities and should be addressed?

205 Bipartisan Policy Center, "Conference on Strategic Health Diplomacy," November 9, 2015, <https://bipartisanpolicy.org/event/conference-on-strategic-health-diplomacy/>.

206 Kaiser Family Foundation, "Breaking Down the U.S. Global Health Budget by Program Area," *The Henry J. Kaiser Family Foundation* (blog), May 31, 2019, <https://www.kff.org/global-health-policy/fact-sheet/breaking-down-the-u-s-global-health-budget-by-program-area/>.

207 Donor Tracker, "Global Health," accessed September 2, 2019, <https://donortracker.org/sector/global-health>.

Background

The world has made great strides in reducing preventable mortality with global life expectancy increasing by 5.5 years from 2000 to 2016²⁰⁸. Much of this improvement has been a result of U.S. contributions to global health, particularly given AIDS was driving down life expectancy during the 1990s²⁰⁹ prior to the establishment of the President's Emergency Plan for AIDS Relief (PEPFAR).

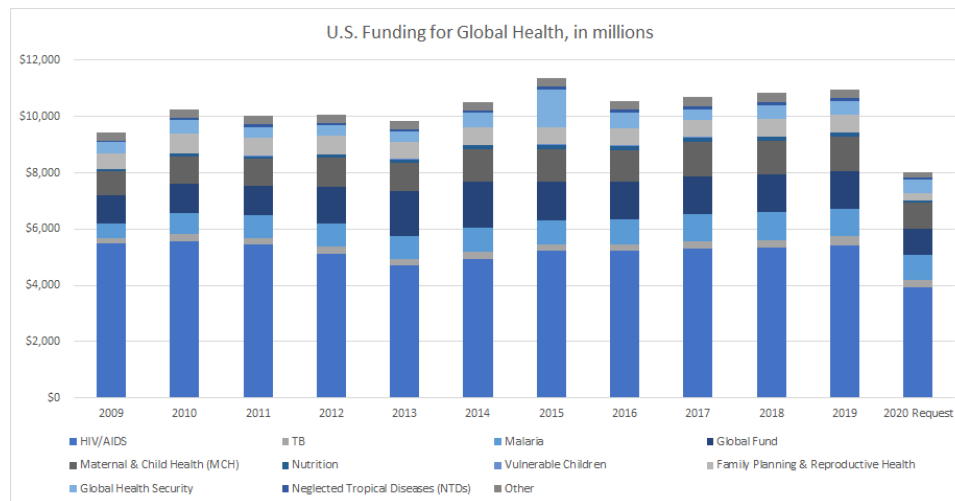
Global health receives bipartisan support with both Democratic and Republican administrations creating and supporting major global initiatives. President George W. Bush started PEPFAR in 2003 and the President's Malaria Initiative (PMI) in 2005. President Obama's administration introduced the U.S. Global Health Initiative in 2009, negotiated the 2030 Agenda for Sustainable Development in 2015, and prioritized the Global Health Security Agenda (GHSA) by Executive Order in 2016. As recently as April 12, 2019, Representatives Gerry Connolly (D-VA) and Steve Chabot (R-OH) reintroduced the Global Health Security Act of 2019 to "prepare for and respond to infectious disease outbreaks"²¹⁰. In the face of pandemic and antimicrobial resistance threats, health security has emerged as a particularly important opportunity for bipartisan cooperation.

208 World Health Organization, "Life Expectancy," WHO, accessed July 8, 2019, http://www.who.int/gho/mortality_burden_disease/life_tables/situation_trends_text/en/.

209 World Health Organization.

210 Kaiser Family Foundation, "Bipartisan Group Of U.S. Representatives Reintroduce Global Health Security Act," *The Henry J. Kaiser Family Foundation* (blog), April 12, 2019, <https://www.kff.org/news-summary/bipartisan-group-of-u-s-representatives-reintroduce-global-health-security-act-in-house/>.

Figure 1: U.S. global health funding by disease/condition area²¹¹



The international strategy for global health is based on the 2030 Agenda for Sustainable Development adopted by all United Nations Member States in 2015²¹². Sustainable Development Goal (SDG) 3 is to “ensure healthy lives and promote well-being for all at all ages”²¹³ with specific targets for child and maternal mortality, non-communicable diseases with causes such as air pollution and tobacco, HIV, and malaria. The U.S. helped shape the SDGs and committed to supporting their achievement²¹⁴ as President Obama stated on September 27, 2015: “We commit ourselves to new Sustainable Development Goals...we recognize that our most basic bond—our common humanity—compels us to act...we reaffirm that supporting development is not charity, but is instead one of the smartest investments we can make in our own future.”

211 Kaiser Family Foundation, “Breaking Down the U.S. Global Health Budget by Program Area,” *The Henry J. Kaiser Family Foundation* (blog), May 31, 2019, <https://www.kff.org/global-health-policy/fact-sheet/breaking-down-the-u-s-global-health-budget-by-program-area/>.

212 United Nations, “Sustainable Development Goals,” accessed July 8, 2019, <https://sustainabledevelopment.un.org/?menu=1300>.

213 United Nations, “Health,” *United Nations Sustainable Development* (blog), accessed July 8, 2019, <https://www.un.org/sustainabledevelopment/health/>.

214 U.S. Agency for International Development, “Sustainable Development Goals,” September 20, 2016, <https://www.usaid.gov/globalgoals>.

Key Topics

Which programs are delivering results and benefits to the U.S. and should be continued?

President's Emergency Plan for AIDS Relief

The flagship U.S. program for global health is undoubtedly PEPFAR. In November 2018, Secretary Pompeo announced PEPFAR had saved 17 million lives²¹⁵. People on lifesaving antiretroviral treatment (ART) in Africa rose from just 50,000 in 2003 when PEPFAR began to over 14.6 million in 2018, and 2.4 million babies have been born HIV-free to mothers living with HIV thanks to PEPFAR. Beyond the health outcomes, PEPFAR has been the lynchpin of U.S. “strategic health diplomacy” by also improving security against the threat of HIV and driving socio-economic development to generate trade partnerships and goodwill towards the U.S.²¹⁶

In FY2019, PEPFAR funding was \$5.4 billion and 50% of the U.S. global health budget²¹⁷. However, President Trump proposed a \$1.5 billion cut in FY2020, which would be the lowest level of funding since 2008²¹⁸. This is particularly challenging for the UNAIDS Fast-Track targets: to achieve 90% of all people living with HIV knowing their status, 90% of those diagnosed on sustained antiretroviral therapy (ART), and 90% of those on ART achieving viral suppression, which eliminates the risk of transmission²¹⁹, by 2020.

The Global Fund to Fight AIDS, Tuberculosis and Malaria

The Global Fund finances HIV, tuberculosis, and malaria programs in low- and middle-income countries and, behind PEPFAR, receives the second

215 The U.S. President's Emergency Plan for AIDS Relief, “Latest Results Show PEPFAR Has Saved Over 17 Million Lives and Accelerated Progress Toward HIV Epidemic Control,” November 27, 2018, <https://www.pepfar.gov/press/releases/287563.htm>.

216 Bipartisan Policy Center, “Conference on Strategic Health Diplomacy,” November 9, 2015, <https://bipartisanpolicy.org/event/conference-on-strategic-health-diplomacy/>.

217 AVERT, “Funding for HIV and AIDS,” accessed July 8, 2019, <https://www.avert.org/professionals/hiv-around-world/global-response/funding>.

218 Kaiser Family Foundation, “Breaking Down the U.S. Global Health Budget by Program Area.”

219 UNAIDS, “90-90-90: Treatment for All,” accessed July 8, 2019, <https://www.unaids.org/en/resources/909090>.

largest share of U.S. funding for global health of \$1.4 billion or 12%²²⁰. The Global Fund is sometimes seen as the multilateral side of the U.S. response to HIV to complement PEPFAR's bilateral nature. President Bush's administration provided the Global Fund with its founding contribution and negotiated the design of this multilateral fund. President Obama's administration pledged \$12.3 billion over three replenishment periods. While President Trump's administration has proposed reduced funding, it will fulfill the Obama administration's pledge to provide two dollars for every dollar pledged by other donors²²¹.

What is the best way to fund these programs?

The U.S. government contributes to global health through both bilateral and multilateral mechanisms. Around 80% is bilateral funding²²² which flows through PEPFAR, PMI, and U.S. Agency for International Development (USAID)'s work on tuberculosis, family planning/reproductive health, and other programs. Major multilateral contributions include the Global Fund to Fight Aids, Tuberculosis and Malaria (The Global Fund), the Global Alliance for Vaccines and Immunization (GAVI), the World Bank, and various health-related UN bodies such as UNICEF and the World Health Organization (WHO).

From a U.S. perspective, the choice between bilateral versus multilateral aid is ultimately a trade off between perceived colonialism and politicisation on the bilateral side and inefficiency and reduced power on the multilateral side²²³. However, a shift towards the new generation of multilaterals, such as the Global Fund and GAVI, may provide a happy medium where the U.S. can maintain an important seat at the table without being perceived as dominating recipient countries and these younger organizations have clearer strategies and less bureaucracy than some of their older counterparts.

220 Kaiser Family Foundation, "Breaking Down the U.S. Global Health Budget by Program Area."

221 Kaiser Family Foundation, "The U.S. & The Global Fund to Fight AIDS, Tuberculosis and Malaria," *The Henry J. Kaiser Family Foundation* (blog), February 7, 2019, <https://www.kff.org/global-health-policy/fact-sheet/the-u-s-the-global-fund-to-fight-aids-tuberculosis-and-malaria/>.

222 Kaiser Family Foundation, "Breaking Down the U.S. Global Health Budget by Program Area."

223 Megan Kilmister, "Bilateral versus Multilateral Aid," *Development in Action* (blog), October 18, 2016, <http://www.developmentinaction.org/bilateral-vs-multilateral-aid/>.

What new areas pose threats or opportunities and should be addressed?

Health security is perhaps the most widely supported area of global health investment. Diseases such as Avian Flu (H1N1), Middle East Respiratory Syndrome (MERS), Zika, and Ebola elevated fears of a pandemic and justified costs to prevent diseases from spreading to the U.S. Key actions on this were President Obama's executive order on the Global Health Security Agenda and reintroduction of the Global Health Security Act of 2019 to Congress by Democratic and Republican sponsors and cosponsors²²⁴. Unfortunately, in the early months of the COVID-19 pandemic, it has become clear that the U.S. and the world was not adequately prepared. The U.S. should seize this opportunity to reinstate pandemic preparedness protocols and cooperate with other states and multilateral organizations to establish and fund treatment and cures, as well as address the global economic impact.

In addition to pandemic threats, antimicrobial resistance (AMR) is leading previously treatable diseases to evolve and evade existing cures. In the U.S. each year, 2 million people get antibiotic-resistant infections and over 23,000 people die from them²²⁵. Continued overuse of antibiotics for treatment and in food-producing animals may lead to a resurgence of diseases previously thought to be curable. The Centers for Disease Control and Prevention (CDC) have been playing a major role in researching AMR and identifying causes and threats, but new solutions are needed to address this global health challenge.

224 Kaiser Family Foundation, "Bipartisan Group Of U.S. Representatives Reintroduce Global Health Security Act."

225 CDC, "The Biggest Antibiotic-Resistant Threats in the U.S.," Centers for Disease Control and Prevention, May 7, 2019, https://www.cdc.gov/drugresistance/biggest_threats.html.



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