



U.S.-China Economic and Security Review Commission

2022 Report to Congress

Executive Summary and Recommendations



2022 **REPORT TO CONGRESS**

U.S.-China Economic and Security Review Commission

Executive Summary and Recommendations

One Hundred Seventeenth Congress
Second Session
November 2022

Printed for the use of the
U.S.-China Economic and Security Review Commission
Available online at: www.USCC.gov

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

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The Commission was created on October 30, 2000 by the Floyd D. Spence National Defense Authorization Act of 2001, Pub. L. No. 106-398 (codified at 22 U.S.C. § 7002), as amended by: The Treasury and General Government Appropriations Act, 2002, Pub. L. No. 107-67 (Nov. 12, 2001) (regarding employment status of staff and changing annual report due date from March to June); The Consolidated Appropriations Resolution, 2003, Pub. L. No. 108-7 (Feb. 20, 2003) (regarding Commission name change, terms of Commissioners, and responsibilities of the Commission); The Science, State, Justice, Commerce, and Related Agencies Appropriations Act, 2006, Pub. L. No. 109-108 (Nov. 22, 2005) (regarding responsibilities of the Commission and applicability of FACA); The Consolidated Appropriations Act, 2008, Pub. L. No. 110-161 (Dec. 26, 2007) (regarding submission of accounting reports; printing and binding; compensation for the executive director; changing annual report due date from June to December; and travel by members of the Commission and its staff); The Carl Levin and Howard P. “Buck” McKeon National Defense Authorization Act for Fiscal Year 2015, Pub. L. No. 113-291 (Dec. 19, 2014) (regarding responsibilities of the Commission).

The Commission’s full charter and statutory mandate are available online at: www.USCC.gov/charter.

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U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

November 15, 2022

The Honorable Patrick Leahy
President Pro Tempore of the U.S. Senate, Washington, DC 20510

The Honorable Nancy Pelosi
Speaker of the U.S. House of Representatives, Washington, DC 20510

Dear Senator Leahy and Speaker Pelosi:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the Commission's 2022 Annual Report to Congress. This Report responds to our mandate "to monitor, investigate, and report to Congress on the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China." The Commission reached a broad and bipartisan consensus on the contents of this Report, with all 12 members voting unanimously to approve and submit it to Congress.

In accordance with our mandate, this Report, which is current as of October 7, includes the results and recommendations of our hearings, research, and review of the areas identified by Congress in our mandate, as defined in Public Law No. 106-398 (October 30, 2000) and amended by Public Laws No. 107-67 (November 12, 2001), No. 108-7 (February 20, 2003), 109-108 (November 22, 2005), No. 110-161 (December 26, 2007), and No. 113-291 (December 19, 2014). The Commission's charter, which includes the 11 directed research areas of our mandate, is included as Appendix I of the Report.

The Commission conducted seven public hearings, taking testimony from 74 expert witnesses from government, the private sector, academia, think tanks, research institutions, and other backgrounds. For each of these hearings, the Commission produced a transcript (posted on our website at www.USCC.gov). This year's hearings included:

- CCP Decision-Making and the 20th Party Congress;
- China's Cyber Capabilities: Warfare, Espionage, and Implications for the United States;
- China's Energy Plans and Practices;
- Challenging China's Trade Practices: Promoting Interests of U.S. Workers, Farmers, Producers, and Innovators;
- China's Activities and Influence in South and Central Asia;
- U.S.-China Competition in Global Supply Chains; and
- Challenges from Chinese Policy in 2022: Zero-COVID, Ukraine, and Pacific Diplomacy.


The Commission received a number of briefings by executive branch agencies and the intelligence community, including both unclassified and classified briefings on implications of China's Zero-COVID policy, China's relationship with Russia after the unprovoked invasion of Ukraine, China's involvement in global logistics, China's cyber capabilities, China's space capabilities, China's nuclear capabilities, and net assessments of U.S. and Chinese military capabilities. The Commission also received briefings by foreign government officials as well as U.S. and foreign nongovernmental experts. The Commission includes key insights gained through these briefings either in its unclassified Annual Report or, as appropriate, in a classified annex to that Report.

The Commission conducted official fact-finding travel this year to U.S. Strategic Command and U.S. Indo-Pacific Command. During these visits we heard from our military's leadership on the threat presented by China in strategic, air, sea, and cyber domains. In addition to onsite meetings, this year we continued to conduct virtual discussions with interlocutors to ensure the continued diversity of perspectives heard by the Commission. The Commission also relied substantially on the work of our excellent professional staff and supported outside research (see Appendix IV) in accordance with our mandate (see Appendix I).

The Report includes 39 recommendations for congressional consideration. The Commissioners agreed that ten of these recommendations, which appear on page 10, are the most important for congressional action. The complete list of recommendations appears on page 32 at the conclusion of the Executive Summary.

We offer this Report to Congress in the hope that it will be useful for assessing progress and challenges in U.S.-China relations. Thank you for the opportunity to serve. We look forward to continuing to work with Members of Congress in the upcoming year to address issues of concern in the U.S.-China relationship.

Sincerely,



Alex N. Wong
Chairman



Kimberly T. Glas
Vice Chair

INTRODUCTION

2022 was a watershed year for China's Communist Party regime and for America's response to its policies. A confluence of groundbreaking events, including Russia's unprovoked invasion of Ukraine and China's growing military threats to Taiwan, led to new, potentially far-reaching changes in international alignments and in the responses by democratic nations to the CCP's conduct. At the same time, as the result of the CCP's novel coronavirus (COVID-19) containment policies that produced lockdowns of major cities, the Chinese people were obliged to live at a greater distance from the outside world. The CCP gave its leader Xi Jinping unprecedented power over the Party and the country. Xi and the CCP relied ever more heavily on nationalist appeals, as was evident in its escalating rhetoric and menacing military actions toward Taiwan.

Faced with a series of crises and unexpected developments, China's Communist Party regime reacted, not by reexamining its assumptions and modifying its approach, but rather by doubling down on existing policies. In the near term these choices have increased the challenge China poses to the security, prosperity, and shared values of the United States and its democratic allies and partners. But heightened awareness of the danger may also be creating new opportunities for implementing effective countervailing policies in response.

Inside China itself, the Communist Party further tightened its grip on society and the economy while Xi Jinping continued to move to take unprecedented personal power over the Party and the government. Critical decisions about everything, from education and popular culture to war and peace, now appear to rest in the hands of one man.

When a new and more transmissible variant of COVID-19 reached China at the start of the year, Xi's commitment to a "Zero-COVID" policy required the inhabitants of large cities like Shanghai to live with draconian lockdowns, cutting ordinary people off from contact with their neighbors and local stores. These disruptions constricted household consumption, slowing the economy and reinforcing

the CCP's tendency to rely on exports and debt-fueled investment to sustain growth. Zero-COVID also made it considerably more difficult for Chinese citizens to travel abroad and for outsiders to visit China. Both the pandemic and the CCP's continuing repression at home caused many institutions overseas to suspend or cancel their longstanding programs and exchanges, leaving China ever more estranged from the world, and especially from the United States, Europe, and America's Asian allies.

In February 2022 Xi Jinping and Russian president Vladimir Putin met in Beijing and announced a further tightening of the already close strategic and economic ties between their countries. The two men declared that their partnership now had "no limits" and pledged to cooperate in opposing "certain States' attempts to impose their own 'democratic standards' on other countries" and in shaping a new international order more conducive to the survival of their own authoritarian regimes. Three weeks later, after the end of the Olympics in Beijing, Putin initiated his unprovoked invasion of Ukraine.

Despite its supposedly unshakeable commitment to the principle of international sovereignty, China has prioritized support for its most important strategic partner. Although it has been careful thus far to avoid openly violating U.S. and other Western sanctions, China has stepped up its imports of Russian oil and wheat while expanding exports to Russia of desperately needed semiconductors. Beijing has also offered diplomatic cover, blaming the war on NATO expansion and faithfully echoing and amplifying Moscow's talking points and disinformation. Much of this activity appears directed at the developing world, where China has been working to cultivate support and expand its presence and influence, in part by appealing to shared anti-Western sentiments.

The war against Ukraine brought America and its democratic allies in both Europe and Asia into much closer strategic cooperation, as these nations then joined in a series of unprecedented economic sanctions and military measures aimed at Russia. For the CCP, these strengthened alliances and sanctions against Russia raised the possibility that it, too, could one day confront similar measures by the United States and its allies. In response, the CCP regime redoubled its ongoing attempts to reduce China's vulnerability to sanctions and export restrictions.

Among other measures, Xi Jinping's so-called "dual circulation" strategy aims to diminish China's dependence on exports and critical imports, while encouraging Western companies to remain reliant on supply chains routed through China. The difficulties Russia is presently encountering further highlight the importance of achieving Xi's goal of technological "self-reliance" and reducing China's dependence on the dollar-dominated international financial system.

The war in Ukraine has contributed to a heightened sense of concern regarding a possible conflict over Taiwan. Beijing has done nothing to ease those anxieties, seizing on the occasion of Speaker of the U.S. House of Representatives Nancy Pelosi's August visit to conduct massive military exercises, including firing ballistic missiles and staging a practice blockade of the island. Here again, China's actions represent an intensification

of an existing trend toward increasingly confrontational, nationalist rhetoric and menacing behavior. In addition to flexing its military muscles, the CCP regime also continued its relentless arms buildup, increasing spending despite the slowdown in economic growth.

The events of the past year have created opportunities as well as heightened dangers. Russia's attempts to use energy as a weapon have underlined the threat to the United States and other countries of excessive dependence on potentially hostile foreign powers for critical manufactured products and materials. It should thus give added impetus both at home and abroad to ongoing efforts to restructure some critical supply chains away from China. China's support for Russian aggression has fueled growing skepticism in Europe about its intentions and may encourage European governments to join with their Asian counterparts and with the United States in taking a tougher stance against Beijing on trade and technology as well as other issues, including the theft of intellectual property and human rights abuses. China's increasing belligerence toward Taiwan and the brutal realities of conflict in Europe (including the speed with which sophisticated weapons are consumed in modern warfare) have highlighted the challenges of deterring a determined aggressor and the importance of maintaining both the standing military capabilities and the defense industrial capacity necessary to defeat aggression should deterrence fail.

There remains a gap between America's growing recognition of the challenges China presents and our responses to date in dealing with them. The purpose of this report is to assess recent developments and to recommend a set of actions that Congress can consider to help meet the challenges, and seize the opportunities they present. ■

THE COMMISSION'S 2022 KEY RECOMMENDATIONS

The Commission considers 10 of its 39 recommendations to Congress to be of particular significance. The complete list of recommendations appears on page 32.

The Commission recommends:

1. Congress direct the Administration to produce within 90 days an interagency report coordinated by the Office of the U.S. Trade Representative to assess China's compliance with the terms and conditions of the 1999 Agreement on Market Access between the People's Republic of China and the United States of America. The assessment should be presented as a summary list of comply/noncomply status of the provisions under the agreement. If the report concludes that China has failed to comply with the provisions agreed to for its accession to the WTO, Congress should consider legislation to immediately suspend China's Permanent Normal Trade Relations (PNTR) treatment. Following the suspension of PNTR, Congress should assess new conditions for renewal of normal trade relations with China.

2. Congress direct the Administration to create an Economic and Security Preparedness and Resilience Office within the executive branch to oversee, coordinate, and set priorities for cross-agency efforts to ensure resilient U.S. supply chains and robust domestic capabilities, in the context of the ongoing geopolitical rivalry and possible conflict with China. This Office would be tasked with:

- ▶ Establishing a dedicated Supply Chain Mapping Unit to determine requirements, set priorities, and coordinate efforts to continuously map, monitor, and analyze the most critical supply chains, including but not limited to semiconductors, rare earths, life-saving and life-sustaining medications and their active pharmaceutical ingredients, and castings and forgings.
 - ▷ The unit would be tasked with developing interoperable performance measures to monitor and assess current U.S. supply chain resiliency and risk mitigation efforts, including data collection on U.S. supply chain dependencies on direct and indirect Chinese suppliers, prioritizing defense-critical supply chains.
- ▶ Establishing a Defense Mobilization Unit responsible for coordinating and setting priorities for:

- ▷ Assessment of the requirements for weapons, munitions, supplies, and other equipment necessary to equip and support U.S. forces and to assist friends and partners in the Indo-Pacific region in a potential conflict with the People's Republic of China, including conflicts of varying duration;
 - ▷ Determination of the adequacy of existing stocks and available productive capacity to meet those needs;
 - ▷ Identification of potential shortfalls or bottlenecks that might impede production and resupply in some scenarios; and
 - ▷ Recommendation of corrective measures to address these problems.
- ▶ Including in its assessments the effects of potential disruptions in U.S.-China trade on defense mobilization and domestic availability of critical materials, products, and supplies. Where it identifies likely requirements for additional capacity, the unit shall determine funding and support mechanisms to ensure the timely development of such capabilities and capacity.
 - ▶ Consulting with other departments and agencies to identify shortfalls in current defense industrial base and supporting industrial capabilities and what additional measures might be needed to address them.

3. Congress enact legislation creating a permanent interagency committee in the executive branch charged with developing options and creating plans for the imposition of sanctions or other economic measures in a range of possible scenarios, including (but not limited to) a Chinese attack, blockade, or other hostile action against Taiwan. This committee would evaluate the potential economic and political consequences of various options, coordinate their implementation, and advise Congress of any amendments to statutory authorities or mandates required to enhance their effectiveness. The committee should coordinate and seek to devise joint plans with the relevant agencies of other governments that may be contemplating similar measures. The committee should

include participants from the U.S. Departments of State, Treasury, Commerce, Defense, and Homeland Security.

4. Congress direct the U.S. Food and Drug Administration in cooperation with other federal agencies, within one year and on an ongoing basis thereafter, to identify pharmaceutical products that utilize active pharmaceutical ingredients (APIs) and other ingredients and inputs that are sourced directly or indirectly from the People's Republic of China and develop alternative sourcing arrangements through available tools and resources, including Defense Production Act authorities. The United States should maximize the production of such goods domestically or, as appropriate, from trusted countries.

5. Congress direct the Administration as part of the Indo-Pacific Economic Framework (IPEF) to negotiate a prohibition on the utilization of China's National Transportation and Logistics Public Information Platform (LOGINK) or similar systems provided by Chinese state-affiliated entities within IPEF member ports. A two-year transition period shall be provided for existing users of LOGINK or similar Chinese-controlled or -affiliated systems to terminate use of such systems and transition to secure logistics systems with no Chinese control or affiliation.

6. Congress direct the U.S. Department of the Treasury to require U.S. corporations and U.S.-registered subsidiaries of foreign corporations to publicly disclose, on an annual basis, all holdings in firms linked to China's military, including those that maintain any production permit, qualification, or certification issued by the People's Liberation Army or China's State Administration for Science, Technology, and Industry for National Defense.

7. Congress create an authority under which the president can require specific U.S. entities or U.S. entities operating in specific sectors to divest in a timely manner from their operations, assets, and investments in China, to be invoked in any instance where China uses or threatens imminent military force against the United States or one of its allies and partners.

8. Congress direct the U.S. Department of Defense to produce a classified report on current and future military posture, logistics, maintenance, and sustainment

requirements to bolster the United States' "capacity to resist force" in the event of a Chinese attack and attempted invasion of Taiwan. The report shall assess the requirements for all scenarios, including protracted combat in a contested environment (e.g., anti-access, area denial), and evaluate how to best enable a dispersed, distributed force in the Indo-Pacific.

9. Congress should make available significant additional multiyear defense funds in conjunction with: (i) a joint planning mechanism made up of Taiwan and U.S. defense officials identifying sets of interoperable and complementary capabilities required for the defense of Taiwan; and (ii) Taiwan legislatively committing significant additional funds to procure its share of those capabilities for its military.

10. Congress, pursuant to the Hong Kong Human Rights and Democracy Act, amend the International Organization Immunities Act to remove Hong Kong Economic and Trade Offices as a covered organization, thereby eliminating diplomatic privileges enjoyed by such offices and their employees in the United States. This amendment could be reversed under one of the following conditions:

- ▶ The People's Republic of China negotiates an agreement with the United States to have Hong Kong Economic and Trade Offices considered an official part of the People's Republic of China's mission to the United States, and subject to the same requirements.
- ▶ China alters its treatment of Hong Kong to allow for sufficient autonomy and abides by One Country, Two Systems as enumerated by the Hong Kong Policy Act. ■

CHAPTER 1: CCP DECISION-MAKING AND XI JINPING'S CENTRALIZATION OF AUTHORITY

Over the past ten years, General Secretary of the Chinese Communist Party (CCP) Xi Jinping has undertaken a wide-ranging effort to restructure decision-making processes within the Chinese Party-state that will continue to have effects at the 20th Party Congress and beyond. Xi has augmented his own authority and systematically centralized decision-making power across all policy areas, preserving and enhancing the CCP's capacity to dominate policymaking and expanding his own authority to drive China's policy agenda. This top-down approach aims to unify the government and the nation under the Party and deliver on Xi's aspirations of enhancing China's strength while avoiding what he perceives as the shortcomings of his predecessors' leadership. Nevertheless, Xi's centralization of decision-making power may reduce the adaptability of lower-level governments and encourage the CCP's reliance on policy approaches that are poorly suited to address China's structural challenges. Should these trends continue, challenges to the United States may include more unpredictable economic policy decision-making, a more assertive foreign policy agenda, and a more aggressive military posture.

TABLE 1
CCP COMMISSIONS AND LEADING
SMALL GROUPS CHAIRED BY XI

PARTY GROUP NAME	ESTABLISHMENT	STAFF OFFICE HEAD
Central Comprehensively Deepening Reform Commission	Established in 2013 as a leading small group. Upgraded to a commission in 2018.	Jiang Jinqun
Central Finance and Economic Affairs Commission	Established in 1958 as a leading small group. Upgraded to a commission in 2018.	Liu He
Central Foreign Affairs Commission	Established in 1958 as a leading small group. Upgraded to a commission in 2018.	Yang Jiechi
Central National Security Commission	Established in 2000 as a leading small group. Upgraded to a commission in 2013.	Ding Xuexiang
Central Commission for Cybersecurity and Informationization	Established in 2014 as a leading small group. Upgraded to a commission in 2018.	Zhuang Rongwen
Central Commission for Integrated Military and Civilian Development	Established in 2017 as a commission.	Han Zheng
Central Commission on Comprehensively Governing the Country According to Law	Established in 2017 as a leading small group. Upgraded to a commission in 2018.	Guo Shengkun
Central Audit Commission	Established in 2018 as a commission.	Hou Kai
Central Taiwan Affairs Leading Small Group	Established in 1954 as a leading small group.	Yang Jiechi

Source: See the full Annual Report for complete list of sources.

Alongside his efforts to centralize Party control, Xi has expanded his own decision-making power by creating new Party groups and taking over the chairmanship of them, including those on economics, national security, foreign policy, and domestic governance institutions (see Table 1). In economic policy, Xi is increasing top-down control over local governments and inserting the Party into all aspects of the nonstate sector in an increasing effort to steer

economic development from the center. Xi has used his position as the head of multiple Party groups on foreign affairs to strengthen CCP leadership of diplomacy and enforce compliance throughout the bureaucracy with his personal foreign policy initiatives, such as the Belt and Road Initiative and Global Security Initiative. In his changes to China's military and paramilitary forces, Xi has emphasized loyalty to the Party while granting himself

ultimate responsibility for decision-making on military matters. Xi has complemented these changes by embedding a broad, regime-centric definition of "national security" into decision-making in nearly every policy area.

Key Findings

- General Secretary Xi's decision-making power has increased dramatically over the past decade, to the point that CCP media have recast the previously negative term "decision by one authority" as a positive feature of China's system. Xi has also overhauled Party rules to give himself an outsized role in the overall governance of the CCP and of China. Xi will likely maintain his high level of control after the October 20th Party Congress and the spring 2023 National People's Congress.
- Under Xi's leadership, the CCP has restructured China's policymaking apparatus by taking decision-making functions away from government bodies and placing them into Party organs, such as leading small groups and commissions. This shift bolsters the CCP's oversight of policy formulation and implementation to ensure stricter adherence to the Party line and marks a departure from prior CCP leaders' more broadly consultative policymaking process.
- Policy decision-making is increasingly centralized and synonymous with Xi's personal leadership, equating loyalty to the Party with loyalty to him. This trend improves policy coordination at the possible expense of policy flexibility, leading to campaign-style governance that effectively addresses short-term issues but limits CCP leaders' ability to correct policy mistakes.
- Xi seeks to avoid the perceived errors of the Soviet Union and China's reform-era leaders. He asserts that previously lax and weak governance by his immediate predecessors damaged the CCP's reputation, cohesiveness, and national governance abilities.
- Xi is enhancing central control over economic decision-making in an effort to ensure the preservation of the regime. Xi justifies this centralization by claiming he and the Party are uniquely capable of steering China toward an increasingly ambitious and nationalistic set of modernization plans. These intentions fail to reconcile with the systemic ailments afflicting China's economy, which Xi and the CCP have chosen to mask by replacing the previous metric of gross domestic product maximization with a proliferating number of top-down mandates and increased central enforcement.
- Xi has restructured the foreign policy decision-making apparatus to facilitate a unified and centrally directed approach to addressing international threats and achieving national objectives. The conduct of Chinese diplomacy now reflects his preference for a more aggressive and confrontational style.
- Xi has restructured the military and paramilitary apparatus to increase centralization and vest more authority in his own hands. Decisions on the use of China's military and paramilitary forces are subject to an increase in the personal discretion exercised by Xi. ■

CHAPTER 2: U.S.-CHINA ECONOMIC AND TRADE RELATIONS

Section 1: Year in Review: Economics and Trade

In 2022, China's economic growth slowed significantly due to the government's stringent novel coronavirus (COVID-19) containment measures, collapse in housing construction and sales, and slow infrastructure construction. Cut off from easy bank loans and other financing, China's highly indebted property developers faced a crisis of confidence as home prices faltered and owners halted mortgage payments on presold units throughout the country. Economic uncertainty amid continued lockdowns also prompted households to save rather than spend, deepening the economy's dependence on exports to drive growth. China's economic slump and weak currency prompted an exodus of foreign capital from China's financial markets and contributed to cooling enthusiasm for expanding China-based operations among multinationals. Beijing also faced continued challenges in its external economic relations throughout 2022, particularly as it attempted to maintain economic ties with Russia while avoiding economic sanctions.

China's response to its abrupt economic slowdown has not employed stimulus on the scale seen

in other major global economies, reflecting policymakers' limited options given the country's staggering debt burden. Deprived of normal sources of fiscal revenue but mandated to generate growth, local governments are dependent on issuing more debt, overwhelmingly to state banks. Bank lending meanwhile remains tepid despite low interest rates. Financial sector development in 2022 continued to focus on reducing volatility, with China creating a state-funded bailout mechanism, as well as further increasing the central government's influence over capital allocation.

China's economy faltered in the first half of 2022 as protracted Zero-COVID lockdowns caused local economies to grind to a halt.

Key Findings

- China's economy faltered in the first half of 2022 as protracted Zero-COVID lockdowns caused local economies to grind to a halt. The Chinese government attempted to employ a modest infrastructure-led stimulus in the second half of the year, though its impact may be limited as local governments struggle to identify useful projects. Despite the economic damage caused by the lockdowns, the CCP remains committed to its Zero-COVID policy, demonstrating its ability to maintain political control even in the absence of economic growth.
- Beijing's credit tightening toward the property sector has become a significant drag on economic growth as developers strain to deliver on presold housing projects. Mortgage boycotts throughout the country demonstrated growing public anger toward property developers as well as broader pessimism about the state

of China's economy. With about 60 percent of urban household wealth concentrated in residential property, a protracted downturn in real estate values would likely exacerbate already anemic consumption among households and continue to weigh on China's economic growth prospects.

- U.S. businesses and investors are reevaluating their engagement in China. Many multinational businesses are delaying further expansion of their China operating segments as stringent COVID-19 response measures worsen the business climate and geopolitical tensions arising

from Russia's unprovoked invasion of Ukraine strain global supply chains. Despite the CCP continuing to encourage foreign capital to flow into its financial markets, U.S. investors in China's financial markets have started to reduce the investment positions they built up, causing capital outflows to accelerate in 2022.

- In 2022, the Chinese government significantly reduced its lending to developing countries while developed countries pushed back against the Chinese government's use of economic coercion and pursued supply chain diversification away

from China. Although it has been careful thus far to avoid triggering secondary sanctions, the Chinese government has maintained friendly relations with Russia after its invasion of Ukraine, supporting the regime by purchasing Russian oil and natural gas. Beijing likely sees coordinated sanctions against Russia as an example of potential repercussions for its intensified aggression against Taiwan, driving China to accelerate ongoing efforts to harden its economy against sanctions and undermine the dollar-led financial system. ■

Section 2: Challenging China's Trade Practices

After many years of attempting to engage China and persuade it to abandon its distortive trade practices, it is clear this approach has not been successful. The United States has an opportunity to develop a new strategy based on building resilience against China's state capitalism and blunting its harmful effects rather than seeking to change it. With the WTO unable to introduce meaningful new rules and procedures, the United States can pursue approaches that advance its own national interests as well as cooperate with like-minded partners. A number of different policy options can support a future strategy.

The U.S. government has a number of ways to bolster its capacity to assess and proactively mitigate the harmful impact of China's industrial policies on U.S. workers, producers,

FIGURE 1
INDO-PACIFIC ECONOMIC FRAMEWORK
FOR PROSPERITY (IPEF) MEMBERS

14 IPEF MEMBERS

- AUSTRALIA
- BRUNEI
- FIJI
- INDIA
- INDONESIA
- JAPAN
- MALAYSIA
- NEW ZEALAND
- PHILIPPINES
- SINGAPORE
- SOUTH KOREA
- THAILAND
- UNITED STATES
- VIETNAM

and innovators. U.S. agencies can enhance coordination to better implement export controls, investment restrictions, and enforcement of intellectual property rights as well as to guard against Chinese courts' assertion of extraterritorial jurisdiction. Chinese economic influence, particularly in the Indo-Pacific, demands a more coordinated international response to its practices. Effective U.S. policy leadership to establish new rules and curb China's economic coercion could galvanize action among likeminded partners (see Figure 1 on previous page).

Key Findings

- China has subverted the global trade system and moved further from the spirit and letter of its obligations under its WTO accession protocol. China's subsidies, overcapacity, intellectual property theft, and protectionist nonmarket policies exacerbate distortions to the global economy. These practices have harmed workers, producers, and innovators in the United States and other market-based countries.
- Having tried and failed to compel China to change its policies, the United States has begun to focus increasingly on defending itself against market-distorting effects of China's policies. The United States can do so by following two concurrent paths: first, it can build its ability to understand and monitor China's trade policies and mitigate their harmful impact through a variety of trade remediation tools and interventions; second, it can coordinate its defensive policies with those of other countries that face similar challenges.
- Years of paralysis and inadequate rules on nonmarket actors have shown that the WTO cannot adequately address the challenges stemming from China's practices. Where the WTO has not succeeded in introducing new rules or combating the economic threat of these practices, the United States and its allies may be able to create new fora of collaboration along discrete topics and sectors.
- The current ability of the United States to overcome the scale and scope of China's harmful policies is undermined by the lack of a coherent strategy and fragmented authorities to mobilize resources, coupled with a deficiency in new tools to address economic injury. The United States is also impeded by its self-imposed barriers to employing and underutilization of available tools and its difficulties in data sharing and analysis.
- Beijing's unrelenting economic manipulation and growing willingness to weaponize its economic position are prompting market-based economies to seek new and alternative frameworks for collaboration on trade. At the same time, Russia's unprovoked invasion of Ukraine is causing advanced democracies to reconsider the national security implications of economic interdependence with authoritarian regimes.
- The United States and likeminded partners have begun to explore new mechanisms that may promote more sustainable and equitable trade while better protecting market-oriented economies from China's state capitalist distortions. New rules and approaches could strengthen supply chain resilience and ensure high standards for services, intellectual property protection, digital trade, and other emerging disciplines that remain unresolved under the WTO. Alternative regional fora and new structures developed with likeminded partners and allies provide the United States potential additional avenues to meet its trade and security goals. ■

Section 3: China's Energy Plans and Practices

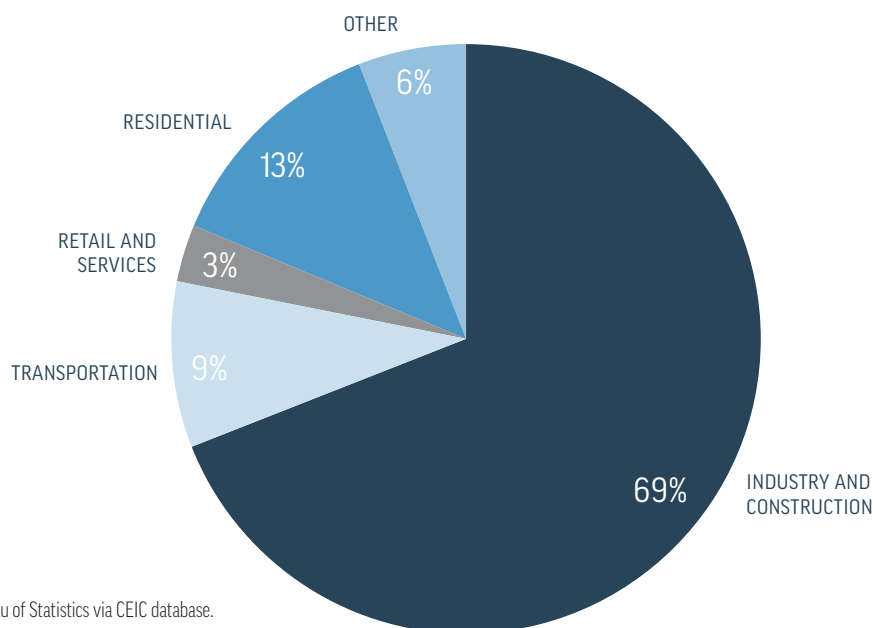
Despite Chinese leaders' stated commitments to decarbonize the economy, China remains heavily reliant upon energy-intensive and carbon-intensive industries and is the world's largest emitter of greenhouse gases (see Figure 2). Its growing energy demand and significant import reliance on fossil fuels drive the government's focus on securing sufficient energy supplies to meet its needs. China thus employs a comprehensive energy strategy that seeks to ensure adequate energy supply and to reduce its vulnerabilities to

maritime energy import chokepoints. By cultivating leadership in clean energy technologies, Beijing is seeking to profit from a global clean energy transition while further deepening its geoeconomic leverage. Ultimately, Beijing's energy strategy will intensify U.S.-China technology competition.

Chinese leaders' efforts to satisfy and secure China's growing energy demand raise global security and commercial risks. In addition to launching a national tanker fleet, China is also increasing its

capacity to secure oil imports by developing the means to project power throughout the Indian Ocean. Additionally, Chinese oil purchases from countries sanctioned by the United States and its partners undermine the efficacy of the sanctions regime. Finally, as China positions itself to lead in commercializing clean energy, global supply chains for technology to accelerate decarbonization could rely on Chinese industries that violate human rights and present commercial risks (see Figure 3).

FIGURE 2
CHINA'S ENERGY CONSUMPTION BY SECTOR, 2019



Source: China National Bureau of Statistics via CEIC database.

Key Findings

- China's demand for imported energy has significantly expanded in tandem with its growing economy, leading it to become a net crude oil importer in 1993. China depends on imports for 72 percent

of its oil consumption, and the overwhelming majority of China's oil imports must pass through maritime chokepoints over which the United States has significant influence. To mitigate its

vulnerabilities, China's government has invested billions of dollars in overland pipelines, launched a national tanker fleet it can direct to sail through conflict zones and potentially run blockades, and

begun building out its capabilities for long-range power projection.

- Through its powerful economic planning agency, the National Development and Reform Commission (NDRC), the Chinese central government imposes strict energy price controls as levers that can be adjusted to remedy imbalances and allocate resources within China’s energy system. These controls contribute to pervasive energy market distortions. Inconsistent and conflicting central government guidance contributes further to local energy system mismanagement. The resulting system is too brittle to correct for sudden energy supply disruptions and price shocks, and it contributed to a domestic energy crisis in 2021 that caused ripple effects throughout the global economy.

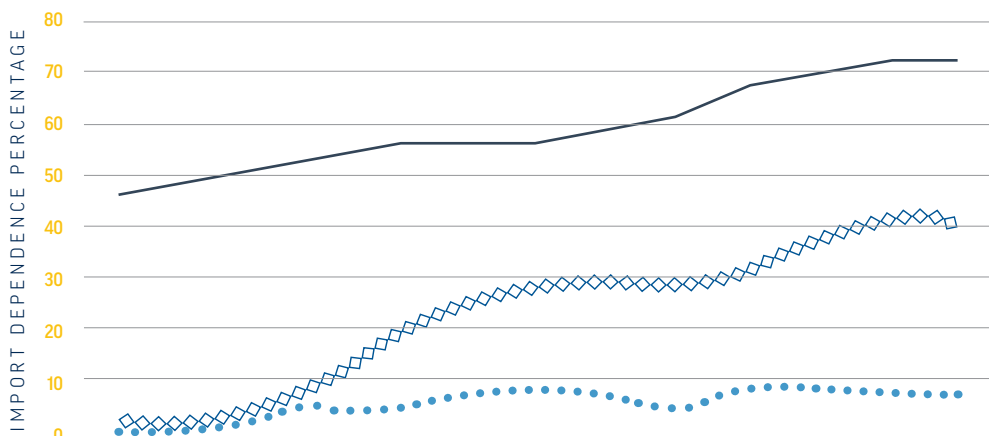
- Despite climate pledges by Chinese leaders, China remains the world’s largest carbon dioxide emitter, and it continues to build out its coal-fired power plants with unprecedented speed. Moreover, decarbonization of China’s energy-intensive economy sufficient to meet its stated goals would require large-scale economic restructuring, and policymakers have yet to make significant progress toward this goal. China’s international and domestic climate targets intentionally delay the politically difficult policies required to meaningfully reduce emissions.

- Chinese national oil companies (NOCs) have also cultivated close relations with suppliers in the developing world, using local corruption in supplier countries as a competitive advantage and targeting oil-rich countries with low transparency

to secure access to resources. Chinese NOCs exert growing control over global oil supplies by coopting foreign oil production through oil-backed loans or by pursuing ownership stakes in foreign oil-producing assets to secure “equity oil.”

- Beijing is cultivating leadership in clean energy technologies in order to secure future markets and supply chains. A secondary goal is for domestically produced clean energy technologies to support China’s decarbonization efforts. China’s status as a global clean energy technology manufacturing hub and the fastest-growing renewable energy market affords it unique advantages in commercializing the next generation of clean energy technologies. ■

FIGURE 3
CHINA’S OIL, GAS, AND COAL IMPORT DEPENDENCY, 2007-2019



Note: Figure illustrates the percentage of China’s total oil, gas, and coal consumption from imported sources.
Source: International Energy Agency, “Oil, Gas, and Coal Import Dependency in China, 2007-2019.”

Section 4: U.S. Supply Chain Vulnerabilities and Resilience

The United States is vulnerable to a number of threats stemming from the concentration of many critical supply chain segments in China, including active pharmaceutical ingredients (APIs), rare earth elements, castings and forgings, and others. Chinese leaders are aware of their supply chain strengths, as well as their weaknesses, and they are taking active measures to limit their own vulnerabilities and sustain and enhance their leverage over certain

U.S. supply chains.

U.S. supply chain risks from China can be measured by exposure and consequence across five stages: materials, components, final products, transportation and logistics, and research and design. Foremost among the challenges to remedying U.S. critical supply chain vulnerabilities are lack of visibility, weaknesses related to sourcing from a single supplier either by

choice or lack of alternatives, and susceptibility to disruption of “just-in-time” delivery. For U.S. defense supply chains, in particular, a dearth of strong demand signals and contraction in the defense industrial base have led to fewer providers of defense systems and materials, lowering capacity for outputs and reducing resilience to interference from and dependencies on China.

Key Findings

- The concentration of production within China for certain critical global supply chains leaves the United States and other countries vulnerable to disruption and potential strategic trade interdictions by the Chinese Communist Party (CCP). Beijing seeks further consolidation and domination of global supply chains to create influence and leverage. The CCP has demonstrated its willingness to wield the resulting trade dependencies as tools of strategic competition and political leverage.
- CCP leaders’ assessments of their own supply chains have led them to a combustible mix of confidence and anxiety. While CCP leaders plan to bolster and leverage China’s strong position in manufacturing, they are extremely concerned about technological dependencies and vulnerabilities. Recent U.S. actions against Chinese telecommunications companies, as well as the coordinated multilateral response to Russia’s unprovoked invasion of Ukraine, have led Beijing to hasten longstanding plans for achieving technology self-reliance.
- A continuing lack of visibility into critical U.S. supply chains likely masks potential vulnerabilities to disruptions and compromise by Chinese state actors. The lack of a coordinated U.S. supply chain mapping and mitigation strategy, as illustrated in recent reports by various U.S. government agencies, continues to hinder supply chain diversification and resiliency across a number of key national security and critical industries, including APIs and rare earth elements that are crucial for U.S. infrastructure, health, and security.
- While numerous supply chain risk management and mapping initiatives are underway, further action in the public domain is needed for standardizing, collecting, and analyzing necessary data, particularly in supply chains reliant upon sole- or single-source suppliers, as in many renewable and alternative energy supply chains. Greater due diligence and verification are needed to protect defense and critical infrastructure supply chains from Chinese counterfeit or corrupted components and to prevent investments by Chinese companies that may compromise suppliers’ intellectual property or limit their ability to participate in federal acquisition programs.
- The U.S. government’s inconsistent spending trends and irregular, outdated procurement practices have accelerated contraction of the defense industrial base, leading to reduced manufacturing capacity, fewer alternative suppliers, and ultimately greater dependence on Chinese suppliers for some critical materials and components. Federal funding practices discourage much of industry, particularly small businesses, from competing for contracts with the U.S. Department of Defense and do not incentivize resilience measures like the ability to surge manufacturing capacity and create and maintain material stockpiles that would mitigate supply chain disruptions and allow the defense industrial base to meet surge capacity requirements if needed. ■

CHAPTER 3: U.S.-CHINA SECURITY AND FOREIGN AFFAIRS

Section 1: Year in Review: Security and Foreign Affairs

The CCP responded to a turbulent year by hardening its foreign and domestic policy approaches. In foreign policy, China's leaders chose to preserve close ties with Russia even after the country's unprovoked invasion of Ukraine, drawing a stark contrast with China's espoused commitment to foreign policy principles of "territorial integrity" and "noninterference." China's diplomats also took advantage of the crisis to promote General Secretary of the CCP Xi Jinping's so-called "Global Security Initiative," an effort to create a new international security paradigm more favorable to China. Many governments, including members of the EU, NATO, and the Quad, publicly condemned China's actions as threatening the norms-based international order and universal values; however, in other countries, especially in the developing world, China faced limited pushback. In the military sphere, China increased the brazenness of its operations in the air and waters around Taiwan, its confrontations in the South China Sea, and its pursuit of overseas basing options. As the People's Liberation Army (PLA) continued to upgrade the quality of its weapons and military equipment, Beijing

unilaterally withdrew from all military-to-military interactions with the United States.

These international actions took place against a backdrop of continued political tightening within China. In an effort to ensure political stability for the "victorious convening" of the 20th Party Congress and presumed extension of Xi's rule, the CCP leadership undertook a series of targeted measures to suppress all potential political dissent both from the broader society and from within the CCP itself. Throughout the year, the CCP continued to lock down cities and promote Xi's Zero-COVID policy

as the only appropriate response to COVID-19. China's ineffective vaccination effort left Chinese society particularly vulnerable to disruption by the more highly transmissible Omicron variant, leading to continued heavy-handed containment measures in cities like Shanghai despite significant public discontent and protests. Local leaders in China even used mass surveillance tools developed for COVID-19 mitigation to suppress unrelated protests and reinforce social control. The CCP similarly continued to tighten restrictions on China's cultural, ethnic, and religious minorities, including the Uyghurs and Tibetans.

The CCP responded to a turbulent year by hardening its foreign and domestic policy approaches.

Key Findings

- The CCP wanted a stable year for the convening of the 20th Party Congress and presumptive extension of General Secretary Xi's rule. They did not get it. Russia's unprovoked invasion of Ukraine and internal discontent surrounding outbreaks of COVID-19 strained China's foreign and domestic policy. Instead of rethinking his approaches, Xi has doubled down on his policy agenda.
- Russia and China in 2022 announced a "no limits" partnership, the culmination of a years-long effort to strengthen ties. This was immediately followed by Russia's unprovoked invasion of Ukraine. Beijing provided diplomatic and economic support to Russia, all while promoting itself as "objective and impartial." The CCP, diplomats, and media amplified Russian talking points and attempted to shift blame to the United States and NATO for Russia's war of choice.
- NATO, along with South Korea, Japan, and New Zealand, declared China to pose a "systemic challenge" to a norms-based international order that upholds universal values. China's diplomats dismissed these concerns and continued to promote the "Global Security Initiative," a still vague security framework that endorses the interpretation of "indivisible security" that Russian diplomats cite in their statements concerning Ukraine.
- The Chinese government took steps toward securing additional overseas access and basing opportunities for its armed forces. In April, China concluded an agreement with the Solomon Islands granting access and transit rights for its military and paramilitary forces in the country. This agreement accompanied a broader push for increased influence in the Pacific Islands region in 2022. In June, a Chinese official confirmed PLA access to a Cambodian naval base. The PLA also appears to be considering sites for a base on the western coast of Africa.
- China's aggressive activities in the South China Sea led to dangerous encounters between Chinese and other countries' ships and aircraft in the region. In November 2021, China began blocking access to the Automatic Identification System (AIS) signals of its ships in the region to obscure their location, breaking an international standard practice for maritime safety. A Chinese Coast Guard ship maneuvered within an unsafe distance of a Philippine patrol vessel in March, and in May the PLA conducted at least two dangerous maneuvers against Australian reconnaissance aircraft operating in international airspace. ■

Section 2: China's Cyber Capabilities: Warfare, Espionage, and Implications for the United States

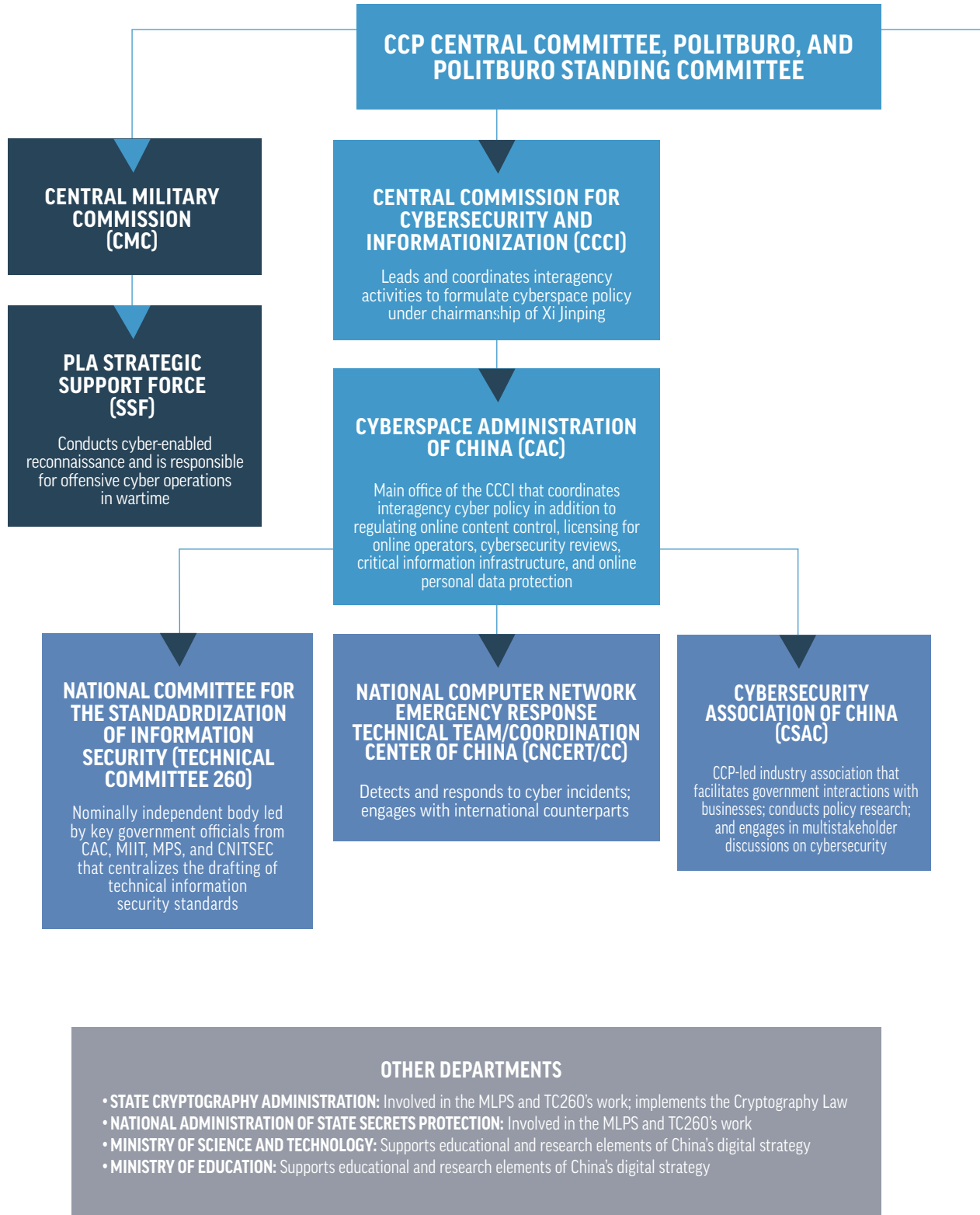
China has engaged in a massive buildup of its cyber capabilities over the past decade and poses a formidable threat to the United States in cyberspace today. The country has achieved this transformation by reorganizing its cyber policymaking institutions (see Figure 4), developing sophisticated offensive cyber capabilities, and perpetrating cyberespionage to steal foreign intellectual property at industrial scale. China has

also played by a different set of rules than the United States in cyberspace, leveraging large swathes of its own government and society to advance its activities in cyberspace. These efforts include regulations requiring civilian companies and researchers to report software vulnerabilities they discover to the Chinese government prior to public notification, the apparent exploitation by the Chinese intelligence services

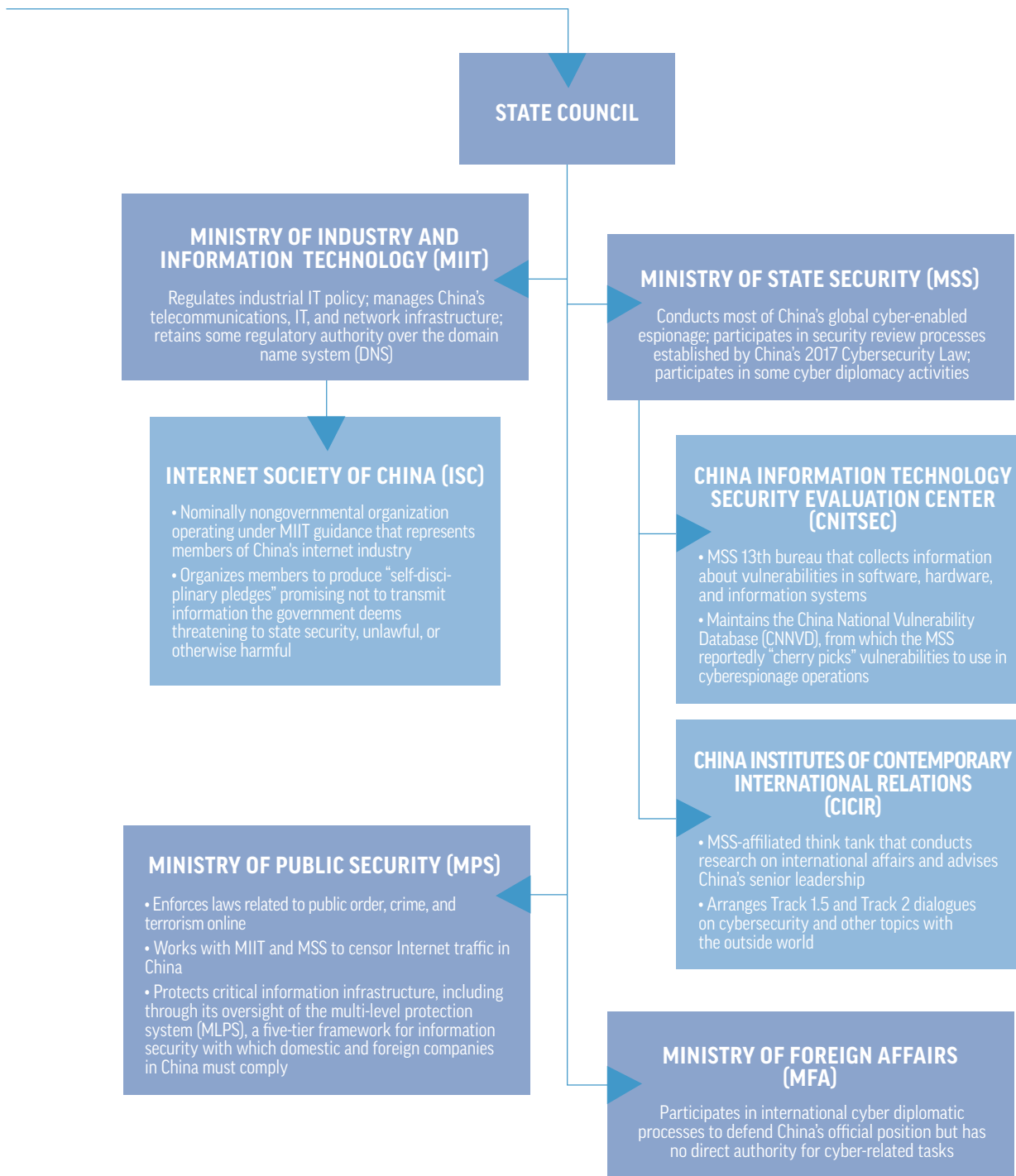
of vulnerabilities reported to the government for cyberspace operations, and the widespread collaboration on cyber capability development with Chinese universities and companies. China also promotes its "cyber sovereignty" norm in contrast to widely held principles of a free and open global internet.

FIGURE 4
SELECTED KEY INSTITUTIONS IN CHINA'S
CYBERSECURITY ECOSYSTEM

SECURITY AND FOREIGN AFFAIRS



Note: This graphic displays a selection of key institutions in China's cybersecurity ecosystem; it is not exhaustive.
Source: See the full Annual Report for complete list of sources.



As a result of these long-running efforts, China's activities in cyberspace are now more stealthy, agile, and dangerous to the United States than they were in the past. Urgent questions remain concerning the United States' readiness for the China cyber challenge, including the adequacy of resourcing for U.S. military cyber forces, the sufficiency of existing protections for U.S. critical infrastructure, and the scope of public-private cybersecurity cooperation.

Key Findings

• China's cyber operations pose a serious threat to U.S. government, business, and critical infrastructure networks in the new and highly competitive cyber domain. Under Xi, the country's leaders have consistently expressed their intention to become a "cyber superpower." China has developed formidable offensive cyber capabilities over the past decade and is now a world leader in vulnerability exploitation. As a result, China's activities in cyberspace constitute a fundamentally different, more complex, and more urgent challenge to the United States today than they did a decade ago.

• China enjoys an asymmetric advantage over the United States in cyberspace due to the CCP's unwillingness to play by the same rules, reflecting a dynamic observable in other areas of U.S.-China relations. The United States and China diverge sharply on the norms that should guide responsible state behavior in cyberspace during peacetime. The main points of contention are China's perpetration of cyberespionage for illegitimate economic advantage, its emphasis on state control over the internet under the guise of cyber sovereignty, and its opposition to

the application of certain principles of international law in the cyber domain. China promotes its preferred norms in existing international and regional institutions and is creating new organizations to supplant existing cyber governance mechanisms in line with its vision for the internet.

• The PLA views cyberspace operations as an important component of information warfare in concert with space, electronic, and psychological warfare capabilities. The Strategic Support Force (SSF) is at the forefront of China's strategic cyberwarfare operations and plans to target both U.S. military assets and critical infrastructure in a crisis or in wartime.

• China's cyberespionage activities are increasingly sophisticated and use advanced tactics, techniques, and procedures (TTPs) such as vulnerability exploitation and third-party compromise to infiltrate victims' networks. China's premier spy agency, the Ministry of State Security (MSS), conducts most global cyberespionage operations and targets political, economic, and personally identifiable information to achieve China's strategic objectives.

• Military-civil fusion underpins China's development of cyber capabilities and conduct of cyber operations. To advance China's military aims, the SSF can mobilize civilian information technology (IT) resources, such as data centers, as well as militias composed of technically competent civilians working in the domestic telecommunications industry, cybersecurity firms, and academia. For its cyberespionage operations, the MSS exploits vulnerabilities submitted to the Chinese government and often employs contractors to carry out state-sponsored cyber operations.

• China's cybersecurity legislation weaponizes the country's cybersecurity industry and research by requiring companies and researchers to submit all discovered software and hardware vulnerabilities to the government before providing them to the vendors that can patch them. This policy, leveraged in combination with domestic hacking competitions and cooperative agreements with Chinese universities, provides China's security services with a steady stream of vulnerabilities to exploit for state-sponsored operations. ■

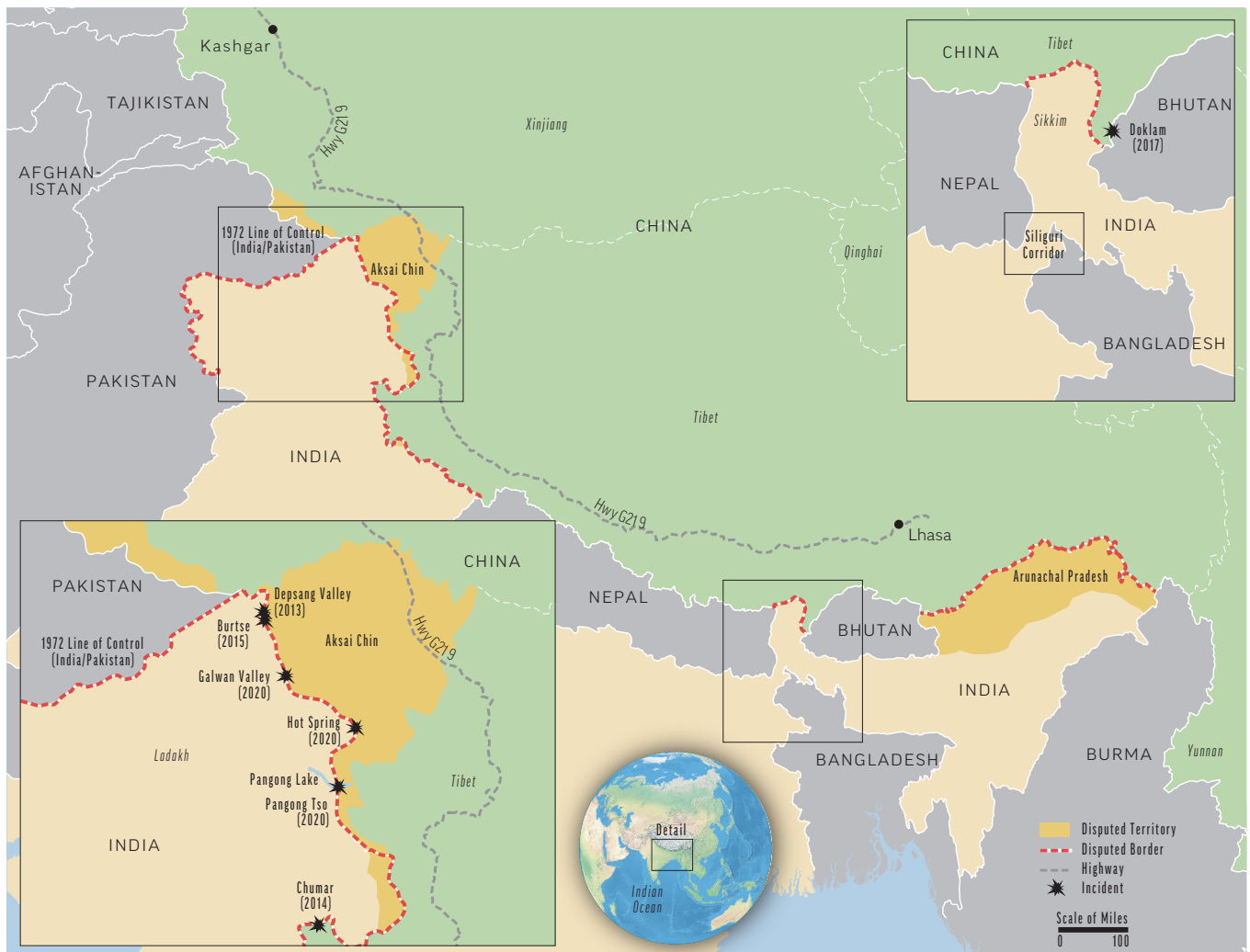
Section 3: China's Activities and Influence in South and Central Asia

Chinese leaders consider South and Central Asia critical to securing China's western borders and ensuring access to Eurasia and the Indian Ocean. Accordingly, the Chinese government has escalated its efforts to exert influence in the regions over the past decade and has tried to establish its

development and internal security interests as regional priorities by leveraging political influence through investment and loans. In South Asia, the Chinese government has become a more significant presence, but it has also damaged its relations with India and contributed to India's increasingly

close relationship with the United States (see Figure 5). In Central Asia, China has accrued significant influence, yet public opinion toward China remains mixed in the region. Meanwhile, the Chinese government remains concerned about its ability to manage regional security risks emanating from Afghanistan.

FIGURE 5
DISPUTED AREAS AND MILITARY INCIDENTS
ALONG THE SINO-INDIAN BORDER (2013 TO 2022)



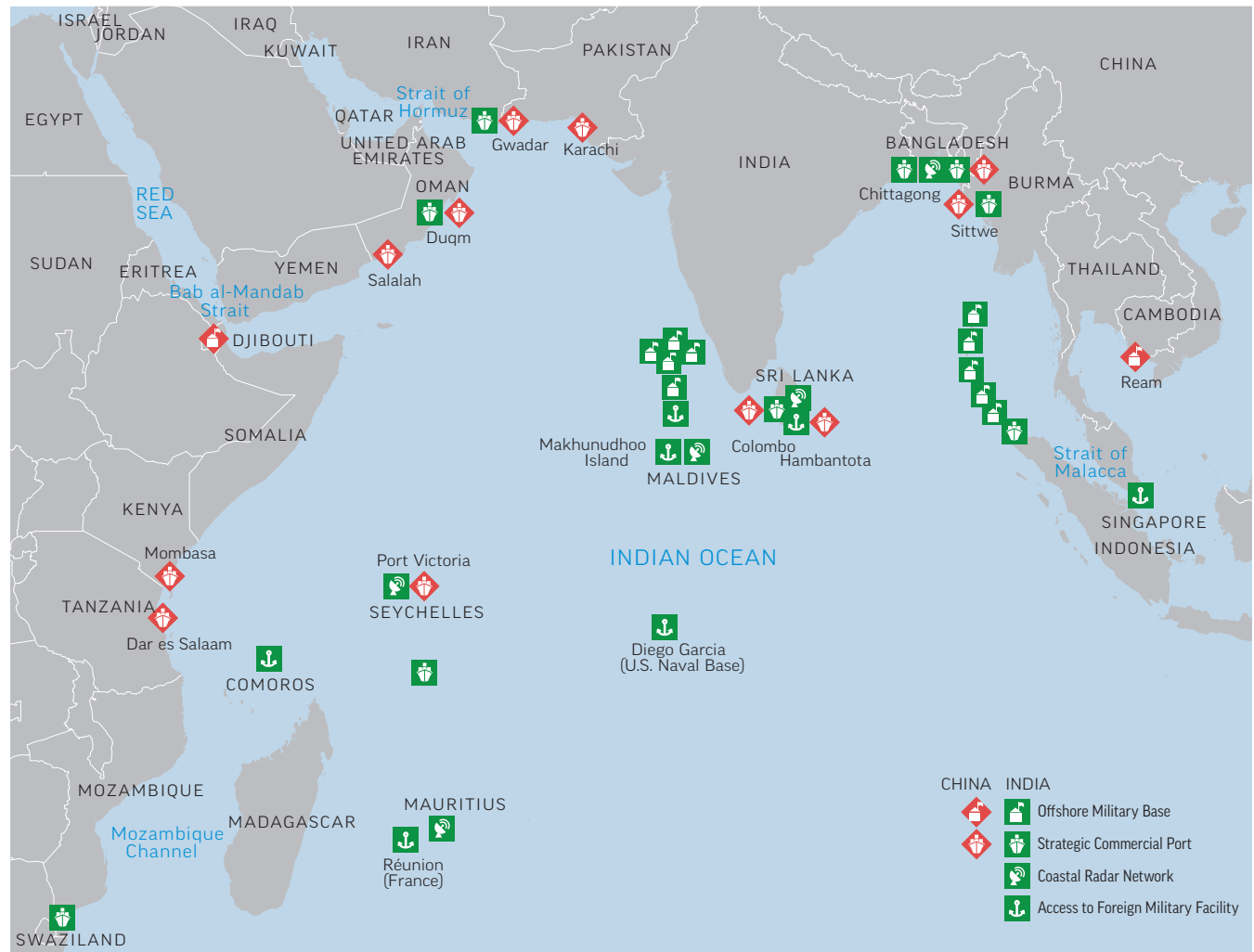
Source: Ashley J. Tellis, "Hustling in the Himalayas: The Sino-Indian Border Confrontation," *Carnegie Endowment for International Peace*, June 4, 2020, 2; Will Green, "Conflict on the Sino-Indian Border: Background for Congress," *U.S.-China Economic and Security Review Commission*, July 2, 2020.

The Chinese government's increasing outreach to South and Central Asia and changes in the regions are challenging traditional balances of power. While Chinese leaders consider the Indian Ocean region as a secondary theater,

China's increasing economic ties, growing network of strategic commercial ports, and greater PLA Navy activity could foreshadow a long-term challenge to Indian and U.S. interests in the region (see Figure 6). In Central Asia,

China's growing bilateral security partnerships and influence in the Shanghai Cooperation Organization indicate the Chinese government's increasing willingness to encroach on Russia's traditional role as the region's dominant security partner.

FIGURE 6
MAJOR INDIAN AND CHINESE SECURITY INVESTMENTS IN THE INDIAN OCEAN



Source: Asia Maritime Transparency Initiative, "Ports and Partnerships: Delhi Invests in Indian Ocean Leadership," *Center for Strategic and International Studies*, December 5, 2019; Chad Peltier, Tate Nurkin, and Sean O'Connor, "China's Logistics Capabilities for Expeditionary Operations," *Janes* (prepared for the U.S.-China Economic and Security Review Commission), April 15, 2020, 26.

Key Findings

- Chinese strategists view the U.S. Navy as China's principal challenge in the Indian Ocean. In response, PLA Navy warships and submarines regularly exercise expeditionary capabilities in the Indian Ocean in what the PLA claims are antipiracy operations. China's efforts to secure its interests in the Indian Ocean region have included significant development financing in Sri Lanka and the Maldives, two small but strategically located island countries near India. Despite these efforts, however, China has yet to convert its economic ties into significant political or security gains.

- Over the past decade, China's government has worked to undermine India's influence in South Asia and exert its own, including by escalating military tensions along the two countries' disputed border. As a result, China-India relations are now at their lowest point in decades. The Indian government has increased its efforts to reduce its economic reliance on China, though it has had limited success to date.

- China has longstanding security ties with Pakistan motivated largely by a common geopolitical rivalry and territorial disputes with India. Since 2015, these ties have been bolstered by the China-Pakistan Economic Corridor (CPEC), an initiative that promises massive infrastructure investment as part of China's Belt and Road Initiative (BRI). While rhetorical support for CPEC remains strong in both countries, its implementation has fallen short of original expectations, and Pakistan's deteriorating security situation makes significant expansion of CPEC highly unlikely in the near term.

- China's engagement in Central Asia and Afghanistan is primarily driven by security concerns and preventing unrest in the regions from crossing into China's Xinjiang Uyghur Autonomous Region. The Chinese government also views the region as an important source of commodities such as oil, natural gas, and uranium and as a gateway to westward expansion of BRI. Its integration with Central Asia has recently accelerated

as the region's traditional hegemon, Russia, has experienced setbacks in the wake of its unprovoked invasion of Ukraine.

- The Chinese government's development financing in South and Central Asia has helped recipient countries build much-needed infrastructure, but it also serves China's own economic and political aims. Its opaque lending, which typically does not require institutional economic reforms, often exacerbates underlying governance issues in recipient countries. Its lending terms are also more onerous than those from the United States or international financial institutions such as the International Monetary Fund. The turbulence in Sri Lanka that has occurred throughout 2022 is exacerbated by the hazards of accepting significant Chinese lending. ■

CHAPTER 4: TAIWAN

In 2022, China adopted a significantly more aggressive stance toward Taiwan, ramping up displays of military force in addition to diplomatic and economic coercion. Beijing has also carefully observed Russia's war in Ukraine, presumably drawing lessons that would inform its approach if Chinese leaders ultimately decide to force unification with Taiwan. While the lessons being learned are not yet clear, Chinese leaders may conclude that managing information, mitigating the potential impact of sanctions,

and examining the Russian military's combat performance are paramount. For their part, Taiwan's leaders may conclude on the basis of Ukraine's experience that they must adopt an asymmetric warfighting strategy, involve the populace in resistance to a Chinese military operation, and build stockpiles of critical materials.

Taiwan's economy demonstrated resilience in 2022, bolstered by global demand for its microelectronics exports. The semiconductor sector remains

heavily dependent on trade with the Mainland, though it was notably spared from the economic coercion Beijing levied against many smaller industries as part of its ongoing campaign to intimidate and punish the Taiwan government for its global engagement. Taiwan's vulnerability to Beijing's coercion is coming into greater focus as the specter of a Chinese blockade looms over the island's reliance on imported energy and food.

Key Findings

- Russia's unprovoked invasion of Ukraine in 2022 provided a contemporary case study of the potential challenges and opportunities the People's Republic of China might face if its leadership decides to attempt unification with Taiwan through the use of force. The war in Ukraine also injected urgency into ongoing discussions in Washington and Taipei about how to enhance the island's self-defense capabilities amid the PLA's massive military buildup as well as current and future challenges and disruptions to the global supply chains vital for weapons production.

- Beijing continued its multifaceted coercion campaign against Taiwan this year to isolate its people from the world. Chinese

officials leveraged their power in international institutions to propagate falsehoods about a global consensus underpinning their "One China" principle and to prevent Taiwan from sharing its valuable expertise on issues ranging from global health to oceanic science. The PLA continued its intimidating and frequent operations in the air and waters around Taiwan, conducting large-scale live-fire exercises in August after Speaker of the U.S. House of Representatives Nancy Pelosi's visit to Taiwan (see Figure 7).

- Taiwan and the United States are pursuing closer economic and trade collaboration. In June 2022, the U.S.-Taiwan Initiative on 21st-Century Trade was launched as the two

economies agreed to pursue deeper integration. The U.S.-Taiwan Initiative will also address shared concerns related to China's nonmarket practices, including discussions on state-owned enterprise and nonmarket economy-related issues.

- China's economic coercion of Taiwan targets export industries that are both relatively small and highly dependent on China's consumer market, attempting to send a political message and inflict pain on Taiwan while avoiding fallout on China's own economy. The Chinese government used the pretext of Speaker Pelosi's trip to increase its economic coercion of Taiwan, implementing a variety of import bans on food products that in particular originate from areas

supportive of Taiwan's President Tsai-Ing Wen. Beijing's decision to leave the far more consequential trade in semiconductors untouched demonstrates its approach to economic targeting of Taiwan industries that are relatively small and highly dependent on China's consumer market.

- Beijing's messaging to foreign and domestic audiences evolved in new and concerning ways. Chinese officials' international messaging asserted China's ownership of the entire Taiwan Strait and conveyed their disdain for international norms. Speaking to its own members, the CCP unveiled and credited to General

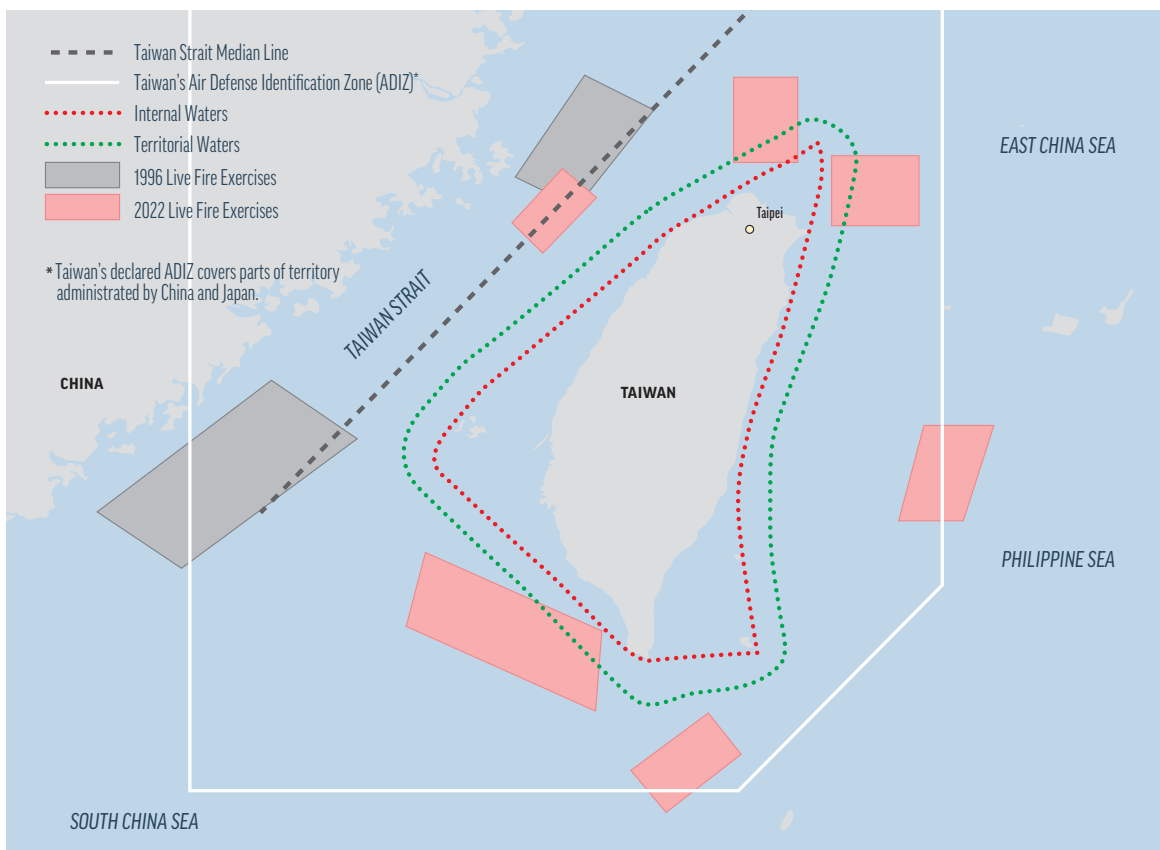
Secretary of the CCP Xi Jinping a new "overall strategy for resolving the Taiwan question in the new era." While much of the strategy repeats longstanding tenets of China's policy toward Taiwan, certain phrases raise questions about whether the CCP could announce significant changes to Taiwan policy at its 20th Party Congress in late 2022.

- Taiwan's effective containment of the COVID-19 pandemic and strong demand for Taiwan exports led to robust economic growth through the first quarter of 2022. In contrast to the extended lockdowns that have shuttered substantial swaths of China's economy, Taipei has shifted

to a less stringent set of COVID-19 management policies, allowing for greater economic openness. However, China's lockdowns and inflationary concerns in advanced economies have slowed Taiwan's growth relative to 2021.

- Taipei is accelerating efforts to respond to risks related to China-centric supply chains, including through cooperation with the United States. Domestically, development and investment initiatives continue to seek to draw Taiwan firms back from the Mainland, recalibrating cross-Strait supply chains. ■

FIGURE 7
CHINA'S 1996 AND 2022 LIVE-FIRE EXERCISES AROUND TAIWAN



Source: Adapted from Kathrin Hille, "China's Military Response to Pelosi Visit Raises Escalation Fears," *Financial Times*, August 3, 2022.

CHAPTER 5: HONG KONG

In 2022, Hong Kong became increasingly isolated and further subordinated under Beijing's control. Security authorities continued their assault on Hong Kong's freedoms while the economy suffered from restrictions guided by Chinese government direction. Stronger mainland influence over Hong Kong is driving key changes to all aspects of life in the territory and more emigration. Hong Kong remains an important offshore financial and business center for the Mainland due to the territory's unique connections to the global financial system. The territorial government is moving to a legal system that increasingly mimics that of the Mainland, threatening prospects for journalists and civil

society as well as U.S. and other foreign businesses and expatriates in the territory.

Beijing has continued its increasingly systematic dismantling of Hong Kong's civic institutions and installation of loyalists in the territory's government in support of advancing security objectives. Hong Kong's rule of law continues to be undermined as only Beijing-approved judges serve on national security cases and security forces increase politically motivated arrests and detention. Following mass arrests of prodemocracy protestors in 2019 and 2020, the number of political prisoners in the territory is rising as Hong Kong authorities continue to

target educators, labor organizers, journalists, and religious leaders. Despite increased political risk, foreign investors continue to rely on Hong Kong as a channel into China, particularly as the territorial government develops new mechanisms for investment.

The territorial government is moving to a legal system that increasingly mimics that of the Mainland.

Key Findings

- With Beijing's handpicked chief executive now at the helm, China firmly controls all branches of Hong Kong's government, ushering in a new era of total control by mainland authorities. Beijing has now successfully inserted loyalists into every branch of Hong Kong's government. By overhauling the election process, it created a rubber-stamp parliament full of so-called patriots, and it has also leveraged the new chief executive's authority to appoint judges.
- Hong Kong is actively working to implement "local" national security rules to reinforce the National Security Law passed in Beijing's legislature in 2020. These new local laws are slated for introduction by the end of 2022 and are expected to feature a comprehensive definition of national security in line with that of the Mainland.
- Freedoms of speech, expression, assembly, association, and religion in Hong Kong—once among the most progressive in the region—have all but vanished as the territory now ranks near the bottom of global freedom indices. Prominent religious figures, such as Hong Kong's senior-most cleric, Cardinal Joseph Zen Ze-kun, have been targeted and arrested; the education system has also come under intense scrutiny as Beijing seeks to shed Hong Kong's British legacy by rewriting textbooks and curricula to revise history and solidify a more unified national identity with the Mainland.

- Recent data suggest Hong Kong's increased departures of expatriates and locals will intensify as the territory introduces new laws to curb public criticism of the Beijing-aligned government has imposed strict Zero-COVID controls for most of 2022. Brain drain and potential loss of talent could be an added damper to Hong Kong's economic outlook. More foreign companies may find Hong Kong less welcoming as they contend with challenges retaining staff, accessing real-time information, and navigating a higher degree of political suppression and control.

- Hong Kong's leadership, in concert with the Beijing government, is actively crafting policies to increase

not only legal, political, and economic subordination of Hong Kong but also cultural and demographic transformation.

- Hong Kong has regressed from its history as a regional hub, shifting to serving primarily as gateway to mainland China. Some U.S. companies are reorganizing operations in the Indo-Pacific to shift away from Hong Kong due to extensive restrictions and difficulties associated with doing business in the territory. U.S. companies are poised to take regional operations and headquarters out of Hong Kong gradually and in greater numbers.

- Hong Kong remains an important part of the Chinese government's growth agenda due to its centrality in renminbi transactions as well as its role in supporting expansion of China's financial services. The CCP's plans to rely on Hong Kong's stock exchange as an alternative to U.S. exchanges have been delayed in 2022, but Chinese companies and banks are set to dominate Hong Kong's business environment as U.S. and other foreign firms depart. ■

COMPREHENSIVE LIST OF THE COMMISSION'S 2022 RECOMMENDATIONS

Chapter 1: CCP Decision-Making and Xi Jinping's Centralization of Authority

The Commission recommends:

1. Congress pass legislation creating a new Federally Funded Research and Development Center (FFRDC) (to replace the Open Source Center closed in 2015) that will translate and maintain a publicly available collection of important open source material from the People's Republic of China (PRC) and other countries of strategic interest. This legislation should require existing FFRDCs to provide to this new entity a copy of all open source Chinese-language materials collected or used in any government-sponsored analytical or related projects on an ongoing basis.
2. Congress direct the Office of the U.S. Director of National Intelligence to produce an unclassified directory of Chinese Communist Party (CCP) senior members and organizations, similar to the "Directory of PRC Military Personalities" produced and updated by the U.S. Department of Defense.
 - ▶ The directory should be updated on an annual basis and consist of an unclassified public report on the CCP, including the Party's organizational structure (including organizations affiliated with the United Front Work Department) and profiles of leaders and organizations at least to the level that the CCP defines as "senior cadre."
 - ▶ The contents of each year's directory should be retained in the form of an unclassified, publicly available, searchable database of CCP members and organizations.

Chapter 2: U.S.-China Economic and Trade Relations

Section 2: Challenging China's Trade Practices

The Commission recommends:

3. Congress consider legislation providing the authority to impose retaliatory trade measures against China in support of an ally or partner subject to Chinese economic coercion. Such legislation shall authorize coordinated trade action with U.S. allies and partners.
4. Congress direct the Administration to produce within 90 days an interagency report coordinated by the Office of the U.S. Trade Representative to assess China's compliance with the terms and conditions of the 1999 Agreement on Market Access between the People's Republic of China and the United States of America. The assessment should be presented as a summary list of comply/noncomply status of the provisions under the agreement. If the report concludes that China has failed to comply with the provisions agreed to for its accession to the WTO, Congress should consider legislation to immediately suspend China's Permanent Normal Trade Relations (PNTR) treatment. Following the suspension of PNTR, Congress should assess new conditions for renewal of normal trade relations with China.
5. Congress direct that any entity subject to national security restrictions or sanctions by a U.S. department or agency, including but not limited to the Entity List, should be denied access to the Clearing House Interbank Payments System (CHIPS), the Automated Clearing House (ACH), and the Federal Reserve's funds transfer system (Fedwire).
6. Congress direct the U.S. Department of Commerce to provide regular (semiannual) reports on its enforcement of

the foreign direct product rules and its approval of export license applications for entities seeking to export to China items produced from technology or software controlled for national security reasons. Such a report shall not identify U.S. exporters, but it shall include:

- ▶ The number of licenses granted;
- ▶ The number of licenses granted per export destination;
- ▶ Item classifications for such licenses;
- ▶ The value of such exports; and
- ▶ The rationale for granting the licenses.

7. Congress direct the U.S. Patent and Trademark Office to mandate that any applicant for a U.S. patent that has received support under a program administered directly or indirectly by the Chinese government provide the same disclosures that recipients of U.S. federal support must provide.

8. Congress direct the U.S. Department of Commerce to develop a process to identify and self-initiate antidumping and countervailing duty petitions covering products from China. In developing the methodology to support such a process, the department shall utilize existing government data and develop new data collection efforts prioritizing the identification of products injuring or threatening to injure small- and medium-sized enterprises or industries facing long-term harm from Chinese industrial overcapacity. The department shall also develop the capabilities for the U.S. government to identify and pursue self-initiation of circumvention, evasion, and transshipment enforcement cases to address products originating from China.

9. Congress direct the U.S. Department of Commerce to update its methodology in determining antidumping duty rates for products from China to net out the subsidy or dumping impact of Chinese-sourced inputs utilized in identifying relevant third-country proxy rates to determine dumping margins. This approach should allow for the adjustment of rates used to identify an appropriate proxy for market-based producers where China's impact on such rates may skew the true market equivalent value of such products to determine dumping margins.

10. Congress consider legislation that would address the Chinese Communist Party's efforts to undermine

U.S. intellectual property protections through its use of antisuit injunctions. In considering such legislation, Congress should seek to ensure the integrity of U.S. patent laws and the strength of our nation's patent system and its support for U.S. innovation by protecting patent rights and the sovereignty of U.S. courts and the U.S. adjudicatory system.

11. In enacting legislation subsidizing research or production, Congress should evaluate whether China can legally gain access to that research or to the knowledge and equipment needed to produce that good to prevent the United States from indirectly subsidizing or supporting Chinese competitors.

12. Congress direct the Office of the U.S. Trade Representative to monitor and publicly identify in an annual report the industries wherein China's subsidies, including state monopolization and evergreen loans, pose the greatest risk to U.S. production and employment. A rebuttable presumption of guilt in antidumping and countervailing duty processes shall result from the findings of this report.

13. Congress create an authority under which the president can require specific U.S. entities or U.S. entities operating in specific sectors to divest in a timely manner from their operations, assets, and investments in China, to be invoked in any instance where China uses or threatens imminent military force against the United States or one of its allies and partners.

Section 3: China's Energy Plans and Practices

The Commission recommends:

14. Congress direct the U.S. Department of Defense to produce a classified report on the feasibility of and the military requirements for an effective blockade of energy shipments bound for China in the event of military conflict involving China. The report should place particular attention on the Strait of Malacca and the feasibility of operationalizing a blockade of shipping bound for China intending to transit that waterway. The report should also consider the extent to which China may be able to satisfy its energy needs during a crisis or conflict through stockpiles, by rationing supplies, and by relying

on overland shipments through current and planned cross-border oil and gas pipelines.

15. Congress direct the U.S. Department of Energy to produce an annual report detailing the extent to which U.S. supply chains for key energy technologies, components, and materials are subject to Chinese control or manipulation.

Section 4: U.S. Supply Chain Vulnerabilities and Resilience

The Commission recommends:

16. Congress direct the Administration to create an Economic and Security Preparedness and Resilience Office within the executive branch to oversee, coordinate, and set priorities for cross-agency efforts to ensure resilient U.S. supply chains and robust domestic capabilities, in the context of the ongoing geopolitical rivalry and possible conflict with China. This Office would be tasked with:

- ▶ Establishing a dedicated Supply Chain Mapping Unit to determine requirements, set priorities, and coordinate efforts to continuously map, monitor, and analyze the most critical supply chains, including but not limited to semiconductors, rare earths, life-saving and life-sustaining medications and their active pharmaceutical ingredients, and castings and forgings.
 - ▷ The unit would be tasked with developing interoperable performance measures to monitor and assess current U.S. supply chain resiliency and risk mitigation efforts, including data collection on U.S. supply chain dependencies on direct and indirect Chinese suppliers, prioritizing defense-critical supply chains.
- ▶ Establishing a Defense Mobilization Unit responsible for coordinating and setting priorities for:
 - ▷ Assessment of the requirements for weapons, munitions, supplies, and other equipment necessary to equip and support U.S. forces and to assist friends and partners in the Indo-Pacific region in a potential conflict with the People's Republic of China, including conflicts of varying duration;
 - ▷ Determination of the adequacy of existing stocks and available productive capacity to meet those needs;
 - ▷ Identification of potential shortfalls or bottlenecks

that might impede production and resupply in some scenarios; and

- ▷ Recommendation of corrective measures to address these problems.
- ▶ Including in its assessments the effects of potential disruptions in U.S.-China trade on defense mobilization and domestic availability of critical materials, products, and supplies. Where it identifies likely requirements for additional capacity, the unit shall determine funding and support mechanisms to ensure the timely development of such capabilities and capacity.
- ▶ Consulting with other departments and agencies to identify shortfalls in current defense industrial base and supporting industrial capabilities and what additional measures might be needed to address them.

17. In enacting legislation subsidizing reshoring or existing production in the United States, Congress should evaluate whether the subsidies may lead to additional dependence on supply chains running through or relying on China to serve that production.

18. Congress enact legislation requiring suppliers to the U.S. government in “critical” sectors, as defined by Congress, to confidentially disclose all tiers of their contractors for the purpose of identifying U.S. supply chain dependencies on China. If suppliers are unable to do this within three years and each year thereafter, they are ineligible to receive government contracts.

19. Congress direct the Administration as part of the Indo-Pacific Economic Framework (IPEF) to negotiate a prohibition on the utilization of China's National Transportation and Logistics Public Information Platform (LOGINK) or similar systems provided by Chinese state-affiliated entities within IPEF member ports. A two-year transition period shall be provided for existing users of LOGINK or similar Chinese-controlled or -affiliated systems to terminate use of such systems and transition to secure logistics systems with no Chinese control or affiliation.

20. Congress direct each federal agency administering Small Business Innovation Research (SBIR) or Small Business Technology Transfer (STTR) programs to develop a due diligence program to ensure the supply chain integrity of participating U.S. small businesses and decrease their dependencies on Chinese suppliers. The program should also include resources for participating

businesses to prevent investments from Chinese firms, particularly those involved in China's Military-Civil Fusion program, that target emerging technologies and innovations valuable to the U.S. Department of Defense and other SBIR or STTR sponsoring agencies.

- ▶ The due diligence program of each SBIR or STTR administering agency should provide financial and technical assistance to U.S. small businesses for up to three years for the purposes of supporting sustained procurement opportunities for the government and improving small businesses' internal capacity for federal engagement. Technical assistance may include establishing procedures for identifying foreign entities of concern within small businesses supply chains.

21. Congress direct the U.S. Food and Drug Administration in cooperation with other federal agencies, within one year and on an ongoing basis thereafter, to identify pharmaceutical products that utilize active pharmaceutical ingredients (APIs) and other ingredients and inputs that are sourced directly or indirectly from the People's Republic of China and develop alternative sourcing arrangements through available tools and resources, including Defense Production Act authorities. The United States should maximize the production of such goods domestically or, as appropriate, from trusted countries.

22. Congress direct the U.S. Department of the Treasury to require U.S. corporations and U.S.-registered subsidiaries of foreign corporations to publicly disclose, on an annual basis, all holdings in firms linked to China's military, including those that maintain any production permit, qualification, or certification issued by the People's Liberation Army or China's State Administration for Science, Technology, and Industry for National Defense.

23. Congress direct the Administration to release a comprehensive public report on the utilization of commercial-off-the-shelf (COTS) procurement of inputs, components, and products from China:

- ▶ By the U.S. Department of Defense and contractors in major weapons systems; in Munitions List items; and in Command, Control, Communications, Computers, Intelligence, Surveillance, and Reconnaissance (C4ISR) items;
- ▶ In critical infrastructure as identified by the U.S. Department of Homeland Security; and

- ▶ In critical supply chains and sectors as identified in U.S. government agency reports submitted per section 4 of Executive Order 14017 on "America's Supply Chains." Such a report shall identify the specific items that were purchased, overall quantities, and, where applicable, the value of the contracts in aggregate by item.

24. Congress direct the Administration to provide a public semiannual report on the volume of products detained, excluded, or seized for violations of the Uyghur Forced Labor Prevention Act and related enforcement activities. This report should detail product sector, product quantity, and whether the shipment was stopped directly or indirectly containing any production linked to Uyghur forced labor. This report shall also detail any and all existing loopholes in U.S. trade law and trade enforcement mechanisms that inhibit the ability of relevant U.S. government agencies to trace mined, manufactured, or procured goods made using Uyghur forced labor.

25. To ensure the U.S. government is able to assess its reliance on foreign sources, Congress direct the U.S. Department of Commerce to calculate U.S. import dependence at the product level across all industries, combining domestic production data (North American Industry Classification System [NAICS] codes) with U.S. export and import data (HTS [Harmonized Tariff Schedule] codes) in order to obtain a clearer picture of the United States' import dependence and provide the results in a publicly accessible database. This database should be consistently updated and should for each industry and product category tabulate dependence on China or any major source location that is known to use components and materials from China.

Chapter 3: U.S.-China Security and Foreign Affairs

Section 2: China's Cyber Capabilities: Warfare, Espionage, and Implications for the United States

The Commission recommends:

26. Congress direct the Office of the U.S. Trade Representative to create an updateable list of Chinese firms operating in critical sectors and found to have benefited from coercive intellectual property transfer,

including theft. Such a list would enable the U.S. Department of the Treasury to ban investment in and the U.S. Department of Commerce to deny export licenses to these firms and related parties for a rolling period of five years to prevent Chinese beneficiaries from further gaining from U.S. intellectual property loss. If additional authorities are needed, such requests should be made to Congress on an expedited basis.

27. Congress direct the U.S. Department of Homeland Security to catalog Chinese-sourced surveillance equipment, first responder communication systems, and smart cities systems used by state and local governments. The Department of Homeland Security shall further identify:

- ▶ Levels of risk from these systems as a result of foreign interference or malicious cyber activity;
- ▶ Plans to remove and replace such equipment to protect U.S. interests; and
- ▶ The necessary resources to implement these plans.

28. Congress pass legislation codifying the concept of “systemically important critical infrastructure” (SICI) and requiring SICI-designated entities, defense contractors, and recipients of federal funding for research and development of sensitive and emerging technologies to undertake enhanced hardening and mitigation efforts against cyberattacks. These efforts shall follow cybersecurity standards and guidance as determined by the U.S. Department of Defense and Cybersecurity and Infrastructure Security Agency. Congress should provide appropriate legal liability “safe harbor” provisions to compliant SICI operators and appropriate support as necessary for SICI-designated small- and medium-sized companies to address the cost of compliance. Such legislation would also require that cybersecurity risk mitigation plans be a condition for the Small Business Administration (SBA) to award grants such as those under the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs. As part of the regular audit process, SBA and any relevant agencies should ensure implementation of these plans and require certification of compliance.

29. Congress direct the U.S. Secretary of the Treasury to prohibit investment in and other financial transactions with any Chinese entities that have been involved in cyber-enabled intelligence collection or theft of intellectual

property sponsored by the People’s Republic of China against U.S.-based persons or organizations under authorities pursuant to Executive Order 13694 on “Blocking the Property of Certain Persons Engaging in Significant Malicious Cyber-Enabled Activities” (amended as EO 13757), including any individuals, research institutes, universities, and companies that have been affiliated with Chinese state-sponsored advanced persistent threat (APT) groups or served as contractors for China’s Ministry of State Security or People’s Liberation Army.

Section 3: China’s Activities and Influence in South and Central Asia

The Commission recommends:

30. Congress direct the U.S. Secretary of State, U.S. Secretary of Defense, and Administrator of the U.S. Agency for International Development (USAID) to submit a strategy on U.S. interests in the Indian Ocean region with considerations for competition with China in the region, including:

- ▶ Enhancing development and U.S. economic activity in the region;
- ▶ Defending freedom of navigation;
- ▶ Supporting and facilitating regional allies and partners in addressing security challenges in the region; and
- ▶ Promoting cooperation with U.S. allies in the Indo-Pacific, including Japan and Australia, and major defense partners, including India, and NATO allies, including the United Kingdom and France, to support a rules-based order in the region.

31. Congress direct the Administration to submit a strategy on U.S. interests in Central Asia with considerations for significant changing circumstances in the region, including:

- ▶ Russia’s diminishing presence as a result of its unprovoked invasion of Ukraine;
- ▶ The Taliban’s rise to power in Afghanistan; and
- ▶ China’s growing influence on members of the Shanghai Cooperation Organization through promoting Chinese governance concepts, including antiterrorism and law enforcement norms aimed at suppressing political opposition and cyber sovereignty and information security standards that empower authoritarian regimes to restrict the free flow of information.

32. Congress direct the U.S. Agency for International Development (USAID), the Development Finance Corporation, and other relevant agencies to make available training to relevant officials in South and Central Asia in assessing and mitigating the risks of China's investment and lending in the regions.

Chapter 4: Taiwan

The Commission recommends:

33. Congress enact legislation creating a permanent inter-agency committee in the executive branch charged with developing options and creating plans for the imposition of sanctions or other economic measures in a range of possible scenarios, including (but not limited to) a Chinese attack, blockade, or other hostile action against Taiwan. This committee would evaluate the potential economic and political consequences of various options, coordinate their implementation, and advise Congress of any amendments to statutory authorities or mandates required to enhance their effectiveness. The committee should coordinate and seek to devise joint plans with the relevant agencies of other governments that may be contemplating similar measures. The committee should include participants from the U.S. Departments of State, Treasury, Commerce, Defense, and Homeland Security.

34. Congress direct the U.S. Department of Defense to produce a classified report on current and future military posture, logistics, maintenance, and sustainment requirements to bolster the United States' "capacity to resist force" in the event of a Chinese attack and attempted invasion of Taiwan. The report shall assess the requirements for all scenarios, including protracted combat in a contested environment (e.g., anti-access, area denial), and evaluate how to best enable a dispersed, distributed force in the Indo-Pacific.

35. Congress should make available significant additional multiyear defense funds in conjunction with: (i) a joint planning mechanism made up of Taiwan and U.S. defense officials identifying sets of interoperable and complementary capabilities required for the defense of Taiwan; and (ii) Taiwan legislatively committing significant additional funds to procure its share of those capabilities for its military.

Chapter 5: Hong Kong

The Commission recommends:

36. Congress direct the Administration to extend the deferral of enforced departure of qualifying Hong Kong citizens in the United States, which would otherwise end in February of 2023. The U.S. Departments of State and Homeland Security shall submit a plan to Congress within 180 days addressing the long-term status and treatment of Hong Kong citizens in the United States.

37. Congress consider legislation requiring U.S. entities with data operations in Hong Kong to submit an annual report on any requests or attempts to access such data from the Hong Kong government or Chinese authorities. This report will also detail the nature of the request or attempt to access and the U.S. entity's compliance.

38. Congress direct the U.S. Secretary of State to include a detailed list of all websites blocked in Hong Kong pursuant to its annual report requirements under the Hong Kong Policy Act to document limitations to freedom of information.

39. Congress, pursuant to the Hong Kong Human Rights and Democracy Act, amend the International Organization Immunities Act to remove Hong Kong Economic and Trade Offices as a covered organization, thereby eliminating diplomatic privileges enjoyed by such offices and their employees in the United States. This amendment could be reversed under one of the following conditions:

- ▶ The People's Republic of China negotiates an agreement with the United States to have Hong Kong Economic and Trade Offices considered an official part of the People's Republic of China's mission to the United States and subject to the same requirements.
- ▶ China alters its treatment of Hong Kong to allow for sufficient autonomy and abides by One Country, Two Systems, as enumerated by the Hong Kong Policy Act. ■



2022 Report to Congress

of the

U.S.-China Economic and
Security Review Commission

Executive Summary and Recommendations