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**“Targeted Reciprocity”
Making Balanced Relations with China Work for Americans**

UNABRIDGED VERSION

Remarks by Henry M. Paulson, Jr.
At the Bloomberg New Economy Forum
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Good morning, everyone

And good evening to my friends watching in Asia.

Let me once again thank my good friend Mike Bloomberg.

Mike’s vision has underpinned this Forum since its inception two years ago.

Mike understood *then* that we need to bridge growing differences among nations to assure a peaceful and prosperous future.

So, I’m delighted to join this Forum in its third year. And I’m pleased to see how it has grown and thrived.

It’s worth recalling that when we gathered for our first meeting, the outlines of our stormy present were *already* apparent.

I remarked then that we’d arrived at “a moment of change, challenge, and potentially even crisis.” I warned that the prospect of a crisis between the United States and China was leading to the risk of an Economic Iron Curtain.

Unstable relations between the two largest economies has contributed to the continuing spread of geopolitical and economic risks. This will disrupt and ultimately fragment the global economic system.

Fast-forward two years. It gives me no joy to report that those warnings have been borne out.

The U.S.-China relationship has become more fraught.

We’ve seen more tariffs.

We've seen heightened restrictions on the flow of technology, disruptions in supply chains, more restrictions on investment, and fewer capital flows in fewer sectors.

We have fewer exchanges, and fewer students and scholars are heading in either direction.

Visas have been revoked.

Journalists have been expelled.

Consulates have been closed.

Proposed acquisitions and investments have been denied.

Political rhetoric has become inflammatory.

And it has given us a taste of how debilitating strategic turbulence can be for the global economy.

The pandemic has exacerbated the situation.

Now, the U.S. and China need to work separately, jointly, and with others to end this crisis, and soon.

President-elect Joe Biden has a generational opportunity to plot a course for America that allows us to compete and thrive.

I've known Joe Biden for many years. He is a unifier and a patriot.

The American administration is about to change, but the clock will not simply be rewound.

The Trump Administration has been responding to real concerns of the American people about China and real failures of China to act as responsible global citizens. The question is how we respond to these legitimate issues.

One perverse benefit of the tensions that have characterized the last few years is that the scope and dimensions of the U.S.-China strategic competition have become much clearer.

Even those of us who didn't agree with every policy choice in Washington or Beijing have come to understand that while new leaders can bring new policies, competition between big powers—and especially between two big powers with rival ideologies and very different political systems—is mostly *structural*.

Competition is now baked into this relationship.

A competitive approach to China was inevitable. But keeping it healthy, and not pernicious, is vitally important. And that won't be easy.

To compete effectively, President-elect Biden will need to get the dimensions of competition with China right.

If he does *that* well, he's sure to have a bipartisan wind at his back.

Competing with China is probably the only goal that both Democrats and Republicans, seem to agree on.

But successful strategic competition is fundamentally economic. America's military and diplomatic strength is rooted in the strength and the success of economic policies at home and abroad.

And make no mistake, Beijing understands that too. Strategic competition will be a cornerstone of U.S.-China relations for the foreseeable future.

I hope that Beijing will recognize it has strong self interest in ensuring that this competition does not yield unnecessary economic turmoil, much less military conflict.

So, what does it mean for President-elect Biden to "get competition with China right"?

For many Americans, the goal of China policy has come to be one thing—achieving "reciprocity."

And here's what people usually mean when they invoke reciprocity:

We will do *with* China only what China does with us.

We will punish China when China harms us.

The outgoing administration made this idea of "reciprocity" the very foundation of its strategy toward China.

The strategy declared that the U.S. would welcome economic relationships rooted in reciprocity—implying that America would shun any and all economic relationships that lack it.

Its vision of reciprocity has been welcomed by a bipartisan cheering section of politicians, businesspeople, and market participants.

And it's gotten some traction in Europe too.

At one level, that isn't surprising: it speaks to an American fundamental sense of fair play.

It's simply unreasonable for Beijing to expect the rest of the world to keep *its* markets open to China unless China continues to open its markets to the world.

I've long made this argument myself. But this cannot be the end of the story.

Here's the big challenge:

America has an open economy. This openness is our greatest competitive strength.

China, by contrast, has an economy that is closed in many areas.

But the fact is, whenever an open economy mirrors the actions of a closed economy, the open one inevitably starts to close *itself* off too.

If achieving reciprocity makes *America's* system more like China's, America will ultimately be the loser.

We can't remain competitive if we become more like China—with its closed, statist model, which I believe isn't going to stand the test of time.

So, it's time to adapt our principled desire for reciprocity to the evolving and real-world needs of American workers, farmers, ranchers, and businesses, both small and big.

It's time to move from reflexive reciprocity that responds fiercely but erratically by doing unto China what China does to us, to a policy that I call "**targeted reciprocity.**"

We need reciprocity **targeted** at the changing needs of the American worker.

We need reciprocity **targeted** to keep American businesses competitive.

We need reciprocity **targeted** to ensure that job-creating capital continues to flow to the United States.

We need reciprocity **targeted** to ensure that best-in-class companies want to remain headquartered in the United States.

We need reciprocity **targeted** not at *anything* and *everything* China does. Instead, the U.S. should aim its demands for reciprocity at sectors and areas where America is the strongest, where we're at our most competitive, and where we have maximum leverage.

Above all, we need reciprocity **targeted** so that America doesn't become less *American* in the bargain.

We must shift from reflexive reciprocity to targeted reciprocity that holds China's feet to the fire without making it harder for Americans to thrive.

Targeted reciprocity would shift our strategy from reactive to proactive.

And it would leverage what's *best* about America without losing sight of what's most *competitive* about America.

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But, the path to success begins at home. And the first step is to reinvest in the policies and values that have made America thrive.

Many people fret that there will be a military crisis between the United States and China, and with good reason. But in the first instance, this is an *economic* competition, not a military one.

Economic power is the foundation of military power.

Economic power made America the world's growth engine.

Economic power enabled China to become a growth engine more recently.

And economic power is enabling investments in America's military, in world-class weapons, and in strategic deterrence.

So, if Americans want to compete with China over the long term and to thrive, we must reenergize the system that has made our country the envy of the world for generations.

We must prove our economic model is better than authoritarian state capitalism.

Our success or failure here will be the key to American global leadership no matter what China does.

We need to look to the future when we design an economic recovery program so that we bolster our competitiveness in the bargain. That means:

- Supporting innovation and entrepreneurship for job creation
- Upgrading our social safety net while maintaining incentives to work.
- Rolling out a modern infrastructure plan that invests, makes regulatory changes, and creates financial incentives to develop technologies of strategic importance, including a best-in-class national digital infrastructure.
- And reforming our immigration policy, so that we attract, educate, train, and retain the best minds from around the world.

We also need to make big, smart, forward-looking investments in education and nurture best-in-class capital markets.

And, importantly, we must address our structural fiscal deficit if we are to maintain prosperity at home, leadership abroad, and protect the dollar's status as a global reserve currency.

Targeted reciprocity is the best means to execute this agenda.

And that brings us to China policy.

We need to make the relationship with China work for Americans in the context of today's realities.

The first priority must be rebuilding the global economy in the wake of COVID-19 and creating jobs and opportunities for Americans, while reducing economic disparity.

As the two largest global economies, it is in the interest of Americans, Chinese, and the world that the U.S. and China find a way to reboot economic growth.

Relentless, debilitating competition where the two governments seek to curtail all trade, investment, and technology flows between them will make that nearly impossible.

Of course, investments that threaten our national security should be prohibited. And there are certain technologies *directly* connected to our national security or critical areas of national advantage for which some de-integration will be necessary and inevitable.

But we must be careful to avoid sequestering so much technology that American companies lose their ability to commercialize and deploy their products in the world's fastest growing market.

And for America's part, our businesses cannot lead the world without access to the world's fastest-growing markets, nor can they realize their potential, unless there is less chaos and more predictability.

Irreparable harm will come to US companies if they are viewed as unreliable suppliers because of ad hoc actions taken by our government.

Companies need to know where the U.S. and China are going to cooperate, where they are going to compete, and where they are adversaries.

There is no question we need *major* adjustments to our economic relationship with China.

And we must reject the increasingly popular idea that merely *having* an economic relationship with China is somehow bad.

What we need is one that is better suited to America's current and *long-term* national interest.

The economic linkages that are the rightful source of so much tension today do, in fact, *benefit* us in important ways.

As one of the largest holders of U.S. Treasury securities, China's holdings help keep our interest rates low, and support our national debt, which is a much larger threat to our long-term competitiveness than is China.

In addition, I reject the idea that we should somehow “decouple” from the Chinese economy wholesale.

These linkages support the American farm sector and rural incomes.

American jobs created by exports to China had been growing faster than from exports to any other country.

Many American multinational companies rely on China’s market for a significant share of their earnings—and China’s rapidly growing domestic market is important to their long-term success.

And so, here’s what an agenda built on **targeted reciprocity** looks like:

President-elect Biden is a multilateralist. He understands we should be working with a carefully-selected group of major nations to press China for structural economic changes.

Biden should join with leading economies—Japan, the EU, the UK, South Korea, and Australia—to leverage a coordinated policy to upgrade the global trading system and its governing bodies, like the World Trade Organization (WTO). It is essential to put in place new global rules for trade, investment, technology, the environment, and the digital world as the rules now lag behind reality.

If *these* allied economies can agree on a framework, they will be in a far stronger position to invite China to join, if it is willing to meet their agreed standards.

If Beijing *refuses* to join this new multilateral effort and remains intransigent, we should again look to a punitive toolkit built on **targeted reciprocity** that includes jointly withholding access to our markets.

Of course, that brings us to the question of *bilateral* tariffs, which have been *the* central feature of the Trump era.

I never favored tariffs—not just because they are a tax on Americans. Their erratic application harmed the U.S. reputation as a global supplier and a safe harbor for investment.

Much of the damage has *already* been done.

And still our trade deficit with China continues to rise.

So, we should now link tariff *removal* to a new approach founded on **targeted reciprocity**.

Simply put, I would *only* remove existing tariffs when we have extracted a reciprocal and tangible benefit from China, met by defined benchmarks in a phased bilateral trade agreement.

The Biden Administration should initiate a comprehensive new round of bilateral negotiations with China. It should aim for a fair, sweeping, and reciprocal trade relationship based on more meaningful competition.

Here is the nub of the strategy:

Instead of President Trump's emphasis on *purchase* agreements, which are a throwback to the managed trade of the 1990s, we need to focus on markets of the *future* by opening key areas to investment and export.

Of course, we'll also need to address the roles and market distortions of China's state-owned firms.

And we'll need to deal with structural and process issues that include services, not just goods.

This agreement should be done in phases with regular deliverables, beginning with easier issues that build momentum to tackle the important but tough ones.

In return, the United States should be prepared to make its *own* market open to trade and investment from Chinese firms while protecting our own national security.

We also need to be more consistent and predictable.

Achieving this will be hard.

But it will be helpful in creating jobs and ensuring a more fair and equitable recovery.

President-elect Biden can steer a healthier course for the U.S.-China economic relationship with a targeted and more strategic form of reciprocity.

He can expand market opportunities for Americans – and bolster *global* growth in the bargain.

Another important component of a refreshed agenda is to forestall environmental catastrophe.

If you know how important the environment and conservation are to me, you'll understand how strongly I feel about this.

Climate change is the most certain, and formidable, economic challenge the world faces.

So, as governments develop their post-pandemic recovery strategies, promoting environmental goods and services should be a core part of fiscal stimulus plans.

China took a positive step by pledging to be carbon neutral by 2060, but we should continue to consider climate change as another economic issue that demands **targeted reciprocity**.

For one thing, working with China is in our self-interest: If we want to prevent the worst climate outcomes and preserve essential and fragile global ecosystems, we'll need China to solve its massive environmental problems at home and adopt better practices abroad.

America *also* needs to capitalize on huge economic opportunities in China and globally.

That means ensuring opportunities for our businesses to invest and export clean energy products and technologies, as well as environmental goods and services.

The Biden Administration plans a fresh start in climate diplomacy, beginning with the Paris Agreement. So, we'll have a new opportunity to rethink the international climate architecture.

By now, it's clear that aggressive voluntary climate targets are insufficient. We need to create a structure with teeth—one that focuses on the major economies, including China, and deals squarely with the problem of free-riding and creates strong incentives to curb emissions.

This should include:

The U.S. and China making joint investments in game-changing technologies that have the potential to help us avoid the most adverse climate outcomes, even if they are not commercially viable.

We should also jointly bring commercially viable clean energy technologies to the scale necessary to address climate change. The U.S. is the country with the most clean-energy patents, but China is the country most likely, and with the greatest need, to commercialize and deploy these technologies at scale.

We each also need to provide incentives to channel private sector capital into innovative solutions that support green development and value nature.

In the same spirit, our two countries should lift tariffs on environmental goods and services: China has resisted WTO negotiations in this area, making it difficult for U.S. firms to fully participate in an estimated \$3 trillion opportunity in China to help clean up its polluted air, water, and soil.

Once again, **targeted reciprocity** can be a negotiating tool and lever to help *all* of us, including Beijing, make concessions that are in the global public interest.

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Ladies and gentlemen, the discussion at this Forum is vital.

We're in the midst of a turbulent and painful period. Yet, for the first time in years, we have opportunities to make a fresh start.

Our first goal must be to crush the virus.

Our second should be to reduce the risks, unpredictability, and volatility that have damaged our citizens' livelihoods and businesses both large and small.

This is President-elect Biden's essential task.

And it is *our* essential task.

Getting strategic competition with China right will, quite simply, *have* to be a part of this:

Competition without unnecessary confrontation should be our goal ... because confrontation *without* effective competition has produced some poor results for the American people:

It has damaged our economy.

It has stunted our export opportunities.

In time, it will threaten the peace of the world and does not make us safer.

And so, we will have chaos and conflict if we cannot get this right.

That is in no-one's interest: Not America's. Not China's. Not the world's.

A clear-eyed but productive U.S-China economic relationship, built on **targeted reciprocity**, is what we need now for the United States to restore and strengthen its global leadership, create a safer America and support world peace.

Thank you very much.