PUBLIC COMMENT: FOUNDATION FOR DEFENSE OF DEMOCRACIES

Executive Office of the President of the United States
Office of the United States Trade Representative

Request for Comments on the Section 301 Investigations of Acts, Policies, and Practices of Certain Economies Relating to Structural Excess Capacity and Production in Manufacturing Sectors

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Introduction

China's economic model uses structural overcapacity to dominate key markets relevant for securing its national power. However, Beijing's economic model is not a proxy for the global economy, in which trade deficits and surpluses are often driven by market factors, and it is not the proximate cause of persistent U.S. trade deficits.

Aggregate industrial overcapacity is a symptom of a specific set of economic circumstances, some of which are produced by normal market forces and others by direct market intervention — it is a disease of degrees rather than definitives. Moreover, the impacts of aggregate industrial overcapacity on trade deficits are mediated through a broad set of macroeconomic considerations.

The United States necessarily consumes more than it produces because it spends more than it saves, regardless of whether its imports are sourced from an allied nation or an adversarial one. Whether other countries choose to either build enough capacity to satisfy aggregate demand or continue to overproduce has a consistent, but limited impact on these underlying dynamics.

This divergence between signal and noise suggests that the U.S. Trade Representative (USTR) should pursue its Section 301 investigation by targeting specific illicit adversarial trade practices using long-standing U.S. trade law, such as potentially imposing counter-vailing duties on key sectors while working with allies and partners to build a more stable global trading community.

Aggregate Industrial Overcapacity Has a Limited Impact on U.S. Trade Deficits

Aggregate industrial overcapacity is a poor proxy for unfair competition and has a limited effect on trade deficits, which are primarily driven by a range of fiscal and monetary factors. In relatively open or mixed economies aggregate excess capacity is primarily driven by private sector investment patterns and reflects decades of specialization alongside limited government intervention. Moreover, persistent U.S. trade deficits highlight America's enduring economic strengths, particularly in contrast to China, whose economy continues to suffer despite posting record trade surpluses.

Nearly all firms maintain cyclical overcapacity, both as a strategy to hedge against demand shocks and as a reality of "lumpy" inputs — investments that can only be made in lump sums rather than linearly scaled to meet aggregate demand.[1] These factors ensure that overcapacity predominantly affects more capital-intensive sectors as they both benefit from economies of scale, placing a premium on significant investment, and are often inflexible, leaving them

[1] Alex Coad, Clemens Domnick, Florian Flachenecker, Peter Harasztosi, Mario Lorenzo Janiri, Rozalia Pal, and Mercedes Teruel, "Capacity constraints as a trigger for high growth," *Small Business Economics*, November 9, 2021. (https://link.springer.com/article/10.1007/s11187-021-00558-6)

incapable of rapidly matching output to changing market conditions.[2] While theoretically inefficient, this overcapacity is often critical for both maintaining macroeconomic stability during times of peace and offering a surge capacity during crises.

These trends largely account for the relationship between specialization in heavy manufacturing and higher levels of aggregate excess capacity. While certain state interventions, such as subsidization, can produce overinvestment and underutilization of manufacturing assets, this pattern is far more likely to occur in designated non-market economies. South Korea is a prime example of these trends — though subsidies provided an initial foundation, decades of investment in capital-intensive sectors such as shipbuilding and microelectronics has allowed Seoul to develop trade surpluses while maintaining a relatively balanced industrial capacity utilization rate of nearly 75 percent.[3]

Even when non-market economies such as China have pursued dominance in key markets to achieve geopolitical ambitions, aggregate overcapacity remains an imperfect indicator of market saturation. While China's trade surplus has risen to record highs, topping $1 trillion in 2025, due in part to a surge in manufacturing investment, its aggregate industrial utilization rate has remained relatively constant within a few percentage points, suggesting that overcapacity remains a poor indicator to determinate overall trade balances.[4] Moreover, despite new tariffs, the United States remains below its long-run average capacity and continues to shed manufacturing jobs, suggesting that U.S. firms have strategically overinvested in production capacity without substantially affecting the country's trade deficit.[5]

Rather, persistent U.S. trade deficits are primarily the result of substantial domestic wealth rather than foreign structural overcapacity and highlight the enduring advantages of the American economy. The combination of a low savings rate, accelerating rates of deficit spending, strong GDP growth, and the resilience of the dollar provide a far more proximate cause of trade deficits, which have remained relatively consistent despite shifts in tariff policy, than the growth in

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[2] Shixin Shi, Hao Li, Hongsong Tang, and Yang Liu, "A study of the impact of de-capacity policies on industry capacity utilization paths: Evidence from the Chinese steel industry," *Public Library of Science One*, December 15, 2023. (https://pmc.ncbi.nlm.nih.gov/articles/PMC10723696)

[3] Dongkeun Lee, "Influences behind the development of South Korea's shipbuilding industry from the 1960s to the 2000s," *Marine Policy*, September 2024. (https://www.sciencedirect.com/science/article/pii/S0308597X24002495); Kim Ji-seop, "Semiconductor Surge Drives 2.5% Industrial Production Rise," *The Chosun Daily*, March 31, 2026. (https://www.chosun.com/english/market-money-en/2026/03/31/NAJQWDHBWRCJLANKPAA7YTE7SU)

[4] Hung Tran, "Breaking down Janet Yellen's comments on Chinese overcapacity," *Atlantic Council*, April 9, 2024. (https://www.atlanticcouncil.org/blogs/econographics/breaking-down-janet-yellens-comments-on-chinese-overcapacity); Joe Cash and Xiuhao Chen, "China's trade ends 2025 with record $1.2 trillion surplus despite Trump tariff jolt," *Reuters*, January 14, 2026. (https://www.reuters.com/world/china/chinas-trade-ends-2025-with-record-trillion-dollar-surplus-despite-trump-tariffs-2026-01-14)

[5] Hung Tran, "Breaking down Janet Yellen's comments on Chinese overcapacity," *Atlantic Council*, April 9, 2024. (https://www.atlanticcouncil.org/blogs/econographics/breaking-down-janet-yellens-comments-on-chinese-overcapacity); Daniel Desrochers and Sam Sutton, "A year later, here's where things stand on Trump's manufacturing revival," *Politico*, April 2, 2026. (https://www.politico.com/news/2026/04/02/manufacturers-still-waiting-trump-tariff-promises-00854987)

foreign manufacturing.[6] The United States continues to consume more than it can produce, fueled by expansive broad-based growth and buoyed by the dominance of the dollar — exactly the opposite of a Chinese economy in which consumers increasingly refuse to purchase what they produce and hoard savings amid an ongoing financial crisis.[7]

Market Distortions Remain a Prevalent Issue Amid the Global Economic Landscape

While aggregate industrial overcapacity may not be the cause of U.S. trade deficits or the loss of manufacturing employment, both non-market and market economies engage in market interventions that can harm the United States, including subsidies, poor labor standards, and other unfair trade practices.

Moreover, industrial overcapacity remains at the heart of China's economic model, with its impacts causing ripple effects across the global economy as Beijing aims to restructure supply chains to fulfill its geopolitical ambitions. Chinese overcapacity also increasingly wields a strategic dimension, having evolved over time from lower-end consumer products into higher-end technological goods that are relevant to national security, such as semiconductors, industrial energy systems, and cellular modules.

While aggregate excess capacity is often caused by normal economic frictions, it can be exacerbated by a range of government interventions, many of which have long been illegal under U.S. trade law. These include subsidization, dumping, forced labor, and certain export promotion schemes, each of which distorts both domestic investment environments and global trade flows.[8] As noted by the USTR, large-scale subsidization often distorts market incentives to encourage over-production, an issue that can contribute to dumping as firms seek a release valve from domestic market conditions. These issues can be exacerbated by forced labor, which erodes human rights while artificially suppressing the cost of production, and export promotion schemes, which directly encourage firms to divert overcapacity abroad.[9]

China's relatively stable aggregate industrial capacity utilization rate obscures its significant market manipulation in steel production, foundational semiconductors, petrochemicals, electric

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[6] Brian Reinbold and Yi Wen, "Understanding the Roots of the U.S. Trade Deficit," *Federal Reserve Bank of St. Louis*, October 9, 2018. (https://www.stlouisfed.org/publications/regional-economist/third-quarter-2018/understanding-roots-trade-deficit); Maurice Obstfeld and Kenneth Rogoff, "Global Current Account Imbalances and Exchange Rate Adjustments," *The Brookings Institute*, May 17, 2005. (https://www.brookings.edu/wp-content/uploads/2005/01/2005a_bpea_obstfeld.pdf)

[7] Hannah Miao, "The Deflation Doom Loop Trapping China's Economy," *The Wall Street Journal*, January 27, 2026. (https://www.wsj.com/world/china/deflation-doom-loop-china-economy-25b0938a)

[8] Pengfei Ge, Rui Zhu, Yize Chen, and Xiulu Huang, "Selective industrial policy and overcapacity: Evidence from a quasi-natural experiment in China," *Economic Systems*, September 2024. (https://www.sciencedirect.com/science/article/abs/pii/S093936252400013X)

[9] Daron Acemoglu and Alexander Wolitzky, "The Economics of Labor Coercion," *Econometrica*, March 2011. (https://onlinelibrary.wiley.com/doi/abs/10.3982/ECTA8963); Daniel Lederman, Marcelo Olarreaga, and Lucy Payton, "Export promotion agencies: Do they work?" *Journal of Development Economics*, September 30, 2009. (https://www.sciencedirect.com/science/article/abs/pii/S0304387809000935)

vehicles (EVs), and other higher-end electronics.[10] While some of these advantages may produce excess capacity, particularly in EVs, steel, and other commodities, Beijing's efforts have largely focused on directing state support to industries with the explicit or implicit aim of collapsing foreign competitors or manipulating global markets to the advantage of Beijing's domestic champions.

The clearest sign of industrial overcapacity in the global economy is China's burgeoning EV sector. While Beijing has recognized that several elements of its state support system have resulted in depressing its domestic markets, a phenomenon captured by the rise of the term "involution," the echoes of its subsidization efforts remain significant.[11] Led by the central government and reflected at the provincial and municipal levels, Chinese firms have historically received significant state support to develop a range of "strategic industries," particularly EVs.[12] While these subsidies have largely subsided as the result of intense domestic competition, heavily leveraged Chinese firms sought to relieve pressure via exports, translating domestic overcapacity into lingering trade tensions due to a persistent trade surplus.

Moreover, China's aims to construct national champions in key sectors often entails a form of "pruning." Beijing effectively determines which firms will continue to survive amid intense competition. This produces short-term overcapacity, which eventually creates vertically integrated monopolies that damage foreign competitors. While depressing global prices for key goods, this phenomenon is intended to channel domestic aggregate overcapacity into state-directed market interventions intended to support Chinese firms' efforts to gain global market share.

Fueled by intense subsidization, Chinese firms have gained a significant advantage in drones, foundational chips, and other critical technologies. While these investments have produced some signs of overcapacity — industrial utilization has recently fallen slightly in key tech manufacturing sectors — their main effect has been allowing Chinese firms to maintain significant pricing power to collapse foreign competitors.[13] Independent estimates suggest that

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[10] Scott Davis and Brendan Kelly, "China manufacturing overcapacity boosts output, stagnation fears," *Federal Reserve Bank of Dallas*, December 30, 2025. (https://www.dallasfed.org/research/economics/2025/1230)
[11] Hung Tran, "Breaking down Janet Yellen's comments on Chinese overcapacity," *Atlantic Council*, April 9, 2024. (https://www.atlanticcouncil.org/blogs/econographics/breaking-down-janet-yellens-comments-on-chinese-overcapacity); Ann Listerud, "The PRC's Overcapacity Problem Depends on Who You Ask," *The Jamestown Foundation*, November 1, 2024. (https://jamestown.org/the-prcs-overcapacity-problem-depends-on-who-you-ask); Yanmei Xie, "An Anatomy of Industrial Involution in China," *The Rand Corporation*, October 24, 2025. (https://www.rand.org/pubs/commentary/2025/10/an-anatomy-of-industrial-involution-in-china.html)
[12] Elaine K. Dezenski, "Trojan Horse: China's Auto Threat to America," *Testimony Before the House Select Committee on the CCP*, December 11, 2025. (https://www.fdd.org/analysis/2025/12/11/trojan-horse)
[13] Yanmei Xie, "An Anatomy of Industrial Involution in China," *The Rand Corporation*, October 24, 2025. (https://www.rand.org/pubs/commentary/2025/10/an-anatomy-of-industrial-involution-in-china.html); Scott Davis and Brendan Kelly, "China manufacturing overcapacity boosts output, stagnation fears," *Federal Reserve Bank of Dallas*, December 30, 2025. (https://www.dallasfed.org/research/economics/2025/1230); Hung Tran, "Breaking down Janet Yellen's comments on Chinese overcapacity," *Atlantic Council*, April 9, 2024.

Quectel, a Chinese cellular module firm, sells at an estimated 15 to 20 percent discount relative to global prices, while Chinese drone manufacturers often sell their products below the cost of production, leading to significant market consolidation.[14] In both cases, however, state-supported investments in manufacturing transformed significant spurts of domestic overcapacity into a global competition via intense price wars. Instead of all factory floors falling silent, consolidation expanded production to capture additional market share.

The U.S. Should Rely on Existing Economic Measures To Counter Unfair Trade Practices Among Allies and Adversaries

This pattern suggests that the USTR should focus on particularly targeting non-market economies based on specific select policy interventions that demonstrably manipulate their trade relations with the United States. As a corollary, this pattern also suggests that the USTR should rely on alternative mechanisms to dispute specific trade practices conducted by the free-market economies listed within the scope of its investigation.

The United States has a robust series of long-standing economic policies to counter unfair trade practices. These include the Tariff Act of 1930, which provides mechanisms to apply counter-vailing duties, counter foreign dumping, and along with the Uyghur Forced Labor Prevention Act, regulate goods made with forced labor.[15] These statutes provide a firm legal foundation for trade investigations given their long-standing nature within international trade law while offering a direct connection between a trading partner's behavior and their subsequent punishment, producing a stronger deterrent effect to ameliorate underlying trade frictions. These statutes also often provide for a form of immediate restitution for American firms by tying punitive tariff rates directly to the rate of foreign subsidization, further deterring unfair trade practices.[16]

In targeting non-market economies, the USTR should focus on disrupting state subsidization in key sectors while enforcing strict trade standards against products and services produced using forced labor. While this approach may overlap with sectors that display classic signs of excess capacity — such as persistently depressed prices despite overwhelming global consolidation — investigations into specific practices long recognized as being illegal under U.S. trade law will lead to more regulatory certainty for American firms. As such, the USTR should consider

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(https://www.atlanticcouncil.org/blogs/econographics/breaking-down-janet-yellens-comments-on-chinese-overcapacity)

[14] Charles Parton, "Chinese cellular (IoT) modules: Countering the threat," *Council on Geostrategy*, March 19, 2024. (https://www.geostrategy.org.uk/research/chinese-cellular-iot-modules-countering-the-threat); RADM (Ret.) Mark Montgomery, Craig Singleton, Johanna Yang, and Jack Burnham, "Securing the Information and Communications Technology and Services Supply Chain," *Foundation for Defense of Democracies*, March 4, 2025. (https://www.fdd.org/analysis/2025/03/04/securing-the-information-and-communications-technology-and-services-supply-chain)

[15] Tariff Act of 1930, Pub. L. 71-361, 46 Stat. 590 (codified as amended in scattered sections of 19 U.S.C.); Uyghur Forced Labor Prevention Act, Pub. L. No. 117-78, 135 Stat. 1525 (2021) (codified at 19 U.S.C. §§ 1307, 1401 note)

[16] Tariff Act of 1930, Pub. L. 71-361, 46 Stat. 590 (codified as amended in scattered sections of 19 U.S.C.)

maintaining or expanding specific sectoral tariffs on key industries, such as electric vehicles, or imposing other import restrictions in retaliation for market distortions. Moreover, the USTR should coordinate with the Commerce Department to pursue alternative avenues of punishing market manipulation, including imposing tariffs under Section 232 of the Trade Expansion Act.

The USTR should also consider using preexisting dispute resolutions mechanisms with close allies and partners named in the investigation, including Taiwan, South Korea, the European Union, Mexico, Japan, and India. Many of these countries have recently signed or are finalizing trade agreements with the United States, giving Washington significant leverage to address specific trade irritants that distort their bilateral trade balances with the U.S. Moreover, the USTR should also consider how this Section 301 investigation may impact other upcoming trade negotiations, such as the review of the United States-Mexico-Canada Agreement (USMCA) with Canada and Mexico, and push for stronger rules-of-origin standards to combat Chinese trade distortions.[17]

Conclusion

The USTR has an opportunity to build a more fair, secure, and sustainable trading system by using long-standing U.S. trade law to prosecute adversarial nations for illegal market manipulations, while continuing to fairly apply rules to allies and partners.

Thank you for considering our comments. We look forward to seeing how our input is incorporated into the USTR's ongoing investigation.

[17] Elaine K. Dezenski and Josh Birenbaum, "Unplugging Beijing," *Foundation for Defense of Democracies*, July 21, 2025. (https://www.fdd.org/analysis/2025/07/21/unplugging-beijing)