ORAL TESTIMONY OF LEO HINDERY, JR. TO THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION ON "U.S. DEBT TO CHINA: IMPLICATIONS AND REPERCUSSIONS"

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Mr. Chairman, other Commission members, I am Leo Hindery, Jr. and I am Chairman of the US Economy/Smart Globalization Initiative at the New America Foundation and a member of the Council on Foreign Relations.

From 2005 through 2007, I was Vice Chairman of the Presidential and Congressional HELP Commission which in December 2007 made recommendations to Congress for the reform of U.S. Foreign Assistance. Career-wise, I am the former chief executive officer of AT&T Broadband and its predecessor Tele-Communications, Inc. (TCI) and of Liberty Media and several other major media and telecom companies, which employed tens of thousands of American workers and aggressively competed throughout Asia and Europe.

Several days ago I finished a two-week trip that began in China, continued down throughout Vietnam, and ended in Thailand via Cambodia. It is a trip that everyone concerned about the nearly unprecedented 19% 'real' unemployment rate in the United States – and the long-term welfare of our workers – should make soon, and a trip that is germane to today's topic.

For in short, without some dramatic changes soon in our trade and economic policies and practices, it is clear that America's Great Recession of 2007 will continue while at once becoming much of Asia's and especially China's 'Great Opportunity'.

I last visited China in February 2008 just after this Recession started. Now, exactly two years later, construction cranes that briefly fell silent are back erecting high-rise buildings, important infrastructure projects that were halted are back being built along with new ones, and ports that had container ships laying at anchor are now again loading ships through the night. Chinese consumers are back shopping – and eating out – with complete abandon, and workers from the far-western provinces and rural China have again left their villages to return to work in China's major cities.

The Great Recession has in fact quickly turned into China's 'great opportunity', with American companies cutting both their payrolls and their capital spending, thereby driving business to China, at the same time that Chinese manufacturers are boosting their global competitiveness, directly on their own and indirectly through subsidies from their partner central government. In just the last year, China's share of our nation's trade deficit in manufactured goods jumped from 69% to an almost unbelievable 80% today, while its share of U.S. imports overall, non-resources and resources combined, increased 20%. And in dollars, China right now is exporting about $330 billion annually to the United States, while purchasing less than $90 billion here.

President Obama got it right on February 3, albeit in my opinion late by about a year, when he told the Senate Democratic Policy Committee that: "One of the challenges that we've got to address internationally is currency rates and how they match up to make sure that our goods are not artificially inflated in price and their goods are artificially deflated in price. That puts us at a huge competitive disadvantage."

Certainly no responsible American economist disagrees with the President's assessment that China's currency is undervalued compared to the dollar (and the Euro) by at least 25% and up to 40%. According to economist Peter Morici, with whose work this Commission is very familiar, this artificial devaluation of China's currency alone creates a staggering 25% illegal subsidy on its more than $300 billion of annual exports to the U.S.

Yet currency manipulation is actually just the tip of the Chinese trade iceberg, albeit a very big 'tip' – at least as concerning are China's overall unfair trade practices.

And contrary to what American workers have been told repeatedly by America's multinational corporations and by the U.S. Chamber of Commerce, the critical issue is not China's relatively low labor costs. As Norbert Sporns, a Seattle-based CEO, recently said, "The major reason why we're [now] sited [in China] is not because of cheaper labor, but because of government support, because of the infrastructure that is laid out properly". And this same logic applies both to computers and consumer electronics, where China's role now extends far beyond assembly where it started, and to China's increasingly dominant role in the 'green economy' that all developed nations, including our own, were counting on to jumpstart their own economies.

To this latter point, while our ongoing stimulus package devotes $80 billion to 'things green', China plans to spend, out of its enormous accumulation of foreign reserves, nearly three times as much, or $217 billion, over just the next five years on such efforts. And, as it has already done so successfully in other industries, China is making all of its domestic green economy expenditures in ways that are at the same time positioning it to become the largest global exporter of such components to the U.S. and other nations, while essentially 'locking out' any of them from importing products into its domestic initiatives.

We have known for several years that something on the order of 90% of China's domination in manufactured goods vis-à-vis the U.S. is due to its subsidies to domestic and foreign-owned manufacturers alike – subsidies based around plant sitings and financings, taxes and of course currency – and to its extremely low environmental standards. And the sad reality is that after years of accumulating market share and building the infrastructure it needed in order to dominate much of the global marketplace, all with the help of massive subsidies and a massively undervalued currency, China's trade advantages in many vital industries are either now so embedded – or, as in the case of the 'green economy' and special-purpose materials, quickly becoming so embedded – that they will exist for years to come even if President Obama is successful in confronting China's manipulated exchange rate, which of course is far from assured.

So, where does all of this leave the U.S. *otherwise*, which is in essence the topic of today's discussions?

According to Richard Haass, the president of the Council on Foreign Relations, "We've [already] reached a point now where there's an intimate link between our solvency and our national security." And it is easy to see why Mr. Haass comes to this conclusion, since the U.S. government in 2010 will borrow one of every three dollars it spends, half or so of which will come from foreign countries.

Not even accounting for the forecasted $1.6 trillion federal deficit this year, the $1.3 trillion deficit next year, and the $8.5 trillion combined deficit for the next 10 years, the U.S. already has about $7.5 trillion in accumulated debt held by the public, of which China, with more than $2.4 trillion in foreign exchange reserves, is the largest single holder. And of course all the while China is every day accumulating ever more American dollars as our nation's largest non-resources importer – its foreign exchange reserves increased $453 billion (or 23%) just in 2009 alone.

And we should not be at all naïve about China's true global financial capability, which far exceeds the extent of its foreign exchange reserves, as large as they alone are. There is an immutable blurring among China's reserves, its financial institutions, and its sovereign wealth fund, all of which are centrally governed and together can act as one with nary a moment's indecision. By market capitalization alone, China has three of the world's four largest banks, the two largest insurance companies, and the second-largest stock market – this capability combined with its already-largest-by-far accumulation of foreign reserves gives China also the largest 'potential' sovereign fund, since it would take only a few wire transfers to turn its government development funds, its government investment corporations, and the overseas investments of its government-owned enterprises into an unparalleled 'financial hegemony'.

Given China's pernicious trade practices and how it has already employed and deployed its ever-increasing foreign reserves position:

- There is no reason to believe that China's immediate threats in response to President Obama's February 3rd speech, both its explicit ones and its implied ones, are false, despite Deputy Assistant Secretary of State for East Asian and Pacific Affairs David Shear's 'Pollyannaish' testimony the very next day to this Commission that they probably are.

- It does not seem particularly informed to suggest, as Mr. Shear also did, that China does not have the (quote) "intention at this time to create a [political] hegemony in Southeast Asia or to displace American influence in the region" (unquote) – of course it does. Just as it also intends to use its foreign reserves to acquire 'blocking positions' in resources and/or in agriculture in Australia, Africa and large parts of South America.

- Mr. Shear is simply wrong as well in suggesting that China's arms buildup is (quote) "consistent with modernizing military forces in general and [is] not in the fashion of an arms race" (unquote) – it absolutely is an arms race for China, and a global one at that, as senior Chinese Admiral Wu Shengli confirmed on April 14, 2009 when he spoke about China's "accelerated and soon [to be] completed deployment of a full-scale 'blue water' navy, including home-grown submarines with nuclear-armed ballistic missiles".

- And we should expect no self-restraint in China's investing in America's vital financial, infrastructure and resource companies and in our 'militarily critical technologies'.

It now seems inevitable that some individual American companies, for example the Boeing Company and those involved in oil exploration off the Vietnam coast, will suffer from Chinese trade retaliation, as likely will parts of our foreign policy and defense agendas. But the Obama administration's job is to look after our national interests first and foremost, and not after individual multinational corporate interests, which means above all else keeping the U.S. economy strong, which is about the only part of Mr. Shear's testimony with which I agree.

Going forward, it is imperative – for financial, employment, competitiveness and national security reasons – that the United States change its growing deficit with China. So, using whatever tools are available, the administration and Congress need to:

1. Go after all of China's illegal subsidies, not just its currency manipulation, just as they need to put a quick halt as well to China's persistent theft of America's hard-gained, valuable intellectual property or IP, which zaps our economy almost as much as China's adverse currency moves. Regarding the latter, a quick and easy solution, courtesy of former Senator Slade Gorton (R-WA), would be to make a finding at the end of each year of the total value of the IP the Chinese have stolen, followed by a tariff during the next year on everything they sell us levied at a rate calculated to recover 150% to 200% of that stolen value.

2. Adopt "Buy American" requirements related to all federal government procurement, which currently makes up about 20% of the American economy. The U.S. is almost alone among the developed nations and China in not having a significant buy-domestic government procurement program, yet no single stimulus effort would do more to resuscitate U.S. employment, especially manufacturing employment, and materially reduce our nation's massive trade deficit.

3. Bring what's called a Section 301 case at USTR against China's "Indigenous Innovation Production Accreditation Program" that was promulgated on November 15, 2009. This Program, which limits all Chinese central and provincial government procurement to companies that have "indigenous" – or Chinese – innovation, is far more restrictive than any other buy-domestic program in the world, and its adverse impacts will very quickly be felt across all industries, but especially in computers and consumer electronics, 'things green', autos and aviation, and specialty materials, where we are desperately trying to hold on to our own manufacturing capabilities. (Because China is still not a member of the WTO Government Procurement Code, a Section 301 action is unfortunately the only remedy currently available.)

4. Because China's heavy reliance on illegal subsidies and currency manipulation as mainstays of its trade practices is a fair predictor of its likely future sovereign fund practices, make review of China's planned investments in the U.S. with much more actionable transparency and in a manner consistent with protecting our national interests and security. Of specific concern are any proposed investments in our nation's ports and transportation industry, natural resources, financial markets, "Advanced Technical Products" manufacturing, and items deemed by the Defense Establishment to be "militarily critical". Before controlling or influencing investments are made in companies in these industries, they should have extensive federal government review, to include a newly-created "national security impact statement" prepared jointly by Commerce and Defense for the Congress and the

administration which would consider the investment's defense, security and infrastructure implications.

5. Promote development assistance not only as a core pillar of national security and American moral values, but, importantly, also as a counterbalance to China's mercantilist practices in the developing world, practices that are as relatively unfair and harmful to these economies as they are currently unfair and harmful to our own U.S. economy and long-term interests. This means specifically that the U.S. should: follow through on its oft-repeated commitments to the Millennium Development Goals; harmonize U.S. foreign policy commitments in development with the actual U.S. development assistance budgets and programs; aim to achieve the development assistance 'target' of 0.7% of GDP by 2015; and use the full range of development instruments, including development assistance, trade openings, aid for trade, and partnerships with civil society.

In closing, I should note that none of these five recommendations – particularly the "Buy American" and the "national security impact statement" recommendations which will likely attract a lot of immediate self-serving criticism – is protectionist or anti-globalization or un-American. Alone and collectively they are simply good, necessary, balanced and, I should note in particular, *reciprocal* economic policies.

Absent them and related actions, however, China's ever-growing foreign reserves, especially its accumulation of U.S. dollars, and its pervasive global mercantilist agenda will have even more dire implications to and repercussions for America's competitiveness in the world and our overall economic wellbeing – and for our national security.

Our two countries must quickly agree on a fundamental readjustment of our current bilateral trade relationship, and the strategic threats to both, should we fail, are obvious. But to start, given how inextricably linked America’s economic security is with national and military security, the United States must, as an overriding principle, be as aggressive in defending its economic interests as China is in advancing its.

Thank you.