

US-China Economic Security and Review Commission

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Remarks Of

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Export Controls and America's Export Competitiveness

Opening

Chairman D'Amato, hearing co-chairs Thompson and Reinsch, other distinguished Commissioners, and ladies and gentlemen, thank you for this opportunity to discuss export controls and their impact upon American export competitiveness.

I want to extend a warm welcome to the two new Commissioners of this distinguished body, Peter Brookes and Kerri Houston, and wish them well during their tenure.

The Sad State of US Export Competitiveness

Last Friday, March 10, 2006, the Washington Post ran a story about how the US trade deficit had reached another all-time high. The article reported how the "insatiable appetite" of Americans for foreign goods had pushed the deficit up to \$68.5 billion for the month of January, 5.3% bigger than in December. Analysts were reported as saying that unless demand for imported goods slows, the US could produce another record annual deficit "for the fifth year in a row, topping last year's imbalance of \$763.6 billion".

The trade deficit with China also jumped dramatically – by 9.9%, to \$17.9 billion. Something is fundamentally broken with this picture.

But the Chinese think they have the answer for the U.S.!

Chinese State Councilor Tang Jiaxuan said recently in a speech to the U.S.-China Business Council in Washington that the U.S. should "lift restrictions on commodity and technology exports" to China. "Increasing exports to China, instead of restricting imports from China, is the right course of action to solve trade imbalances," he said.

The Chinese answer is that the U.S. should abolish all forms of export control. But is this the correct answer? And how do economic trends play into this picture?

Compare with China

Now compare the current U.S. trade deficit situation with the economic track currently being taken by China. At a recent national conference on science and education, China's President, Hu Jintao, was quite outspoken about the need for China to embark on a new path of economic development and innovation "with Chinese characteristics". These Chinese characteristics were focused upon driving innovation, leapfrogging development in key areas of the Chinese economy and making breakthroughs to reinforce the torrid rate of Chinese economic and social development.

I would submit that President Hu clearly gets it. He understands that innovation is core to a nation's export competitiveness and ability to succeed in the global economy. Rational export controls must acknowledge and support this basic principal. He understands that paradigm-shifting breakthroughs – such as the internet, gene sequencing and a host of emerging areas that will fundamentally reshape our lives, stem entirely from the environment a country nurtures in support of its ability to invent and to innovate, not from external controls that seek to "wall off" innovation. These attempts are usually futile and simply serve to impede the flow of commerce.

Who's Going to Lead?

More fundamentally, the question we need to be asking ourselves on these issues is quite simply "who is going to lead"? That's really the ultimate question. No offense intended to my European friends here, but there are really only two options. It's either going to be us or the Chinese. While the Europeans spend their time developing a consensus, China is busy

developing itself into a technology power, with a plan to become a world leader in research and development, with all the attendant social and military influence that it entails.

I'm here to tell you that we need to wake up and realize that our defense industrial and innovation capabilities are eroding. And that erosion is directly attributable loss in the U.S. in innovation leadership. Policies that ignore the increasingly dual use nature of global economies simply exacerbate this trend.

The Rise in Dual Use Economic Growth and the Ability to Innovation

Any discussion regarding the best approach to export controls must acknowledge the increasing trend of world economies to increasingly dual-use approaches to national security and their interplay with economic growth and development. China has built its torrid economic growth upon a foundation of dual use industries since the late 1900's. This has not been an accident. China has carefully created a thorough convergence of civilian and military technology hardware and processes as a key industrial strategy to drive its ability to innovate and to underpin its aggressive economic and military growth.

Reports indicate that while overall standards lags behind world levels, there are emerging pockets of excellence, and the Wall Street Journal reported on Monday, March 13, 2006 that China is rapidly emerging as a global powerhouse in research and development.

This dual-use industrial base is a critical component of China's strategic high-tech economic plans. Currently, its leading dual use sectors include aviation, space, shipbuilding, nuclear, electronics and IT infrastructures.

Civilian and military integration has accelerated under a program targeting selective acquisitions of dual-use technologies, often at the "whole company" level. We saw and commented upon this trend in the context of the IBM-Lenovo transactions. As noted in this Mondays Wall Street Journal, the rate of sino-western joint ventures in manufacturing and R&D continues to accelerate, especially in semiconductors, computers and software development.

The Chinese are not alone in taking this approach. As with the Chinese, our own Defense Department is much more reliant on the private sector (off-the-shelf) technologies than it has ever been in its history. One example of this that I am personally familiar with is the Trusted foundry partnership of IBM at its East Fishkill, NY location. IBM's "trusted foundry" is guaranteed a certain amount of revenue by the DoD in return for maintaining a specialized semiconductor capacity deemed essential to national defense.

Therefore, the issue of export controls must be laid on top of larger trends in the defense industry over the past 15 years since the end of the Cold War. Even before the end of the Cold War, there was recognition that defense manufacturers were no longer the 800-pound gorilla when it came to procurement. Compared to the commercial market you had a smaller and smaller share of many key sectors like electronics.

As a result, defense manufacturers are more reliant on, and integrated with, commercial suppliers than at any time in the past. That is why it is critical to our national interest to have a strong commercial industrial base here in the U.S., and why any export control regime cannot be allowed to stifle our ability to innovate.

Innovation and the Role of Export Controls

Technology is the key to the strength of our industrial base and our future as a superpower. We cannot compete on price; instead we have to be more innovative and productive than anyone else. Our military superiority depends on technological superiority. We still have that superiority now, but history should teach us that we have to work hard to maintain that lead. History shows that it can be relinquished in the bat of an eye. In 1946, we thought our lead in atomic capabilities could be measured in decades. Just three short years later, the USSR had the bomb. In 1957 the USSR launched, Sputnik, beating us to space and embarrassing us into the investments that we should have been making all along.

Many argue that as a result of these trends towards dual use economies technology has now become a commodity. "We're living in a world where technology has become a commodity," and Intel spokeswoman recently stated. "Restricting access to markets would have a pretty significant impact on the U.S. technology sector."

A good example of how this ties in with export controls is Rochester, New York-based Gleason. Gleason recently sold \$20 million of machine tools used to make gears to Chinese companies last year, roughly 15 percent of total sales. Export control regulations under consideration at that time might have forced it to abandon customers such as a Chinese transmission maker that sells supplies to both commercial and military companies, Gleason recently told us.

“We could look like a less reliable supplier,” the Gleason executive said to us. “And one lost sale is not an isolated event. It could lead to the loss of substantial follow-on business for years to come.”

Export Controls Must Balance Export Competitiveness

Because of these and similar concerns, on Thursday, July 14, 2005, I rose on the House floor in opposition to the *East Asia Security Act of 2005* (HR 3100). That bill, which was placed on the suspension calendar in anticipation of easy passage, contained provisions that would have unintended consequences for our exporters, not just to Peoples Republic of China (PRC), but also for some of our largest export markets in Canada and Europe.

In a matter of minutes I was successful in orchestrating the turn around of 63 votes, sending the bill to defeat.

I have always strongly supported the efforts to strengthen our arms embargoes and making them more multilateral, particularly against China. Obviously, trying to strengthen the weakest link in the arms embargo against China with our friends in Europe will serve the cause of peace and freedom in the Pacific Rim region.

However, at the same time, we must be wise in our effort to achieve this important goal so that we do not weaken our overall global competitiveness and give more reasons to foreign customers as to why they should not buy American-made products.

I opposed HR 3100 in part because it would have required an export license for every transaction and a notification to Congress, including spare parts, regardless of dollar value. This could have added a huge costly and regulatory burden on U.S. companies specializing in the defense trade and

no doubt could have persuaded some of our closest allies to withdraw from cooperating with us.

In addition, HR 3100 would have imposed a new export-licensing requirement for “dual use” products (primarily commercial goods that may have a military application) that currently do not require an export license if the item is intended for military end use by the PRC.

These deficiencies in HR 3100 highlighted basic considerations that must inform any debate or passage of export controls to avoid harming U.S. competitiveness and our ability to be successful as an exporting nation.

Things to Consider with Export Controls

We should never forget that export controls cost about \$10 to \$20 billion in lost exports per year as well as roughly 200,000 jobs, according to studies performed by the Institute for International Economics. Most other nations do not have even the limitations we have now on our exports. So having HR 3100 add yet another burden on our overall ability to export and to be competitive struck me as a vain effort to make us "feel good" that we doing something against the Chinese.

The potential damage to U.S. industry, especially the defense and technology sectors, from such a broad approach to export controls is significant. In the aerospace sector alone, total U.S. aerospace sales to the European Union exceeded \$23 billion last year, accounting for 40 percent of U.S. aerospace exports and supporting more than 600,000 American aerospace jobs.

Based upon my experience with HR 3100, and the overarching need to focus upon and drive U.S. innovation growth, any approach to export controls must embody the following principals to encompass sound public policy:

- Export controls must be targeted and focused upon clearly defined national security priorities. Broad sweeping rules that impose burdens and costs on U.S. industries without achieving a concrete target or protecting a key technological asset serve no useful purpose.
- Export controls must be effective – and by that I mean they must be multilateral! Unilateral export controls do not work. Export controls

cannot be an exercise in academics or a misguided attempt at establishing “world leadership” **when no one else will follow them and will simply use them to gain competitive advantage for commodity technologies.**

- Export controls must be transparent and impose clearly defined consequences that can be known by industry in advance. We can’t ask industry to be agile in the market place when they must constantly be looking over their shoulders at potential enforcement penalties!

Given the growing interdependence of our military capability and our core ability to innovate, following these basic principals is essential to continued economic growth and our ability to remain a world leader. In this regard, the insight of Frederic Bastiat, the brilliant 19th century French economist, is critical: “When goods cannot cross borders, armies will.”

Thank you.