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**“China’s Industrial Policy and its Impact on U.S. Companies, Workers and the**  
**American Economy”**  
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Thank you very much for inviting me to testify. This commission is one of the most important information resources I use as a journalist.

Virtually all of the domestic manufacturing and technology executives and workers I cover understand the reason the United States is in its current economic predicament, and why it will take a long time for the country to recover. Few of them were “taken by surprise” by the country’s economic travails.

They understand that the United States government has effectively ignored the essential role manufacturing plays in the economy. It has done so at its peril. Its senior leadership has been distracted over the past 20 years and has barely acknowledged that the country is facing an unprecedented competitive challenge posed by dozens of countries, but particularly by China. Until it addresses the underlying cause of the financial sector’s collapse, which is the massive imbalance in trade, the glum economic mood of the country will not change. There are too many millions of Americans who intuitively know -- because they shop -- that the country no longer produces what it consumes. America’s wealth is no longer in America. The American industrial sector knows very well that until the government puts in place policies that encourage U.S.-based production of a new generation of consumer and industrial products, there can only be an anemic economic recovery.

I have been covering science, technology, industry and government in Washington, D.C., for the past 26 years. I was the founding editor of New Technology Week in 1987 at the height of Japan’s challenge to U.S. technology dominance. I covered the deliberate and in many ways successful U.S. response to that challenge. Ronald Reagan was an economic nationalist (a reluctant one). He and many of his political appointees in the Defense and Commerce Departments -- as well as a number of members of Congress -- understood that in order for the United States to win the Cold War with the Soviet Union it could not lose the Economic War with Japan. Reagan invested heavily in digital technologies, the fruits of which propelled the country through the 1990s. After a great deal of debate, Reagan also adopted trade policies that defended American workers and important “strategic” industries including automotive, machine tools and semiconductors. It is the reason he remains a hero in America’s heartland among “Reagan Democrats.”

The primary “issue” that I have been covering as a journalist for the past eight years is this: How is the United States dealing with the rise of China?

With the meltdown of the U.S. economy, that question has now been answered.

Two weeks ago as I was just preparing my written testimony for this hearing I went to the Google search engine and typed in “China’s strategic industries.”

The first listing -- the prized position, the place on Google where companies pay money to appear -- was this hearing.

That tells you something very important.

It means that the United States-China Commission is about the only government organization analyzing the most important issue facing the United States of America.

So let me tell you my approach in preparing for my testimony here today. I went on a U.S. government goose hunt. Searching through Web sites. Calling offices. Talking to more than a dozen people in the Washington, D.C., technology and industrial policy community -- some I have known for years and others they recommended. Collectively, these people have hundreds of years of experience working in Congress, government agencies such as Commerce, DOD, the State Department, and the International Trade Commission. They have worked in the White House, the Office of the United States Trade Representative and throughout the Washington, D.C., technology, trade and manufacturing communities.

First I wanted to see if I could locate places within the government that identify any or all of China’s “strategic” industries. I sought to find some meaningful analysis of what these industries are; the companies that constitute them; China’s policies to promote them; and whether or not the U.S. federal government has any type of mechanism to alert American companies of overt Chinese challenges to their industries or their specific enterprises.

I will describe later some of what I found, but aside from an occasional report, there is very little.

Also, I should say that as a journalist covering these issues from Washington, D.C., I am not an expert on what China considers to be its “pillar” industries. However, I have been chronicling in great detail China’s impact on American industries, the American economy and American workers. China’s unrelenting drive to develop robust manufacturing and research and technology capabilities with the help of foreign companies has had a profoundly detrimental impact on dozens of U.S. industries, ranging from consumer electronics, printed circuit boards, semiconductors, telecommunications equipment, batteries, computer components, materials, automotive parts, consumer goods, furniture, textiles and apparel. The list is comprehensive and entails virtually every industrial sector in the United States. Americans impacted adversely by China’s industrial, trade and currency policies have testified many times before your commission. You have heard their stories. You have given them voice.

In doing research for this hearing I also wanted to verify what I have long known to be the case: that the United States government not only has little knowledge of what is going on in China (save for the USCC), but also has little comprehension of the repercussions for American industry, employers and, most important, for American workers and taxpayers. There is no mechanism to systematically track China’s thrust into “strategic industries.” Nor is there a robust mechanism in place to defend the interests of American companies and workers who must compete with entirely unfair Chinese trading.

Finally, there is still no strategy to be found anywhere in the government to counter China's and other foreign nations' successful displacement of American industries.

What I found, instead, was a government that held in contempt Americans concerned about massive trade imbalances and the loss of American industry and jobs. A speech by the recently departed Under Secretary of Commerce for International Trade, Christopher Padilla, given on November 13, 2008, provides an indication of the government's attitude toward those who express concern about preserving the wealth-creation engine of the United States. Padilla describes people opposed to the U.S. government's free trade policies as being "pessimistic populists," a pejorative euphemism for "protectionist." Such "pessimistic populists," says the man who was in charge of the Commerce Department's trade functions, "fear the world, and blame its products, its people and its investors for our economic anxieties. [They] cannot be appeased."

In his speech, Padilla did not mention the trade deficit or the loss of four million manufacturing jobs over the course of the previous eight years. Like virtually all adherents to "free trade," Padilla staked out the moral high ground: "I stand on the other side of this debate, with those who embrace the enduring optimism of economic openness." As hundreds of executives in the domestic manufacturing community have told me (with remorse) over the past eight years, it is impossible to have a reasoned discussion with people holding such "religious" convictions. (Padilla's speech "Reflections and Projections: A Trade Transition Memo for the New Administration," before the Washington International Trade Association, is located at [http://trade.gov/press/speeches/padilla\\_111308.asp](http://trade.gov/press/speeches/padilla_111308.asp).)

Padilla and others like him have mis-labeled many concerned Americans as being "protectionists" or "pessimistic populists." Many of the manufacturing executives who hire Americans to make products are fully aware of the benefits of trade. They just want the U.S. government to put in place industrial and trade policies that favor American interests over those of foreign governments, foreign companies, U.S. multinationals that have moved production offshore, shipping companies, retailers that buy from cheap factories overseas, Wall Street wizards who pressure companies to fire American workers and shift production offshore so they can make additional pennies per share, and all of the economists, lawyers and lobbyists successfully representing these people in Washington, D.C.

All of these well-funded interests have won the economic debate -- they claim that cheap prices and offshore outsourcing are good for Americans -- but the United States has lost the underpinnings of its economy.

In the 1990s, the story that I covered was the rebirth of American industry. A big part of the story was the popular business technique of studying the "best practices" of the world's best companies, and adopting them.

What has become abundantly clear in the past decade is that the United States federal government does not study the best practices of foreign nations' increasingly successful economic, technology and industrial development programs.

In every case, what was told to me by people I spoke with in preparation for my testimony here confirmed what I have known as a journalist in Washington covering competitiveness for 22 years: the United States government has largely disassembled the mechanisms by which it was monitoring foreign

technology development and economic threats to America's most important industrial sectors. With little knowledge of what is happening overseas, particularly in China, the United States does not have the ability to formulate any type of effective response. It does an ad-hoc job of defending American companies and their workers confronting those threats. It does not even assure that the benefits of the massive investments it is making in research are accruing to American taxpayers who fund the research.

The result of such negligence is now readily apparent to tens of millions of Americans. The U.S. economy is in ruins. Yet the "free trade" forces are in hyper-mode, pouncing on any type of pro-American policy that smacks of "fair trade." They are ready to blame the "pessimistic populists" for a massive fall-off of international trade similar to what (arguably) occurred after the Smoot-Hawley tariff bill of 1930. Yet a massive decline in international trade is occurring without there having been implemented any substantive protectionist measures in the United States for decades.

The United States government has allowed -- indeed encouraged -- the loss of its most important "strategic industries," one after another. The evidence resides within the story told by the trade figures released every month by the Census Bureau. These figures are about the only real indicator the government keeps of the health of specific industrial sectors.

There are, however, pockets of people in government and Congress concerned about these issues. I have worked with them for years. They are passionate about protecting the interests of America over the interests of foreign countries and multinational companies that are benefiting from foreign trade, labor, environmental and government practices that would be illegal in the United States. For the most part, this small cadre of Patriots work for institutions that are enervated after decades of neglect and budget cuts.

They have expressed to me on countless occasions that the U.S. government is structured for a different era driven by an outdated mindset that the country has the most productive workers, the best technology, and a system of unfettered free trade that will benefit the majority of Americans. For the hundreds of thousands of manufacturing workers who are losing their jobs in "low-tech" industries targeted by cheap foreign imports, there is the Trade Adjustment Assistance Program to help them retrain for new opportunities. Unfortunately, the entire country is now on a massive "Trade Adjustment Assistance."

The U.S. governments' effort aimed at tracking Chinese industry was described to me as being a case of "benign neglect." There is a lack of awareness within government of China's capabilities and even less appreciation of China's momentum in advanced technology development, commercialization and production. "The problem is getting bigger and the capability to track it is being diminished," said one government technology veteran. "Who is studying their capability?" asks an industrial scientist managing a government R&D agency. "That is a big blank. We're competing globally but we don't know what we're competing against." Said another: "We're not even in the game. There is an insidious process going on."

Here is some of what I found:

#### International Trade Administration

If there is one place in the government that would be monitoring U.S. and foreign strategic industries, it would be the ITA. This is home of the "Manufacturing Czar," who resides in the division's

Manufacturing & Services Bureau. There are a few nuggets on the ITA Web site, but there really is not much about China. Two reports produced in March 2008 under the “automotive” link (“The Road Ahead for the U.S. Auto Market,” and “Automotive Parts Industry Annual Assessment”) paint a grim picture of the U.S. auto industry. In the auto parts report, the ITA Manufacturing division notes that the Detroit 3 have been “advocating that U.S.-based suppliers move production to lower cost countries or risk losing future contracts.” There is no analysis of why they are doing so, nor of how many auto suppliers have moved. The report does not describe what other countries are doing to entice them. There is nothing about what the U.S might do to counter such an economically destabilizing trend. Both reports provide little insight into the activities of Chinese and Indian parts and auto producers. The “Road Ahead” report notes that “globalization and foreign competition continue to impact the U.S. economy particularly the automotive industry.” Both reports provide little by way of dealing with the pending collapse of the American automobile industry.

### STAT-USA “State of the Nation”

STAT-USA is an online subscription service run by the Commerce Department that says it is the “Federal Government’s best resource for monitoring the U.S. economy.” Frankly, such a claim is specious and the Web site is not worth the \$200 annual subscription fee for anyone involved in the industrial technology community. There are links to statements made by Fed Chairman Ben Bernanke and daily releases on Treasury yield curves, commercial paper and bond rates. It posts the economic releases from most government agencies, such as monthly trade statistics, import price indexes, employment, GDP and earnings. Most of these are available for free on those agencies’ Web sites. There is nothing on the site from the State Department’s commercial or scientific attaches or any of the intelligence agencies describing overseas industrial developments, nor anything of substance describing the true condition of various U.S. industries.

### The DOD’s Office of Industrial Policy

This office has repeatedly and clearly stated for years that the U.S. defense industrial base is robust and that the Pentagon is not vulnerable to supply disruptions caused by a reliance on foreign producers of essential defense technologies. “The Department of Defense is not aware of any foreign vulnerabilities within its supply chains,” it states in its latest “Foreign Sources of Supply” report published in September 2008. It notes that the last time it assessed the military supply chain was in 2003. The office states that that the Department’s industrial policy is geared toward working with foreign suppliers. “The Department incorporates foreign items and components into many important systems, and in some cases the Department may be dependent upon foreign supplies for these items,” it says. “However, this does not mean the Department suffers from a foreign vulnerability. Foreign dependence usually does not equate to foreign vulnerability. The Department is not vulnerable if it is dependent on reliable foreign suppliers, just as it is not vulnerable when it is dependent on reliable domestic suppliers. Foreign vulnerability would occur only if the Department was dependent upon suppliers from a single or small group of countries that had the capability and political will to halt shipments to DOD in time of need, and when such delivery denial would cause direct and unacceptable impact to operations. In short, for there to be foreign vulnerability, DOD must be dependent upon the foreign source (no alternative sources available or that could rapidly become available), and there must be a significant, credible, and unacceptable risk of supply disruption due to political intervention by the host country or countries.” The DOD Office of Industrial Policy’s Web site is worth viewing. There are current reports on various industries (such as the recent “Assessment of Industry Investment in U.S. Domestic Production of Strategic Materials,” January, 2009), <http://www.acq.osd.mil/ip/>.

DOD's "Annual Report To Congress on the Military Power of the People's Republic of China 2008," is located at <http://www.defenselink.mil/pubs/china.html>.

The United States Trade Representative publishes an annual "Report to Congress on China's WTO Compliance." This is good.

[http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2008/asset\\_upload\\_file192\\_15258.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2008/asset_upload_file192_15258.pdf).

The International Trade Commission published an excellent report, "China: Description of Selected Government Practices and Policies Affecting Decision Making in the Economy," in December 2007.

This is by far the best government study found about China's industrial policy intentions:

<http://www.usitc.gov/publications/pub3978.pdf>.

#### Director of National Intelligence:

Over the past month, Dennis Blair, the director of National Intelligence, has briefed both the House and Senate on the "Annual Threat Assessment of the Intelligence Community." In his first sentence to both the Senate Armed Services Committee on March 10 and the House Permanent Select Committee on Intelligence on February 25, Blair said that the "primary near-term security concern of the United States is the global economic crisis and its geopolitical implications." He told the Senate hearing that "time is probably our greatest threat. The longer it takes for the recovery to begin, the greater the likelihood of serious damage to U.S. strategic interests. Roughly a quarter of the countries in the world have already experienced low-level instability such as government changes because of the current slowdown."

Most of Blair's 45-page testimony is devoted to terrorist extremists. At the February 25 hearing before the House of Representatives, he did not field a single question on China or on the "economic crisis and its geopolitical implications." Members instead focused on the prison at Guantanamo Bay, cyber terrorism, and the situation in Afghanistan, Pakistan and Iraq.

Blair's March 10, 2009, testimony to the Senate Armed Services Committee is located at

[http://www.dni.gov/testimonies/20090310\\_testimony.pdf](http://www.dni.gov/testimonies/20090310_testimony.pdf).

A transcript of Blair's hearing before the House Permanent Select committee on Intelligence is located at [http://www.dni.gov/testimonies/20090225\\_transcript.pdf](http://www.dni.gov/testimonies/20090225_transcript.pdf).

"Global Trends 2025, A Transformed World," from the National Intelligence Council, states that among its "relative certainties" is the emergence of a "global multi-polar system" with the rise of China and India. By 2025 "a single 'international community' composed of nation-states will no longer exist.

Power will be more dispersed with the newer players bringing new rules of the game while risks will increase that the traditional Western alliances will weaken. Rather than emulating Western models of political and economic development, more countries may be attracted to China's alternative development model." The 99-page report is located at

[http://www.dni.gov/nic/PDF\\_2025/2025\\_Global\\_Trends\\_Final\\_Report.pdf](http://www.dni.gov/nic/PDF_2025/2025_Global_Trends_Final_Report.pdf).

#### World Technology Evaluation Center (<http://www.wtec.org/>)

The World Technology Evaluation Center is a private organization hired by government agencies to analyze foreign technology development. In the course of my research for this hearing, I spoke with its president, Duane Shelton.

“The little bit of scholarship that I do is pointing with alarm to China in science and technology,” he explains. “I have been trying to get this in front of some members of Congress who might be aroused to do something about this, but I have had very little luck. They are up to their necks in alligators right now and long-range problems like this take a back seat.”

Shelton’s views were typical among those involved in international science and technology issues. He says the United States does not monitor the development of strategic and potentially “disruptive” technology taking place in China. He recently read that virtually all of the key ingredients used in American antibiotics are now produced in China. “I am currently writing about President Truman setting a goal of maintaining leadership in science because of his experience in World War II,” Shelton says. It was important for the United States to continue inventing new technologies in the absence of war, which had just produced such things as the atomic bomb, radar and penicillin. So Truman created the National Science Foundation. “And now we found out that all of our penicillin is made in China, which is a potential adversary of ours,” says Shelton. “This is shocking.”

Having conducted dozens of foreign technology capability studies over the past 20 years, Shelton says the United States is no longer the world leader in many important areas. His organization just finished a study on catalysts, a valuable and widely used technology, and found that there is little technical capability left in the United States, much of it having shifted to China. “I think this is very alarming,” he says. “But I have to tell you that as I try to convince other people, it doesn’t seem to get through to them.”

In the late 1980s and early 1990s, there was concern over these issues. The government created the Critical Technologies Institute operated out of the White House Office of Science and Technology Policy. It was busy putting together “critical technology” lists and contemplating policies needed to encourage their development in the United States. “But over the years as more and more technologies were lost and the manufacturing capacity went abroad and there were multiple sources of supply, our government just gave up: ‘there is a free marketplace and we will always buy things in the market so don’t worry about it,’ ” says Shelton.

Today, China is investing huge sums in new technology, production capabilities and science and engineering education. “Everything has changed overnight,” says Shelton. “A lot of people went to China five years ago and they saw peasants pushing wheel barrels. But if you haven’t been there in the last year, you are out of date.”

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