

U.S.-China Commission Hearing on Chinese Investment in the U.S.
May 9, 2013
Testimony before the U.S.-China Economic and Security Review Committee
Submitted by
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and
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Distinguished members of the Commission, it is a high honor and privilege to appear before you today to share my thoughts on the trends and implications of Chinese investment in the United States with regard to my particular area of defense expertise, namely, defense acquisition. My testimony reflects nearly 8 years of experience, from 2003 through 2010, both at the Pentagon and in the theaters of war in Iraq and Afghanistan, from both the standpoints of procurement of major systems within the Department of Defense and the Department of the Army programs of record, as well as contingency wartime procurement of weapons, goods, services and reconstruction and nation building infrastructure programs in non-permissive environments. It also reflects my post-government experience. In all instances, my testimony reflects my own opinions and not necessarily the organizations or businesses with whom I am affiliated.

My bottom line up front is that China's aggressive, unfettered pursuit and transfer of manufacturing capabilities, raw materials, key technologies and intellectual property, equity investment in, or acquisition of, US companies exposes our defense industrial base to unacceptable risk. The processes by which top policymakers assess this risk, including the CFIUS process, have been relatively ineffective at safeguarding important strategic assets, including critical defense contractors and subcontractors.

My testimony is not based on a pro- or anti-China position. China is a major power and must be accorded that status and attention. My concerns and my desire to testify today center on our US needs for independent defense strengths and capabilities in our supply chain.

Meanwhile, Chinese governmental and non-governmental entities are perusing our defense industrial base from multiple directions. Individual business transactions, on their face and taken separately, appear innocuous. Yet, taken as a whole, they seem to indicate that Chinese firms (with the support and cooperation of their own government and with Communist Party ties) will own game-changing capabilities at every step of the supply chain.

Thus, with US foreign interests almost entirely focused on the Middle East, the entire US defense industrial base and supply chain has become critically at risk to our loss of control and options.

To win conflicts and wars, to project American power and exceptionalism, to support our NATO, Middle East, and Asian allies and coalition partners, and to protect American interests abroad, we must own and control our critical defense and national security supply lines and industries. In recent years, the Department of Defense and White House policy makers seem to have fallen into a false argument that, because we now live in an era of globalization, the US can persistently rely on the amorphous "global

community” to supply us with critical materiel and technologies when and if we need them, at prices we are willing to pay, and within the timeframes (or “surge” needs) that we require.

My observations about our own system are that all government procurement rests on the basic principles of cost, performance (of the program if developed from scratch), and schedule. To meet these principles our military-industrial complex relies heavily on government organic capabilities in its labs and depots and on the capabilities of a US contractor industrial base on which we have relied even more heavily after 1974, when we became an all-volunteer, non-conscripted, and much smaller and capable military.

Today’s battle space, for our nation, has three players: (1) The warfighter, (2) the expeditionary civil servant, and (3) the expeditionary contractor. All three are highly integrated into the mission and all three run nearly the same risks of casualties, particularly when forward based. All three rely completely on the strength of our supply chain and our commitment to an industrial policy and its ability to surge for war, which requires maintaining expertise and stockpiles in times of peace.

Some of my observations during my government tenure that reflect on today’s hearings and affect our outcomes are:

- Our reliance on large system integrators and larger and larger prime contractors in an era of globalization in which our government may or may not have the expertise to understand and analyze and assess the risk factors in the subcontractor base, including reliance on Chinese influence, real or oblique.
- Our organizational inability to have visibility into the second and third tiers of sub-contractors on our major and lesser defense acquisition programs from the standpoint of corporate origins and legal structures to the authenticity of materials, goods and services.
- Our alarming vulnerabilities along the supply chain for strategic and critical materials. From FY1992 through FY2006, The US has sold \$6.1B of \$7.2B worth of strategic materials since 1992 (an 85% reduction) from its stockpiles and the number of warehouses went from 99 to 3.
- The loss of defense programs, technologies and intellectual property either by cyber theft, theft of trade secrets, legitimate mergers and acquisitions, and subsequent transfer of entire companies to, primarily, China, and the resulting impairment to our supply chain and in turn our national security.

Following my retirement in April of 2010, I became involved in the founding of the Strategic Materials Advisory Council (SMAC). The Council conducts grassroots advocacy campaigns to promote the reliable, long-term supply of strategic and critical materials and associated technologies. The Council is committed to equitable international trade for U.S. companies and those of allied nations, while ensuring a secure and reliable industrial and technology base for U.S. national security. I am pleased that many outstanding defense and science professionals have joined the Council in this effort.

The Council’s clear objective is to respond to threats to the U.S. industrial base and the critical materials supply chain and associated technologies. The mission is to ensure a reliable, long-term supply of strategic and critical materials and the technologies

associated with them to support American economic and national security interests through the adoption of U.S. government policies and industry initiatives that promote domestic and allied nation production, research, recycling and workforce development. This will be achieved by supporting development of domestic resources and promoting cooperation with key allied nations. The Council provides advice and counsel to industry, government, and other stakeholders.

In the last six months, I would offer a major example of our US government's "not seeing the forest for the trees" and of its having a "head in the sand and not connecting the dots" approach to foreign acquisitions of U.S. technologies.

A123 Systems – a U.S.-based manufacturer of advanced lithium-ion batteries that was awarded nearly \$250 million in U.S. taxpayer-funded stimulus grants – provides critical electrical storage for various applications, including civilian and military vehicles and satellites, renewable energy sources involving key US infrastructure, and other deployable power systems. The company entered into numerous research and development contracts with the Department of Defense and but was allowed to be sold at bankruptcy to a major Chinese company with significant ties to the Chinese Communist Party.

The U.S., through its ineffective and flawed CFIUS process, compromised our nation's intellectual property and manufacturing capabilities by allowing this sale. This occurred despite strong congressional inquiry and "non-concurs" from key agencies, including the U.S. Army.

As the Strategic Materials Advisory Council noted:

"For over thirty years, China has pursued an overt economic strategy of acquiring both natural resources and promising technologies. This strategy creates Chinese dominance of entire supply chains for selected materials and related technologies. Allowing Wanxiang to acquire A123 Systems would continue this trend and make the U.S. dependent on an unreliable foreign source for yet another critical defense component. For example, China has a near monopoly of rare earth production that allows it to manipulate the supply for a range of defense and renewable energy products, including nickel-metal hydride battery production. The U.S. must not allow China to acquire a similar position with A123's lithium-ion battery technology and dominate its supply chain as well."

The Committee on Foreign Investment in the United States ("CFIUS") failed to apply common sense to the A123 transaction and focused on economic and business investment advantages instead of adequately evaluating national security risks.

My concerns about the CFIUS process are based on two issue sets: (1) the unreliability of certain foreign firms and (2) the strength (or weakness) of U.S. industry. As an example and to answer the "free trade economists," one must acknowledge that, though it has a voracious economy, China is not a free trade state. Trade with China is different. The Chinese government – and military – support and often own Chinese industries. We should not be fooled by the duality that, to the West, Chinese firms present themselves as capitalist free trade entities. Through previously well investigated

activities, such as notable, well-publicized cyber-attacks and the ensuing reports (see the Mandiant Report) we must recognize that the Chinese business sector and the state are one in strategy and policy, if appearing tactically to be different.

In all wars, our nation's qualitative military edge came about because of our supply chain strength. Military advantage relies on the US industrial base. We are experiencing an unacceptable erosion of that qualitative edge through the factors listed about and many other factors that have come to the attention of the Commission.

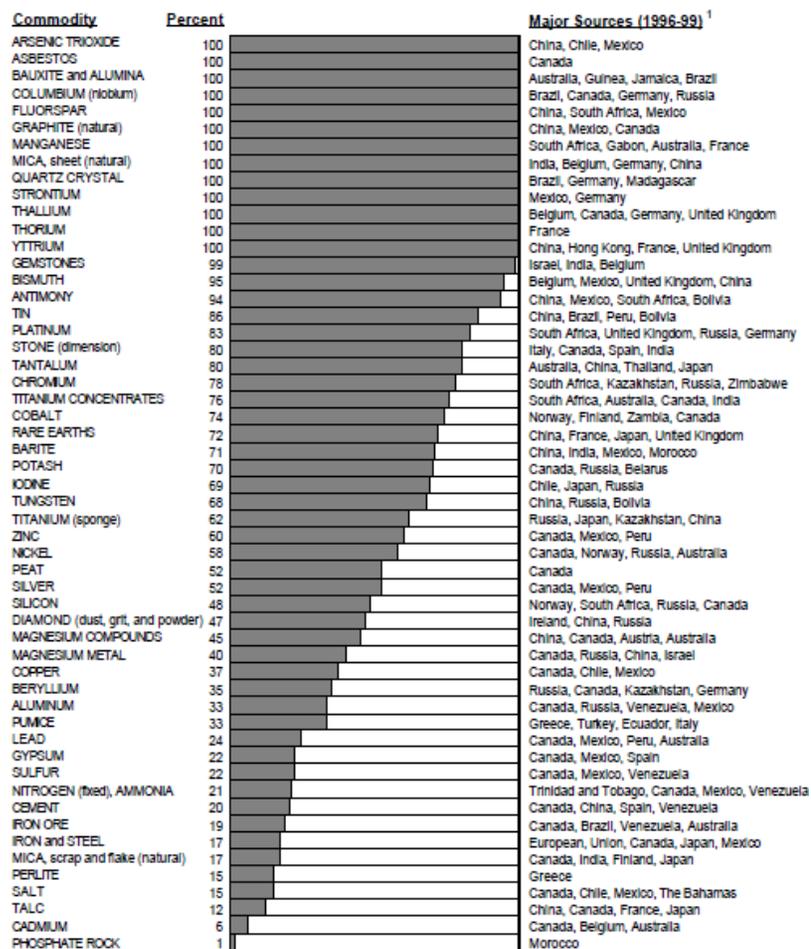
Members of the Commission, I appreciate the opportunity to appear briefly before you today to further this national conversation and am happy to take your questions.

Exhibit 1: Elements of Chinese Industrial Strategy



Exhibit 2: Nonfuel Mineral Resource Dependence

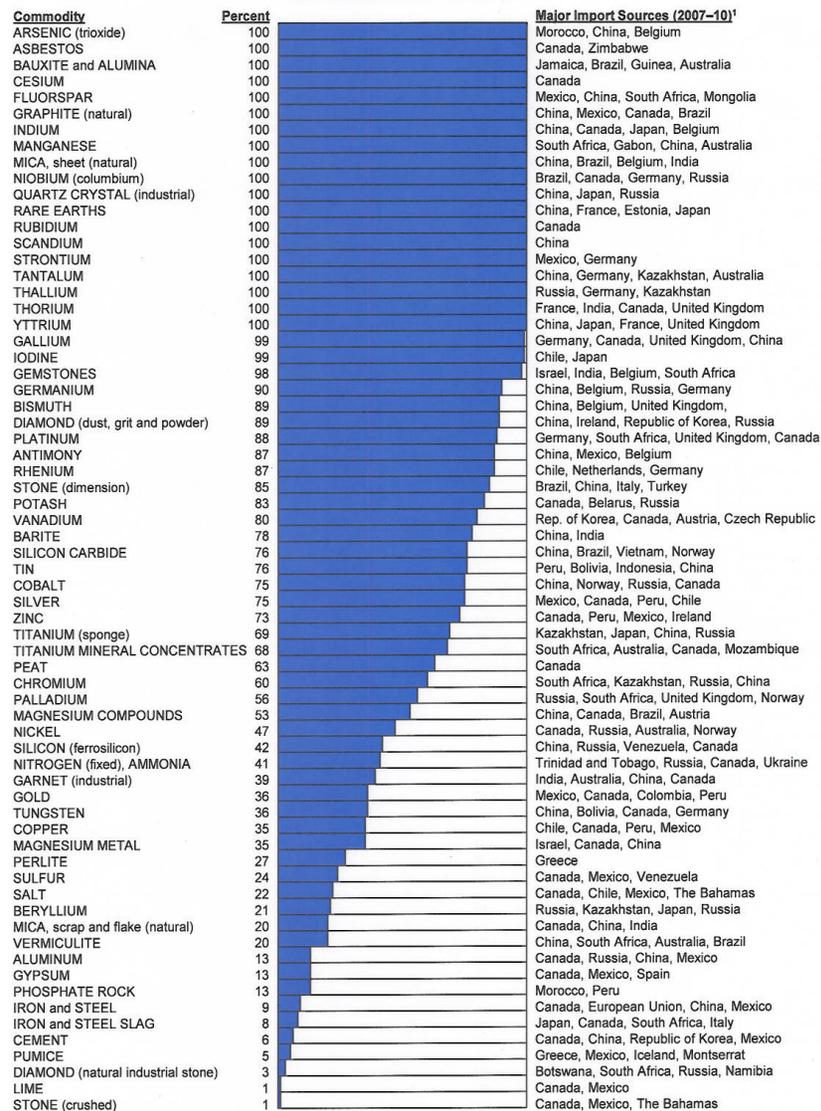
2000 U.S. NET IMPORT RELIANCE FOR SELECTED NONFUEL MINERAL MATERIALS



Additional mineral commodities for which there is some import dependency include:

Galium	France, Russia, Kazakhstan, Canada	Rhenium	Chile, Germany, Kazakhstan, Russia
Germium	Russia, Belgium, China, United Kingdom	Selenium	Philippines, Canada, Belgium, Japan
Indium	Canada, China, Russia, France	Vanadium	South Africa, China
Mercury	Canada, United Kingdom, Kyrgyzstan, Spain	Vermiculite	South Africa, China
		Zirconium	South Africa, Australia

2011 U.S. NET IMPORT RELIANCE FOR SELECTED NONFUEL MINERAL MATERIALS



¹In descending order of import share.