CHINA'S IMPACT ON THE U.S. AUTO AND AUTO PARTS INDUSTRIES

HEARING

BEFORE THE

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

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CHINA'S IMPACT ON THE U.S. AUTO AND AUTO PARTS INDUSTRIES

Monday, July 17, 2006

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION
Washington, D.C.

OPENING REMARKS OF VICE CHAIRMAN CAROLYN BARTHOLOMEW

The Commission met at University of Michigan, Dearborn Campus Fairlane Center, Dearborn, Michigan at 8:35 a.m., Chairman Larry M. Wortzel, and Commissioners Michael Wessel, George Becker and Daniel A. Blumenthal (Hearing Cochairs) presiding.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you, everybody. We're expecting our first member of Congress to join us at 8:45. We have a few opening statements by Commissioners. I just wanted to say good morning and thank you to everybody for attending our hearing.

I'm Carolyn Bartholomew, Vice Chairman of the U.S.-China Economic and Security Review Commission. We're here today in Michigan, the home of the American "Big Three" auto companies, to examine the impact of China on the U.S. auto and auto parts industries. We are also considering the importance of America's automotive industry to the overall health of the U.S. industrial base and to the nation's military security.

Our Commission advises Congress on U.S. policy and legislation affecting our economic and security relationship with China. As part of our efforts, we hold hearings both in Washington and around the country to hear from the people and industries most affected by China's rise as an economic and military power.

Last year, we held a similar hearing in Ohio to hear from the auto, machine tool and rubber industries among others. We were in Columbia, South Carolina the year before, and it's been very interesting to go out and talk to people who have been affected in their communities.

Our Commission submits an annual report to Congress containing our conclusions and recommendations. Past annual reports and hearing transcripts are available on our Website, www.uscc.gov. The record of this hearing will also be included on our Website.

A number of our commissioners recently returned from a fact-finding trip to China during which we toured an integrated auto plant with stamping, welding, painting and assembly operations all under one roof. It's a joint venture between Citroen and Peugeot of France and a Chinese company, Dong Feng Automobile Company.

As in many such cases in China, the plant appeared to benefit from a wide array of special subsidies such as tax abatements, favorable loan rates from state-controlled banks and discounted land purchases.

Should the cars being made there be exported, they also will enjoy a 15 percent to 40 percent export subsidy in the form of an artificially undervalued currency. In addition, the Chinese auto industry sits behind a protective 25 percent tariff on imports of foreign-made cars.

The U.S. auto industry, which enjoys no such protection or subsidies from Washington, faces a daunting challenge in competing with the Chinese industry. U.S. auto parts suppliers, who represent an even larger pool of workers than the companies that assemble the cars face even greater challenges.

China maintains high tariff and non-tariff barriers to imported auto parts. Imported parts face tariffs of 10 percent to 25 percent. U.S. part suppliers face a difficult choice: move production to China and risk arbitrary government tax, regulatory and licensing actions, and the loss of proprietary technology, or keep production at home and protect intellectual property, but compete on a very uneven playing field.

In sum, China's activities in these industrial sectors pose a major challenge to their U.S. counterparts. The repercussions will be felt in overall U.S. economic performance and the vitality of our defense industrial base, the economies of several states, and in scores of cities, towns and communities. The Commission believes this issue is of high importance, but it merits the close attention of Congress.

I would like to thank the University of Michigan's Dearborn campus for making these facilities available today and thank all of you who have come to offer your thoughts and your analysis to us.

I'd also like to submit for the record a statement that we've received from Governor Granholm and from Representative Kildee, and now I'd like to turn over the hearing to the two cochairs, Commissioner Dan Blumenthal and Commissioner Mike Wessel. Mike is sitting in for Commissioner George Becker, the former International President of the United Steelworkers Union, who is cochair and is unable to be with us here today.

Thanks very much.

[The statement follows:]

Prepared statement of Vice Chairman Carolyn Bartholomew

Good morning and thank you for attending our hearing. My name is Carolyn Bartholomew. I am the vice chairman of the U.S. China Economic and Security Review Commission.

We are here today in Michigan, the home of the American "Big Three" auto companies, to examine the impact of China on the U.S. auto and auto parts industries. We are also considering the importance of America's automotive industry to the overall health of the U.S. industrial base and to the nation's military security.

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Our Commission submits an annual report to Congress containing our conclusions and recommendations. Past annual reports and hearings transcripts are available on our website, www.uscc.gov. The record of this hearing will also be included on our website.

The Commission recently returned from a fact-finding trip to China during which we toured an integrated auto plant with stamping, welding, painting and assembly operations all under one roof. It is a joint venture between Citroen and Peugeot of France, and a Chinese company, Dong Feng Automobile Company. As in many such cases in China, the plant appeared to benefit from a wide array of special subsidies, such as tax abatements, favorable loan rates from state-controlled banks, and discounted land purchases. Should the cars being made there ever be exported, they also will enjoy a 20 percent to 40 percent export subsidy in the form of an artificially undervalued currency. In addition, the Chinese auto industry sits behind a protective 25 percent tariff on imports of foreign-made cars.

The U.S. auto industry, which enjoys no such protection or subsidies from Washington, faces a daunting challenge in competing with the Chinese industry. U.S. auto parts suppliers, who represent an even larger pool of workers than the companies that assemble the cars, face even greater challenges. China maintains high tariff and non-tariff barriers to imported auto parts. Imported parts face tariffs of 10 percent to 25 percent. U.S. parts suppliers face a difficult choice—move production to China and risk arbitrary government tax, regulatory and licensing actions and the loss of proprietary technology, or keep production at home and protect intellectual property but compete on a very uneven playing field.

In sum, China's activities in these industrial sectors pose a major challenge to their U.S. counterparts. The repercussions will be felt in overall U.S. economic performance, in the vitality of our defense industrial base, in the economies of several states, and in scores of cities, towns and communities. The Commission believes this issue is of high importance and that it merits the close attention of the Congress.

I'd like to thank the University of Michigan's Dearborn campus for making these facilities available today, and all who have come to offer their thoughts and analysis to us. Now, I'd like to turn over the hearing to the two co-chairs, Commissioner Daniel Blumenthal and Commissioner Michael Wessel, who is sitting in for Commissioner George Becker, the former International President of the United Steelworkers Union, who is unable to be here today.

OPENING STATEMENT OF DANIEL BLUMENTHAL HEARINGCOCHAIR

HEARING COCHAIR BLUMENTHAL: Thank you very much and welcome to our hearing and thank you very much to the University of Michigan for hosting us today.

As Chairman Bartholomew said, our Commission looks broadly at the national security implications of our economic relationship with China and the issue in terms of our economic relationship always comes down to not whether we should be trading with China but the issues of fair trade, the issues of playing by the rules set by the world when China agreed to join the World Trade Organization.

Today we're going to talk about the U.S. auto and auto parts industry which holds a special place in our manufacturing and our economy. The production of cars and trucks, as you know, employs computer scientists, skilled craftsmen and engineers of all stripes. It's one of the biggest users of steel, textiles, rubber and semiconductors. The average cars uses 18 computers to monitor fuel flow, pollution control, ignition timing, airbag deployment and braking systems. Cars may employ radar and collision avoidance systems and satellite technology to find their way. The process of designing and creating a car is one of the most technologically sophisticated endeavors in business today.

So we feel that the survival of a healthy auto industry is the key to supporting many of our technical skills that have an important crossover effect in our national security. Today we'll be hearing from witnesses who can draw that connection with first-hand knowledge of how the erosion of our auto and auto parts industry directly affects and threatens America's defense industrial base as well as its economic and technological future.

Today's newspapers are filled with grim news about the industry. Layoffs, wage and benefit cuts, plant closings, dividend cuts and company consolidations are widespread and growing. The auto parts industry is similarly undergoing particularly hard times.

The principal customer base, the Big Three, has suffered from declining sales of finished vehicles and therefore the quantity of their parts being ordered has also declined. Foreign-based transplant operations while helping us do better have still not made up the slack, and China's exports of auto parts is on the rise as well.

The United States imported $5.4 billion in parts from China in 2005, which is a 39 percent increase from the previous year and, by contrast, U.S. parts shipments to China declined two percent in the same period to $623 million in 2005. More than a dozen major auto suppliers in the United States filed for bankruptcy protection in 2005.

We had invited the Big Three to testify today and really regret that we can't hear from them today in order to help us make our recommendations to Congress. We know that the auto industry is caught in a bind, as Chairman Bartholomew mentioned, in terms of moving their operations to China to make money, for much of the same reason that China's auto industry is growing so fast: the subsidies we hear about in the central, provincial and local governments in the form of discounted land, tax abatements, below market interest rates, loan forgiveness and lax enforcements of environmental standards.

Adding to that is the undervalued currency, and you have a huge incentive for producing in China. The same U.S.-based companies that have been attracted to use China as a manufacturing base now fear the loss of such subsidies if they criticize Beijing's policies.

We welcome our witnesses to today's hearing and thank you very much for your timely testimony. We appreciate your thoughts about the challenges faced by the auto and auto parts industry as a result of what many perceive as unfair competition with China and about the overall effect on our nation's defense-critical industrial base.

Thank you.

[The statement follows:]

Prepared Statement of Commissioner Daniel Blumenthal
Hearing Cochair

Welcome to the Commission's hearing on China's impact on the U.S. auto and auto parts industries.

America's auto industry holds a special place in manufacturing and in our economy. The production of cars and trucks employs metallurgists, computer scientists, skilled craftsmen, and engineers of all stripes. Today's cars are one of the biggest users of steel, textiles, rubber, and semiconductors. The average car uses 18 computers to monitor fuel flow, pollution control, ignition timing, airbag deployment, and braking systems. Cars may employ radar in collision avoidance systems and satellite technology to find their way. The process of designing and creating a car is one of the most technologically sophisticated endeavors in business today.

No wonder, then, that the survival of a healthy auto industry is a key to supporting many of the technical skills that have a crossover effect on our nation's security. We will be hearing from witnesses today who can draw that connection. They have first-hand knowledge of how the erosion of our auto and auto parts industry directly threatens America's defense industrial base as well as its economic and technological future.

Unfortunately, today's newspapers are filled with grim news about the industry. Layoffs, wage and benefit cuts, plant closings, dividend cuts and company consolidations are widespread and growing. The auto parts industry is undergoing some particularly hard times. Their principal customer base in the United States—the Big Three—has suffered from declining sales of finished vehicles and therefore, the quantity of their parts being ordered has also declined. Foreign-based transplant operations here, while doing better, have still not made up the slack. At the same time, China's export of auto parts is on the rise. The

United States imported $5.4 billion in parts from China in 2005, a 39 percent increase from the previous year. By contrast, U.S. parts shipments to China declined 2 percent in the same period to $623 million in 2005. More than a dozen major U.S. auto parts suppliers filed for bankruptcy protection in 2005.

The Commission also invited the Big Three to testify today, but none took us up on our offer. Nor did the companies designate anyone to testify on their behalf. We regret we cannot consider their views in open session and provide their testimony and recommendations to Congress. But America's auto industry is caught in a bind. While the North American operations of Ford and General Motors lost money last year, their operations in China apparently made money for much the same reason that China's auto industry is growing so fast:: subsidies from the central, provincial and local governments in the form of discounted land, tax abatements, below-market interest rate loans, loan forgiveness, and lax enforcement of environmental standards. Add to that the artificially undervalued Chinese currency, and you have a huge incentive for producing in China. Unfortunately, the same U.S.-based companies that have been attracted to use China as a manufacturing base now fear the loss of such subsidies if they should criticize Beijing.

We welcome our intrepid witnesses to today's hearing and thank you for your timely testimony. We appreciate hearing your thoughts about the challenges faced by the auto and auto parts industries as the result of competition with China and about the overall effect on our nation's defense-critical industrial base.

COMMISSION VICE CHAIR BARTHOLOMEW: Congressman Levin, welcome. We look forward to your testimony and we very much benefited from your brother's testimony in Washington recently.

PANEL I: CONGRESSIONAL PERSPECTIVES

STATEMENT OF SANDER LEVIN, A U.S. CONGRESSMAN FROM THE STATE OF MICHIGAN

MR. LEVIN: I'll try to do half as well. He's in Washington today. Thank you for inviting me to participate with other distinguished presenters who are going to talk about this important issue. You have a copy of my testimony, and let me, if I might, summarize it, and then perhaps there will be some time for back and forth. I know you have a very full day.

As I was preparing my remarks, I thought back over the battle of China's entry into the WTO and there seemed to be at that time two clear factors. One was that China had already become a very large economy and that it provided an opportunity as part of globalization, an opportunity for their own population, opportunities for businesses and workers.

There was also a clearly second factor, and that was a competitive challenge. Even in those years, they seemed distant. They weren't that long ago. It was clear that China was going to become a major competitor far more than it was at the time. As a result, as China PNTR was presented to the Congress, the determination was made to provide some specific provisions as to their entry into the WTO to make sure that there was compliance by them with their WTO obligations.

There were several provisions that were placed into the PNTR legislation that had been agreed to by China and became applicable under WTO rules to every country in addition to the U.S. which had negotiated the accession agreement.

The automotive industry of the U.S. took on the opportunities presented by China's growing economy and its entry into the WTO, and my testimony lays this out, and others will talk about it. The automotive industry of the United States is a major participant in China's blossoming economy and it has provided what China wanted, and that was competitive products, major investment, enhanced technology, to put it mildly, and also employment for hundreds of thousands of Chinese.

But their emergence, China's emergence, has really increased the importance of addressing these issues of compliance and to address the major problems because of China's failure to comply effectively, and in my judgment, the Bush administration has failed to vigorously stand up for the American automotive industry, and I think it's been reflective of its overall passive approach to the maintenance of a strong manufacturing base in the United States, and I'm glad to be sitting here with my distinguished colleague John Dingell.

As much as this failure of the administration to stand up for the American automotive industry in these past years and its reflection on its overall passive approach to maintaining a strong industrial base in this country, these problems loom even larger for the future. The automotive industry has not only, as I said, participated in the Chinese economy, but the failure of the administration to take strong measures has helped to contribute to what you have considered on many occasions the record-setting deficit with China.

Let me quickly highlight some of the problems that face the automotive industry because of the failure of China to abide by its commitments and the failure of the Bush administration to take a vigorous active proactive approach.

The first one I mention in my testimony relates to local content requirements. The WTO prohibits local content requirements of the kind that China has been following. Their tariff classification system, their tax structures essentially puts major pressure on U.S. auto parts producers and motor vehicle assemblers. And there are now new regulations that, in essence, as I understand them, require 60 percent domestic content and localization of all major high technology components, and you cannot emphasize that provision enough.

Secondly, as I point out in my testimony, there's been a surge of violations of intellectual property rights provisions relating to auto parts. Auto parts are being copied, misrepresented and sold as genuine, and this obviously has a major impact on the ability of U.S. manufacturers of auto parts to participate in the Chinese economy, and there are numerous examples of unauthorized trademark usage, of people, of entities saying they're authorized service centers when they're not.

The third relates to their investment structures. China now requires joint ventures. I was just reading a few days ago about the purchase by China of a distinguished name of an automobile. You perhaps read about that. They can come here and produce it. There are no restrictions as to their entry into the U.S. market. We don't require that they joint venture with anybody. If they want to, they can just come here and produce those cars. They also have a 49 percent requirement. Minority ownership cannot exceed 49 percent. So this is a third aspect that relates specifically to the auto sector and China is the only major nation in the automotive world that has these restrictions.

Fourthly, and I'm not sure how much you will delve into this today, because I haven't seen all the testimony, but it's clear that China is now developing its own system of regulations. They're under the umbrella of safety/environmental systems. However, clearly these regulations are going to have a major impact on American producers, American workers, and in my judgment they relate more to controlling their market than they do to the environment or safety.

I mention a fifth one, and that is China's tariff of 25 percent on imported automobiles. It's so much higher than our own, and as I understand it, they're attempting to argue that they should be exempted, as the Doha Round unfolds, from any comprehensive tariff reductions because they're a new member of the WTO. That would be, I think, mind-boggling to say that the fourth largest automotive sector in the world would be exempt from any negotiated tariff reductions because they're a new entrant.

Let me just briefly talk about the U.S. government response. I think there's been under the administration of President Bush essentially a culture of noncompliance.

Let me give you just a few examples. We battled this out in the China PNTR legislation. There was a provision for an annual review within the WTO. If there hadn't been that provision negotiated in the accession agreement, there would have been a review every four years. So we said, look, China's an exceptional developing economy, it's huge, it's going to become larger. There should be an annual review within the WTO.

I think it's been made a mockery of. It's been perfunctory, and the GAO has studied the U.S. response to this provision and has found that our approach has been ineffective. Essentially, there have been written responses by China and sometimes not even that. And so we've lost the benefit already of five years of what should have been comprehensive vigorous review of China's compliance with its WTO obligations.

Let me also mention, though, this hasn't yet affected the automotive industry. A second provision that we placed in the China PNTR legislation was an import surge safeguard. And we said, look, there's likely to be a surge of products from China with its very low labor costs, with its state subsidization, and we want a provision so when there was injury to American businesses and workers, that there would be action taken.

This was negotiated. It's part of the WTO structure. So far there have been six cases filed against China by entities that thought that they were harmed by import surges. In four of the six cases, the ITC recommended action. In none of them has this administration taken any action. None.

What signal does that send? It essentially says let it happen. Whatever happens will work out in the wash. This approach, I think, has been reflected in the WTO dispute settlement system and the failure of the administration to use it vigorously. It's filed only 14 cases in the last five years, many less than the previous administration.

Finally action was taken by the administration regarding local content requirements and you know of this I think, and there may be more testimony, and a complaint was filed. Under the WTO procedures, there's a 90-day consultation period. Essentially what the Chinese government has done has been to stonewall. Nothing has happened during this 90-day period.

There was, therefore, a deadline, and after that a panel could be filed for, and I found it disconcerting that the U.S. and others did not immediately file for a panel. It sent again the wrong signal. Look, China is part of the world economy; it's become more and more so. There was no avoiding that. What could be avoided was allowing them not to play by the rules, and sometimes they have, but too often they haven't.

This is going to have I think an increasing impact for the automotive sector. We're going to see more and more parts coming here from China. They are more and more taking advantage of the technology that our companies there have imparted to the Chinese economy.

Also, you're going to see more and more of their vehicles coming here. The automotive sector is already under immense stress. It's doing its best to maintain itself. If it's not doing its best, it's doing much, and it's trying to do even better, and it isn't going to be able to succeed in all these efforts if other countries with large automotive sectors don't follow the rules, don’t follow the rules.

So what is a problem today looms as a much larger problem in the future, and I want to finish by saying this. Sometimes the Bush administration has said, well, we're not getting enough information from the automotive sector of the United States. They seem to be hedging, and here's the answer. Look, they now have major investments in China. The same was true, you'll remember, as to Japan as they tried to break into the auto parts companies into the Japanese market.

They found it difficult sometimes to be as strong as they might have been because they were also trying to do business with them. There's a role for government to stand up for American business and workers. There's a role for government to be an active partner. If you just take the notion to let international trade happen willy-nilly, if the rules are violated, in the end, it won't matter much because the country that violates will only hurt itself, which I think is incorrect and sometimes nonsensical. The industry, automotive/auto parts, needs a vigorous active partner of the U.S. government.

So far it has failed to have it, and my hope is that this hearing will spotlight the need for the government of the United States to become a vigorous, active, yes, constructive partner of the automotive industry of the United States.

Mr. Dingell and I have this industry in our bloodstream. But more important, it's a vital part of the American economic bloodstream. So I congratulate you on this hearing, and if you would like, before I scoot over to Clinton Township, if there are a few questions, and then the senior member of the United States House, and the champion for the auto industry, along with others of us, will take over.

Thank you very much.

[The statement follows:]

Prepared Statement of Sander Levin
A U.S. Congressman from the State of Michigan

When Congress considered China's entry into the World Trade Organization, I cautioned that China's role within the global economy was both an opportunity and a competitive challenge. Because of its size and growth in its economy, Congress insisted on particular provisions within the legislation granting Permanent Normal Trade Relations (PNTR) with China in an effort to ensure its compliance with World Trade Organization (WTO) rules and regulations.

The American automotive industry has worked to take on the opportunities of the rapidly increasing Chinese domestic market. In 2005, U.S. Automakers sold 722,493 passenger vehicles in China, a 27 percent increase from 2004 and representing 23 percent of overall sales. American participation in the Chinese automotive sector has provided competitive products, major investment, enhanced technology, and employment – all of which were goals of the Chinese government.

China's emergence as the fourth largest and fastest growing automotive industry in the world has increased the importance of addressing the major problems presented by China's failure to meet it obligations when entering the WTO. The Bush Administration has failed to vigorously stand up for the American automotive industry, reflective of its over-all passive approach to maintenance of a strong manufacturing base.

Our failure to address these problems hinders the U.S. automotive industry now and looms as an even greater threat in the future. It contributes to the record-setting trade deficit with China. In 2005, the U.S. – China bilateral trade deficit in goods was $202 billion which accounts for a full 25% of the overall historically immense U.S. trade deficit. Let me highlight some of these problems.

1. WTO rules prohibit local content requirements and no other major auto producing country has local content requirements in their auto sectors. But China's tariff classification system and tax structures pressure U.S. auto and auto parts makers to source Chinese-made parts. Newly released regulations require automakers to reach 60% domestic content and the localization of all major high technology components. If allowed to stand, this results in shifting to Chinese suppliers or the movement of parts production to China.

2. The recent surge of serious Intellectual Property Rights (IPR) violations in auto parts is unprecedented in terms of size, scope and severity. Auto parts are being copied, intentionally misrepresented, and sold as genuine -- all in direct violation of China's trademark laws, which are clearly not being enforced in violation of its WTO obligations. The most common counterfeit parts are aftermarket maintenance and high volume items such as brake pads, wheel rims and filters and often do not meet national or international safety specifications.

There also are numerous examples of unauthorized trademark usage on the signage of independent service centers falsely claiming they are authorized service centers, and the theft of unique and protected design elements from individual parts to the entire look and design of a vehicle is alarming.

3. China's auto investment structures restrict the development and operation of the U.S. automotive sector in China. For example, foreign auto investment is only allowed as a joint venture with a Chinese partner and, importantly, the foreign partner (the U.S. company) is limited to 49% minority ownership. China is the only major nation with such restrictions.

4. China is developing its own automotive safety and environmental systems for its automotive industry rather than using norms developed internationally over a long period of time. The results of these enumerable rules and regulations seem less to be a response to environmental or safety concerns and more an effort to restrict the openness of its market.

5. China's WTO accession commitment was to lower its 25% tariff on imported automobiles. Now despite its major status in motor vehicle production and sales, it has been arguing in ongoing WTO negotiations that as a new member it should be under no obligation to be part of any agreement that requires the further lowering of tariffs.

<u>The U.S. Governmental Response</u>

The U.S. Automotive industry needs a vigorous U.S. governmental partner to tackle these problems. Unfortunately, the Bush Administration has allowed a culture of non-compliance to set in as to China's adherence to both the commitments they made when they entered and their ongoing practices.

China PNTR provided specifically for an annual review of the degree to which China was complying with their commitments. The rigorous timetable was established for China because it was far larger and far more competitive than any other developing economy. The Administration has completely failed to make this a meaningful review and to use it as leverage to bring about full compliance. The Government Accountability Office (GAO) documented lack of active participation in the reviews, untimely submissions by the U.S., ineffective procedures that allowed China to refuse to submit a written response, and no resulting conclusions or recommendations.

In short, we have lost the major benefit of five years of annual reviews because the U.S. has allowed them to become a meaningless exercise with no sign of a different course being set prior to their expiration in 2011.

The China PNTR legislation also provided a specific import surge safeguard that could be used when China unfairly flooded the U.S. market with imports. A total of six cases has been brought against China under this mechanism, known as Section 421. The U.S. International Trade Commission (ITC) made affirmative market disruption determinations and proposed a remedy in 4 of the 6 cases. The Bush Administration rejected providing relief to the domestic industry in every case. These cases may not seem directly relevant to the automotive sector (pedestal actuators, wire garments hangers, iron water work fittings and steel pipe), but the approach by the Bush Administration does not bode well for the future use of this special trade law and it sends a signal to our industry – don't bother to bring a case under the domestic trade law because we won't be there for you even if the ITC finds in your favor.

The Bush Administration has been very lax in using the WTO dispute settlement system to challenge the unfair trading practices of our trading partners. We have filed only 15 cases total in the last five years. Often when you press the office of the United States Trade Representative (USTR) on this, they indicate that they have not heard many complaints from domestic industry or domestic industry has not done the legal leg work to allow them to bring a case. Given the examples I cited this morning, this is a completely unacceptable approach. It is the USTR's job to lead the charge to end these violations and create a more level global playing field for U.S. business.

Finally, earlier this year the U.S. and the European Union, later joined by Canada and Japan, filed a complaint with the WTO against the local content requirements I described. The Chinese have stonewalled through the 90-day consultation process provided under WTO rules. The U.S. missed the July 6th deadline for requesting the formation of a WTO dispute settlement panel. This is such a serious matter that it is disconcerting when any deadline is missed. In addition to a lack of action at the WTO, we have failed to make clear that China's position in the negotiations on tariff reductions is a non-starter.

Conclusion

China's exceptional pace of economic growth has been providing significant opportunities and unique challenges. The American private sector has shown its interest in participating in the growth. The major challenges require a partnership role from our government that has been seriously lacking in important respects and that is strong, not halting, clear not opaque, persistent not inconsistent and proactive not passive. And sooner, not later.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Congressman Levin. Your statement will be entered into our record. We have one question.

COMMISSIONER D'AMATO: Thank you very much, Congressman Levin, for that very comprehensive and powerful statement on the state of the industry and the situation. Looking down the future, if we're going to be importing into the United States Chinese manufactured cars, what would be your thought if it was clear that in those vehicles there was substantial components or parts that in fact were violations of Chinese commitments in IPR--that there were counterfeit parts, or that there were parts that had been taken as a result of theft essentially by the Chinese company of

American parts?

Do you think that we would be well within our rights to say we should not allow cars to be imported into the United States, there are violations of their commitments in IPR, that, in fact, are knockoffs of ours, that have essentially prejudiced the American auto industry? Down the road we're going to be looking at a wave of Chinese-made cars and my thought is that there is going to be serious problems with a lot of the components in those cars. What recourse do you think we ought to be pursuing now in terms of trying to head off this or trying to indicate where we would stand on that kind of a trade?

MR. LEVIN: First of all, that underlines the importance of the surge provision. I don't want to reminisce too much about the past. We had a real battle over China PNTR, and there was an insistence that I was part of that there be provisions to make sure that we had some safeguards against a surge of products and a violation of the rules by China under which they came into the WTO, so there is this surge provision.

Number two, we have to get off dead center regarding their violations of IPR. There's a WTO mechanism, and it's somewhat like what we do about currency--talk, talk, talk. No action. And while there is argument about the availability of a WTO remedy on currency--it's never been tried; I think we should have no question about a WTO remedy as to violations of intellectual property.

A second effort that we ought to take is to be much more vigorous, and this illustrates how the automotive sector of the United States wants trade to be a two-way street, and they want the two-way street to be even. So the answer is we have rights under our WTO obligations and abilities. We just don't use them. We better. You mentioned the vehicles. What about parts? We've just begun to see the influx.

Let nobody think that the Chinese economy is not capable of producing high-tech products including auto parts, and we cannot tolerate a one-way street like we did with Japan. For 15, 20 years, we've been trying to sell a brake in Japan. And they have kept us out. I think what American producers are saying is give us a break.

COMMISSIONER D'AMATO: Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Congressman Levin.

MR. LEVIN: Thank you very, very much, and I'm privileged to be able to be here today and to be joined by two of my colleagues, and I think Senator Stabenow will be joining us.

HEARING COCHAIR BLUMENTHAL: We are honored to have you. If we could move to Congressman Dingell, and first we'd like to thank the Congressman very much and his staff for helping us put together this hearing in Dearborn. We very much appreciate it. Congressman

Dingell, please go ahead.

STATEMENT OF JOHN DINGELL A U.S. CONGRESSMAN FROM THE STATE OF MICHIGAN

MR. DINGELL: Mr. Chairman, and both cochairmen, Chairman Becker and Chairman Blumenthal, thank you for your kind words. Mr. Chairman and members of the Commission, I want to thank you for holding this hearing today and for coming here to Dearborn, which is in the heart of my district and right in the center of automobile manufacturing in the state of Michigan, to explore the issues that the industry faces with an emerging China.

I would observe that your presence here is welcome as the spring, and you need not express any thanks to me for any cooperation we have given, but the delegation very much appreciates your presence, and we'd like you to know how grateful we are to you. We hope from your presence here today, ladies and gentlemen, there will be some awareness generated inside the administration of the needs to address the problem.

The University of Michigan-Dearborn is a splendid institution and, of course, is always very helpful, and I think we all owe them a vote of thanks for their kindness to us today.

You will be hearing from my colleagues, from business people, from their employees, from representatives of organized labor, and from the academics. I believe all of us will have a similar message: China offers enormous opportunities to the United States, but their current policies offer enormous risks, and I see very little being done by our government to address the risk component.

I want to say that my good friend and colleague who has just spoken, Mr. Levin, has made a number of excellent points which I will not redo. I want to say that I'm pleased to be with my good friend and colleague Mr. McCotter, who has been a great help in these matters also.

Over the next few years, the economic potential of the Chinese market will be rivaled only by the American market. It is not unreasonable and, in fact, very likely that by the middle of this century, they will be the world's largest market. For our own economic prosperity and security, it is then vital that American products have the same access to the Chinese market that Chinese products have to ours.

The central problem we face in the trade relationship with China is that we are a free market and they are closed. They will tell you that they are a free market, but that is not true, and in point of fact, they are very much a government-controlled market. We view trade as a way to raise all boats. The Chinese view trade as a zero sum game where China will benefit to the detriment of openness, fairness, and agreed-upon rules for everybody else.

Take, for instance, the two biggest challenges in our trading relationship: wholesale manipulation of the Chinese yuan and the epidemic of counterfeiting that imperils American intellectual property and our long-term technical innovations. Both of these are immensely helpful or rather helpful to China and hurtful to our people.

I'm sure that no one in this room needs to be educated on Chinese currency practices and their effect on the U.S. economy. We all know that the Chinese yuan is undervalued by 15 to 40 percent. This essentially produces a tremendous subsidy for Chinese goods and artificially raises the price of American goods in China while lowering Chinese goods prices in the United States.

But the effects of the Chinese currency manipulation on the world economy are even more pernicious. Chinese behavior in this particular area provides cover for other competing nations to engage in the same underhanded practice. When China is able to manipulate their currency by 40 percent, Japan and Korea and soon others will be following suit.

So long as China is able to continue their manipulation, Japan and Korea feel that there are no ramifications. When two of three largest economies in the world manipulate their currency, the norms of a free enterprise system are altered and we begin to see terribly bad effects on world trade and on the United States and the other major trading nations.

This worldwide manipulation particularly hurts our auto industry, but it is not limited in its impact on the auto industry. In an age where Japan, Korea and Europe and their companies and American automobiles should compete on an equal and fair footing throughout the world, the currency manipulation of Japan and Korea provides a discount of $5,000 on sedans and up to $10,000 on trucks, and information on that matter has appeared in the annual statements of some of the Japanese corporations.

Mr. Chairman, this manipulation would not be occurring if China were held more accountable for its manipulation. One of the messages that we try to give you today, and we hope you will give in your comments, is that we do not here in Michigan or the auto industry seek a handout. We only seek a fair and decent and level playing field and equal and fair treatment. We think that our government should and we hope that our government will, but so far it has not addressed that problem the way they should.

Mr. Chairman, if China were more properly held accountable for its manipulation, this other manipulation by our other trading partners I believe would not be occurring.

The second factor in our relationship that must be addressed is the lack of any adequate standards for American intellectual property. In the

Energy and Commerce Committee where I sit as ranking member, we took testimony from the Federal- Mogul Corporation of Southfield, Michigan. They showed us Champion sparkplugs that are made in Chinese knockoff factories. These sparkplugs are identifiable by no particular device that would make it clear they are Chinese. They are identical to sparkplugs made in Michigan.

U.S. products penetrate the Japanese market, but there is increasing counterfeiting stripping the U.S. manufacturer of its advantage in technology, workmanship, and corporate memory. Despite repeated prodding by the United States government, this situation is getting worse.

Chinese officials who are able to track the Internet usage of their individual citizens claim an extraordinary inability to shut down factories that produce blatant forgeries of American goods.

This is of increasing concern as more U.S. companies open operations in China. Oftentimes these factories and the facilities can only be opened and operated with a minimum level of Chinese content or with a partnership with the Chinese or a Chinese company or individual. My colleague, Mr. Levin, mentioned this.

It is the view of many that this enables Chinese and engineers and corporations to reverse engineer American products and use American intellectual property for their own purposes and to beggar their neighbor trade policies which are so hurtful to the United States.

The United States-China relationship is developing. I believe that if China is able to engage the world through rules based on systems we and our allies have so meticulously constructed, an emerging China will be an unparalleled opportunity for the United States and for the rest of the world.

World trade will benefit and China will benefit, but if this is not the course of events, serious problems are in store for the United States and the rest of the trading world which complies with the rules. The actions of the Chinese government on currency manipulation, intellectual property protection, not to mention environmental conservation and labor rights, have not been to a standard that we practice or a standard that we're entitled to protect and to expect.

I believe change is possible, but it is going to take an enormously strong effort by the United States, great vigilance, and it will take the good works of this Commission, which I believe you will do and which I look forward to having you do with all vigor and to help us.

I want to make just a quick observation about this. I said this earlier, but it is something which merits consideration. We're not here asking you for preference or for handouts. That is not what we seek from you nor is it the recommendation that we ask you to come forward.

We ask you to come forward with a recommendation to the administration which says insist that the rules be observed by other countries, China, Japan, Korea and others, and that the trading system which offers this world such enormous opportunity and such wonderful chance for growth and benefit to every nation is enforced according to these fair rules.

We ask that we have our government work on behalf of our people, that it does the things that are necessary to see to it that fair rules are created and fair rules are fairly and strongly implemented. It is not a handout we seek, but simply fair treatment.

Ladies and gentlemen of the Commission, I thank you for being here and I look forward to the comments of my two dear friends and colleagues, Mr. McCotter and our good friend Senator Stabenow, who work very hard on these matters, too. Thank you, ladies and gentlemen of the Commission.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Congressman Dingell. I'd like to acknowledge Congressman McCotter.

MR. McCOTTER: When a bill passes the House, it's got to go to the Senate.

COMMISSION VICE CHAIR BARTHOLOMEW: Along those lines, I just want to acknowledge that we started speaking with Mr. McCotter back in February when he testified before us, and we talked about wanting to come up here to Michigan. Mr. Chairman, you should know that Mr. McCotter said we needed to be coming to Dearborn and we absolutely needed to be working with you and your office, so he's been very helpful through all of this and thank you all for coming.

HEARING COCHAIR BLUMENTHAL: Thanks for your guidance and thanks for your patience, and we'll move to Senator Stabenow now.

STATEMENT OF DEBBIE STABENOW
A U.S. SENATOR FROM THE STATE OF MICHIGAN

SENATOR STABENOW: Thank you, Mr. Chairman, and thank you to both of my colleagues and to Congressman McCotter, thank you for allowing me to speak and, of course, our chairman, Congressman Dingell, whose words are always very wise.

I want to particularly express support to each of you for the work that you've already done. As a member of the Banking Committee, I have used your work as it relates to currency manipulation and other economic issues and am here today to both thank you and urge your continued vigilance and frankly to ask for your help to continue to what we as a federal government need to do.

I think we're in a broad sense at a crossroads in a global economy. This isn't about protectionism. You couldn't stop the Internet or your cell phone if you wanted to; it would jump any law we put up. This is about how we're going to compete effectively in a global economy and whether or not this is going to be a race to the bottom for Americans in wages and loss of way of life or whether this is going to be a race to the top, and I believe that you start with the race to the top with so many of the issues that you are grappling with because it has to start with a level playing field on trade.

Our American businesses and workers have to know the rules will be the same, that the rules will be enforced, and then we together have to tackle the issues like the cost of health care and energy and then race to the top with education and innovation. I believe that's the American formula for success in a race to the top. But it really starts with where we are in this discussion today, about whether or not our businesses and workers know that we will have a level playing field and other countries will not be allowed to cheat quite frankly, and this is particularly timely and important here in Michigan where the trade deficit with China continues to post record levels and jobs are continuing to be lost.

We are harmed directly in Michigan. We are the poster child for what happens in a global economy when we do not enforce our trade laws. We are the epicenter of manufacturing which has created the middle class of this country. We have--proudly so--created the middle class of this country not just through our auto industry, which we are very proud of, but through the furniture business and a wide variety of other manufacturing entities that have been here in Michigan. But now, if we don't pay attention and if we don't get it, in a global economy of what it takes to succeed, we will find ourselves in a real fight for our way of life, and you know the numbers. I will just repeat by saying that in 2005, the U.S. hit an all time trade deficit with China that totaled $202 billion and that's a formula that directly relates to job loss for us in Michigan as well as across the country.

Last month, China's global trade surplus hit an all time monthly record of $14.5 billion more that they are able to sell to us than we are able to sell to them, and last week the World Bank declared China as the fourth-largest economy in the world. So we better get this right and that's why we need your recommendations and your leadership.

At the same time, China leads the world in piracy and counterfeiting and currency manipulation. They're not the second, they're not the third, they're not the fourth, they are the leader in unfair illegal trade practices, which is why this hearing is so important.

For us in Michigan when you look at the numbers, 2004, the auto parts counterfeit market was about $12 billion--$12 billion--in 2004, and that equates to about 200,000 jobs, good-paying jobs, middle class jobs, that people take care of their families on and have a good life on. So this is serious.

In 2005, China was ten times more likely than any other of our trading partners to have sent pirated products over our borders and most recently it's been estimated that in total China's counterfeiting and piracy actions have cost us, our American industries, about $250 billion a year. That's money that could be invested back here in America in jobs.

So we're here because our jobs are at risk. It's not just about a theoretical discussion about competition. This is about whether or not China is going to be able to continue to cheat or other countries, as my colleagues have talked about. They're stealing patents, they're producing counterfeit products, they're manipulating their markets, and these are all illegal today, period.

One of the most frustrating things for me as a member of the Banking Committee is to see the U.S. Treasury Secretary come in every six months. We ask for a report on currency manipulation, we know it's happening, and yet they come right up to the edge, and then they say, "well, technically, we can't say it's happening."

If they would just file a report, we would be able to act, and quite frankly, there is tremendous frustration in the United States Senate. We were able to get 67 members on a bipartisan basis to vote to proceed to a bill to force the administration to do what they ought to be doing, and so I feel very strongly, as do colleagues on the Banking Committee on both sides of the aisle, that enough is enough on this issue, and it's time to step up and use the appropriate authority that we have to fight for American businesses and American workers.

Since I've been in the Senate, I have been speaking out loudly about the loss of manufacturing jobs, fighting everyday for a level playing field and unfortunately what we have heard over and over again from the administration is assurances that China is making progress. I don't see it.

It's been five-and-a-half years that I have been in the Senate. I don't see it. Instead I see a growing trade deficit. We all know the numbers. I just spoke about the numbers. We're losing jobs. We're losing businesses. Every time I ask about our trade policy with China, the administration claims they are warning China and that this time, this year, it's going to be different. I don't think they take us seriously. I think they only take us seriously if we are tough enough to stand up and use the legal mechanisms that we have to be able to level the playing field.

So it's time to stop warning and to start acting, and your voices loudly and clearly in recommendations are critical to that.

The administration has continued to give China a way out by stating they don't have the enforcement structure in place, which also I do not agree with. If China was able to stop the sale and the production of counterfeit Olympic products, it's clear they have the ability to stop the sale and production of any counterfeit products. They just don't feel the need. They don't take us seriously.

The administration hasn't pushed hard enough and we are trying to get that sense of urgency going and pushing very, very hard. I will say that there are some things that are happening that are very positive. Based on your recommendations about creating a chief prosecutor, international prosecutor, I've introduced legislation in the Senate with my Republican colleague Lindsey Graham, and we have received bipartisan support to move forward for a U.S. Trade Prosecutor that would be on our side for our businesses and our workers to be able to enforce against trade violations.

We have the support of both Chairman Grassley and Ranking Member Baucus on the Finance Committee. They have put this concept, this position, into a larger trade bill that is currently before the Senate. In the House, my colleagues Representative Camp and Representative Levin have introduced a companion bill. So we are poised and again I would ask for and urge your continued support for this idea since it came from members of your Commission for us to get that done.

The impact of China's manipulative behavior and the continued pressure we've been putting on the USTR has also led finally to a first step, which is to dedicate a division to China trade enforcement. So we've got that set up. Now the question is: are we going to use it? Are these going to be words on paper, persons sitting in an office, or are we actually going to have the muscle that comes from a commitment that this needs to get done?

We all know that China manipulates their currency, and as I indicated before we're not doing anything about it. The Economic Policy Institute has measured that we've lost over 51,000 manufacturing jobs in Michigan alone, just from China, not Japan. And that doesn't count losses from 2005 or this year.

We also know that China is not the only place. China, Japan, South Korea, other countries are involved in other practices that are illegal, but I believe if we can step up on China, which is the major force right now on so many of these fronts, that we will send a message to other countries. It's important to acknowledge what our companies have to go through to do business in China. As you know, in order for a company to distribute a project in China, they are required to do three things: provide full specs, which are considerably more comprehensive than any American policy; they have to allow and pay for a team of Chinese engineers and managers to visit their American plant, again a stipulation not required for an American investment; and they have to send a complete working model of the product to a government research lab in China.

Imagine that? Basically, the companies are forced to divulge trade secrets in order to do business in Chinese markets, and then what do they do? They take that information, they make it in a Chinese company invested in by the Chinese government. We're smarter than this. We ought to be able to figure this out here that this isn't working for us.

I have to tell you one story, and this isn't about autos, but furniture, which is also impacted. We're the largest furniture producers in office furniture and other furniture in west Michigan, and a gentleman who has a wood machinery business, Peter Perez from Grand Rapids, came to me originally, and he actually got me interested in the idea of the trade prosecutor, which you had recommended, because he showed me a product that he had patented and developed that he sells for $70. It involves how you cut the end of a piece of wood. It's a piece on a saw, and he developed it, patented it, and showed me the package and the box, the directions, and so on.

After he put it out for $70, a Chinese business came in and stole everything including the box, the packaging and the directions, and was selling it for $10.

He said I went to court and there was the Chinese business and the Chinese government. He said I'm there by myself and he said to me you guys are the ones that are supposed to be enforcing. This is international trade violations here, not just my individual business. Now he ultimately was able to actually win the case, it was so egregious, incurring all the costs, but came back to me and said where is my federal government fighting for me, and that's what led me to look at your recommendations and to come up with the bill that relates to a trade prosecutor's office.

We've got to have a place for folks to go so that when that patent is stolen, when that product is stolen, there's somebody that will act on behalf of American businesses and not hold our companies hostage which is what's happening right now.

Let me just emphasize again that there is a tremendous amount at stake for us. Our U.S. auto industry alone employs 350,000 people a year, and that doesn't count all the supporting cast. It doesn't count auto suppliers and financial accountants and researchers and dealerships and everybody who relies on the auto industry. The total jobs at stake are about 4.5 million good-paying jobs, and I would stress again that this is about middle America. I believe it's about our way of life in this country because I believe these jobs have created our middle class way of life, and that the rules matter.

As a country and as a state, we should all be fighting for these jobs, and I'm hopeful that with your continued support and advocacy and wise thoughtful recommendations that you can help us light the fire we need to be able to get this right in a global economy.

Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Senator Stabenow. I think we should now move to the very patient Congressman McCotter for his statement.

STATEMENT OF THAD McCOTTER
A U.S. CONGRESSMAN FROM THE STATE OF MICHIGAN

MR. McCOTTER: Thanks. Chairman Henry Hyde has a wonderful saying whereby in a committee he says that everything that needs to be said has been said, but not everyone has said it. So I will try, although it will be difficult, to make a couple points, perhaps in the international sense, perhaps in a conceptual sense, that have not been made in the practical sense of day-to-day reality.

I would like to begin by saying perhaps it's because I'm 40 now, but I'm having my first wistful summer, and I'm remembering that I was born in the Arsenal of Democracy, Detroit 40 years ago. In those 40 years, we watched the Arsenal of Democracy eroded by unfair trade practices, most notably at the present time, but the unfair trade practices of Communist China.

I've watched a generation of my peers have to leave this state upon graduation from college to look for other jobs as the manufacturing sector and the auto industry tried to deal with their unfair competitors. And now with my older friends, I watch their children leave our state for futures uncertain because of the continuing decline of manufacturing both within our state, within the Midwest, and within our nation.

One of the clear reasons for this decline is, again, the unfair trade practices of Communist China, as has been mentioned, with the currency valuation, with their counterfeiting, with their dumping, with their pirating, and yet it continues unabated.

It was born of a bad, I believe, policy decision. The policy decision was that a constitutional republic whose fundamental principle is the consent of the governed could somehow engage in free trade with a communist country who believes the vanguard of the proletariat has an absolute right to direct the lives of its citizens toward some perceived goal of utopia which does not exist.

Can we continue on this path and expect a different result than the one we see now? Can we continue to expect fair trading practices from a country that will put people in jail for three years for handing out bibles that will suppress the Falun Gong, that can run a command and control economy, will not allow labor unions to build up any opportunity for the improvement in the quality of lives of their workers?

One of the fundamental acts of hubris on the part of the United States in dealing with Communist China has always been the thought that if we trade with them, in 20 years they will look more like us. My fear is that within 20 years, we will look more like them, and if we do not have a manufacturing base both for our economic prosperity and our international security, then the United States by the time I am 60 will no longer be a United States recognizable to me or to my parents or to my grandparents. These are the stakes which we find.

Now, in our day-to-day work as members of Congress, every now and then we don't have such bipartisan comity, and the practical day-to-day low intrigues of political life interfere. You as a Commission have an opportunity to address some of the larger conceptual questions that we, on a day-to-day basis either because of politics or because of the necessities of practical policymaking, do not have the luxury in which to indulge.

I would ask you to look at the concept of whether a free country can expect fair trade with a communist nation? I ask you to look at the reality of whether or not the United States, as some in the administration will tell anti-communists like myself, that our trade practices are designed to make China more capitalist and more free, do we not think that somehow the Communist Chinese think their trade practices make us less democratic and less free in the long run or are we simply smarter than they are?

To date the trade deficit would show that we are not necessarily so. I would also ask if we can look at the larger long-term consequences in terms of international situations where the United States through its trade deficit is providing the steroids to the Communist Chinese superstate, while at the very same time we emaciate ourselves? What are the long-term international ramifications?

The trade deficit is not simply a number. It is American money going offshore into the hands of someone who is either an adversary or an ally, but at the present time when they pump $10 billion into trying to get Iranian oil or whether they allow the North Korean state to continue to dabble in long-range missiles that can hit the United States, I would argue that in my mind they are more of an adversary than an ally.

But these are the longer-term conceptual questions that you as a Commission, I believe, would be well availed to deal with and would well serve your appointing power to provide recommendations and detailed possibilities for them to consider. I don't think that this was sufficiently done at the time. I don't think it's being sufficiently done now, and I think that Senator Stabenow, Congressman Dingell, Congressman Levin and myself would all agree that in the absence of the proper planning, that it is our constituents who have felt the brunt of a trade practice that was built more on a hope than upon a reality.

Thanks.

Panel I: Discussion, Questions and Answers

HEARING COCHAIR BLUMENTHAL: Thank you very much. I think all of you were gracious enough to stick around for a couple of questions and I'm wondering if any commissioners have questions?

HEARING COCHAIR BLUMENTHAL: Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you very much for being here, all three of you. As I look at this international system that we have now, our corporations are focused on shareholder value, and from what I can see the Chinese have figured out how to put incentives into place including the currency undervaluation to make our corporations find it profitable to move our industrial and technological base across the Pacific Ocean to China and then to ship the goods back here, and their getting into the WTO was enormously important because it locked our tariffs down, and we didn't have the ability without getting out of the WTO to deal with this kind of situation.

So it seems to me what we need to be doing is thinking, as you said, Senator, comprehensively about a national vision and strategy, so that we can have our corporations find their incentives to keep the higher value-added jobs here rather than having them migrate. What would be in that system is the enormously important thing I think the Congress and we have to be looking at. It may be tax policy. Clearly it's exchange rate policy. It's being very aggressive on IPR, using 421 whenever we can, but I think it's a more comprehensive vision and policy that we have to be putting in place.

Do you see it that way, Senator and Congressman McCotter and Chairman Dingell?

MR. DINGELL: The answer to your question is yes, and to what you have said, I would say amen.

SENATOR STABENOW: If I might just add another amen, and also say that a couple of years ago we tried a little bit to move in that direction when, if you remember, after the European Union took us to court saying that the way we taxed international investment by our companies, we were unfairly subsidizing through our tax system, and they took us to court. They won. We had to rewrite our tax laws under what was called the FSC, or Foreign Services Act, and so on.

In there, I was proud to champion what became a part of that law, which gives a lower tax rate--I call it the "More Jobs Tax Credit," a nine percent tax credit if you create jobs or economic activity in the U.S. rather than taking it overseas. That's a positive step in the right direction. It substantively will equate to about a $6 billion tax cut.

We didn't do the next step though, which was to take away the subsidies for investing overseas. So, on tax policy, we did a piece of it. We said if you create economic activity, if you create jobs here, you'll get a lower tax rate, but there are still a number of things that we are doing on the tax policy side we need to do.

I would also argue and I'm sure you have heard or will hear from our major manufacturers that in a broad sense we've got to tackle health care. We're the only country that funds health care the way we do. We spend twice as much of our GDP on health care as any other country, and have 46 million people and counting with no health insurance. There is something wrong with this picture, and there are a number of ways. In fact, that's a major emphasis for me, and there are a number of ways that we can and should be changing that as well as dealing with energy policy.

If we in Michigan are going to have five ethanol plants by the end of the year, and if we can be able to say buy your fuel from middle America rather than the Middle East, frankly we would dramatically change what the world situation looks like. But then on education and innovation, we know that the future is high tech manufacturing, it is innovation, and in the broad sense, you know, it's very troubling to me when we see the president propose the largest cut in education in the history of the country next year right at a time when we ought to be boldly and aggressively moving.

Not only is China cheating on trade practices, they produced some--I don't know the exact number--it was something like 700,000 engineers last year compared to 70,000 in America, something like that, so we've got to be boldly and aggressively moving on education for the future and innovation and technologies and so on as well.

So I think it's a broad picture that we have to look at. Otherwise, it's a race to the bottom. If the strategy is, you know, if you'd only work for less, we can be competitive, that's a loser because there will always be somebody in another country who can work for less, and that's been the strategy unfortunately in recent years. But I don't think we can, you know, while we do this, if we don't deal with a level playing field, then we can't get beyond that.

I would just say one more thing, and not on China but Korea. Right now the administration is negotiating a trade agreement to open South Korean borders, but let's look at what's happening. Last year, they sold I believe again the numbers are something like 700,000, 720,000 vehicles into America. We could only get 4,000 into Korea because of non-tariff trade barriers as well as the fact that their tariffs are higher than ours.

Now, if we don't deal with that and we open the border more to Korea, what are we doing? But, again, China is the big example here because of their size, their economic impact and what they are doing. If we can get it right with China, then we can go on and we need to address the other issues as well.

MR. McCOTTER: I would like to echo a lot of that in the sense that when we talk about citizenship amongst the corporations, it's always been my position that we, whether Republican, Democrat, libertarian, whatever, within a constitutional republic, our first ultimate attachment is our citizenship that we share, and that the first priority of any citizen is to perpetuate this revolutionary experiment in democracy; it is not to enhance the profits of any individual corporation or entity who is suckered here in the bosom of liberty and derives its protection and its benefits and its prosperity from our nation and our nation's government.

I would think that they should put that first. I would think it is easy to say that the United States has to do things internally to make us more competitive. That is true. Everyone would agree that education is a critical issue. Everyone would agree that health care is a critical issue. I think we would all feel in our heart the grief at watching human potential trapped in an urban underclass that we have yet been able to release in the United States.

But the critical distinction to me is that the United States, we can have these differences. We can have these arguments and we can have these consensuses reached through a free democratic process, just as over time we have had a social safety net evolve; we have had free public education evolve; we have had the benefits of life in the United States built up over a long period of time through our free institutions.

My concern is that if we tend to focus on the United States of America becoming more competitive without looking at the unfair competition that has come our way from unfree countries, from totalitarian countries, from communist countries, it's that you will never be able to compete with a country that does not have to care for the needs of its citizens.

It will not happen, and what will then happen is, if there's a continued emphasis solely on what the United States has to do, will be what Senator Stabenow said, is you will then have internal pressures within the economic system of the United States, because we were being dealt with unfairly, for these very same corporations to then deal unfairly with the workers.

I say this as a Republican who is committed to the rule of law and to the sanctity of contracts, and yet here in our districts, in our state, what we tend to see is that the pressure to compete when only internalized within the United States tends to have dire consequences for the worker and especially the retirees of these manufacturing entities that have gone out of business due to this unfair competition.

So I would say, yes, that we have to do things here in the United States to become more competitive and more entrepreneurial, but I would also argue that simply to look at the United States and say that Communist China is a reality, unfair trade practices by communist countries are a reality, and that we then have to race to the bottom here internally would be a horrible mistake.

COMMISSIONER MULLOY: Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you. Would you indulge us for another question?

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you very much to all of our witnesses both for appearing here today and for your leadership on behalf of the people of your great state of Michigan. They benefit enormously and we're benefiting from your wisdom.

There seems to be a sense among the policy elite that our industrial base in this country no longer matters and that the future of our economy is in our ability to innovate. Now many of us, of course, disagree with the concept that our industrial base doesn't matter and believe that it does for a number of reasons including our ability to defend ourselves down the road.

But I wonder if you could just speak briefly about the role of the U.S. auto industry both in terms of the American economy and the role of the auto industry, the role it has played in innovation, and our ability to innovate and compete as we move forward?

SENATOR STABENOW: To start, let me say we make things and grow things in Michigan, and we do it very well, and I don't think you can have an economy nationally that doesn't make things and grow things and add value to it.

The auto industry has been the top industry, the top job provider in the country, in the world. It has been, first of all, the focus, as I said before, of the middle class of this country and the innovations that have come from that have gone into our military. We're very proud that in the BRAC process that looked at closing facilities around the country a year ago, that we actually ended up adding jobs in Michigan.

We were very pleased to see them coming up from Alabama and Virginia to Michigan to Warren to a place called TARDEC and TACOM because if the military drives it, we make it, fix it, improve it. We do. We do all of the work here in Michigan that relates to the military.

When you look at space, when you look at other efforts that have been leveraged from manufacturing, coming from this state, it really has been a foundation. As you talk about our national defense, as you talk about the steel industry, as you talk about manufacturing, furniture, we could go on and on and on.

If we lose our ability to create things, make and expand, of course, it's different. This isn't your father's factory anymore. We can show you environmentally friendly, green plants that are high tech that are very close to here. We'd be happy to have you come and visit to see what we're talking about.

But the technology and the brain power that has come from there is critical to the future of this country. Frankly, I think the administration thinks as long as you can buy an automobile, it doesn't matter where it's made. It certainly matters. In this economy, here in Michigan, it's not just about the plant. It's the international headquarters. As I said before, it's the auto suppliers and the accountants and the advertising and all of ripple effect that takes 350,000 jobs and makes it 4.5 million because we are the international headquarters.

So that makes a difference. And what happens if we in fact don't have the capability to manufacture anymore? A few years ago we were threatened and we continue to be concerned about whether or not we're going to be able to make steel in this country? And what does that mean? You know there are only some six mines left in the country that you can pull iron ore up out of the ground and make steel, and we were very concerned about that from a defense standpoint, military standpoint, as well as economic standpoint.

These fundamental industries matter. They will change, they will evolve, and the innovation is coming right from here, and we know that. But we cannot give up on these industries, and frankly I think we can be competitive. I have no doubt. If there is a level playing field, we can compete with anybody and win.

MR. McCOTTER: Regarding the intellectual policy elites, I would just make two points. The first is I think they should be paid on performance. Secondly, I would remind them, the intellectual policy elite, that Patton's 8th Army didn't drive think tanks to liberate Europe.

Your question is an excellent one and it is right very much at the heart of the problems that lie before us and that you are looking into. First of all, the auto industry is not a low tech industry. When I was a boy, there were 190,000 people working over here at the Rouge plant; today there are about 13 or 14,000. They produce more cars. This doesn't mean that those jobs have been moved overseas. What it means is we have become enormously more efficient. We used to spray cars with a spray gun. Today, you dip them and the car is better.

The automobile that comes off the assembly lines over here at Rouge or any of the other plants in this country have a computer control system that is more advanced than that which was on the first lunar lander. These are no low tech, and if you look, the designing and the manufacturing of the automobile is high tech.

But if you look at how important this is to the economy, first of all, one job in seven in this country is dependent on the automobile industry. Each of those jobs is there. It may be glass in Pittsburgh. It might be steel in Youngstown or Detroit. It may be textiles in the Carolinas. It might be wood or wood products somewhere. It might be rubber in Akron. This is a critical part of the U.S. economy and it is high tech. They manufacture cars now that are designed largely on the computer, and the slide rule that

I used to use when I was going to college, you don't. You use a computer instead. And you get the computer to turn the car around on the computer, upside down, and move it all around, and make a judgment as to what that car or what that part is going to do and how it's going to look and how it's going to work. That's a critical part of U.S. manufacturing.

So Silicon Valley out there in California has a real interest in what we do here. Now, how important is this? Autos we use as an example, but autos are only a part of it. Imagine what this country would do if we had to fight a war again as we did when I was a boy and when I was in the Army in World War II. We won that war partly on the battlefields, but very much right here in our manufacturing operations in the United States.

Willow Run, when I was a boy, was a cornfield. All of a sudden, it was a bomber plant that produced 24,000 liberator bombers, the largest produced bomber in the history of aviation, tremendous aircraft and it won. It not only bombed Germany, but it won the battle of the Atlantic because of the enormous range it had, and just to the north and to the east of here, you can see the Chrysler Tank Arsenal. There they produced M-4 tanks which they produced something like about 60,000 of them, and those tanks won the war. It was a massive production.

We armed ourselves. We armed every other country in the world because we had the capacity to manufacture. If that is lost, the ability of this country to be a leading power of the world and to fight wars or to do whatever else that we have to do is gone. Imagine an army of this country fielded by an America that can't produce boots or can't produce tanks or can't produce tires or can't produce guns or can't produce any of the other things that are important, and we are, I repeat, high tech here. We use the most advanced technology and if you would like, I would be delighted to arrange tours of the plants so that you can go through and see the extraordinary competence and effort and skill and the advanced technology that is used in these plants.

This country in terms of the technology of its manufacturing or the quality of its manufactured products need take second-place or need to hang its head in the presence of no one. We are the best. And if our auto industry weren't as good as it is, it would have been driven under a long time ago by the unfair competition which is imposed upon it by our trading partners.

The Chinese are just following a succession of other wrongdoers, and they are using instrumentalities like the World Trade Organization: where it is good for them, they insist on us complying; where is it is good for them, they disregard compliance in their own operations. And as a result, you can see what is happening in the way the money flow is going: we have an enormous trade deficit with the Chinese which grows every year.

So, you, my dear friends, are going to be the force that's going to help us get the story to the administration of the facts and you are going to have to tell them that they have to focus on a proper cure. I said this several times, but I have to say it again, we seek no handouts. We seek a government which will see to it that we are fairly treated. Seeing to it that we are fairly treated in the world marketplace in manufacturing and by our competitors is not a whit less important than seeing to it that we have the weapons and the equipment to fight a major war.

So I thank you for what you're doing. I thank you for your question and I pray for your success and I beg you help us to get fair treatment for our people here.

HEARING COCHAIR BLUMENTHAL: Thank you very much to all of you for your excellent testimony and your excellent comments. We benefited from all of your comments. We'll take a five minute break and then reconvene to do our second panel.

Thank you very much.

[Whereupon, a short break was taken.]

OPENING STATEMENT OF COMMISSIONER GEORGE BECKER HEARING COCHAIR

HEARING COCHAIR WESSEL: In deference to the members of Congress, I withheld from giving Chairman Becker's statement, and I apologize. We're already running late, but Commissioenr Becker was to be cochair of today's hearing. He was unable to make it and asked me take over and fill in his shoes, something that I could only dream of doing, but I'll take a stab at it.

The Commission is pleased to be meeting today here in Dearborn, an excellent venue for a hearing on China's Impact on the U.S. Auto and Auto Parts Industries. Michigan is the heart of auto and auto parts production here in the U.S.

Today is the first field hearing the Commission has held this calendar year and it is intended to respond to our congressional mandate to assess how the U.S.-China trade and investment relationship is affecting vital regions and sectors of our economy.

The hearing follows an earlier hearing we held in Akron, Ohio, in October of 2004, which addressed, in part, the changing nature of China's auto and auto parts sector and its impact on U.S. interests.

At that time, we learned that U.S. producers had already set up production activities in China through joint ventures and that U.S. parts manufacturers were setting up shop not only to service those joint ventures but also to supply U.S. production facilities here at home.

Since our hearing less than two years ago, the U.S. auto and auto parts industries have gone through dramatic changes. We've seen Delphi, a giant in the sector, declare bankruptcy. We've seen Ford and General Motors having their debt downgraded as their market shares and prospects continue to decline. We've witnessed the offer of buyouts for tens of thousands of workers as the auto producers seek to shed employment and production and reduce their presence here in the U.S.

At the same time, we've seen the continuing rise and expansion of China's capacity and capabilities in this sector. Their success has mirrored the failures here at home. China is already exporting auto parts and is but a few years away from exporting built-up vehicles.

The questions we come here to Michigan to seek answers to are:

What does China's success mean both for China itself and for our own future here? Is there a connection between their rise and our fall? Is China's success coming at our expense?

These are questions not just for Michigan but for our entire nation. The auto parts and automotive sector is one of the real engines of economic growth here in the U.S. America created the modern automotive industry and helped to open a new age of transportation. The sector has provided innumerable jobs and has helped make the American dream real for countless Americans.

It has been an enormous contributor to economic growth and has helped spur innovation in our economy. It has been the largest user of semiconductors integrating high technology into our transportation system. It is a major user of steel, glass, rubber and countless other products. Its industrial capacity has created the demand for skills that have been put to use not only in this industry but have created advantages in many others.

Its industrial capacity has been used in time of need to outfit our nation to fight the wars to keep our people safe and to promote freedom and democracy around the globe.

What does the decline of this industry mean for us? What happens when the demand for these skills begins to evaporate? What happens when plants shut down? Will we have the surge capacity we may need if a large-scale conflict erupts?

Manufacturing is an indispensable part of the U.S. economy. Two-thirds of the money that the U.S. spends on research and development is spent by the manufacturing sector and 90 percent of new patents originate in manufacturing. Manufacturing is also important for the maintenance of the middle class with its jobs paying 20 percent more than the average American jobs accompanied by better benefits.

Before we turn to our witnesses, all of whom I sincerely thank for accepting our invitation, I want to make a special point of singling out the leadership of the major auto companies and their trade association for refusing to appear before us today. It's no secret that they've been expanding their operations in China and have looked at China as a place to source parts and in the long-term probably vehicles.

Too often they act as if China is the future and America is their past. I for one don't want to accept that notion. But from years of experience on this Commission, it's no secret that too many U.S. companies are reluctant to speak out on China's policies and practices, not to mention their own.

I'm told that the Big Three are concerned that criticizing China in any way might result in the advantages that have been showered upon them in order to persuade them to move their operations to China to begin to dry up. Indeed, we've been told that already the Chinese have indicated that subsidies and preferences given to joint ventures are going to be withdrawn and that Chinese indigenous companies will begin to expand. They've learned enough from us and are ready to go it on their own.

I look forward to today's hearing to shed some light on these questions. Our nation needs some answers. Thank you.

[The statement follows:]

Prepared Statement of Commissioner George Becker
Hearing Cochair

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But, from years of experience on this Commission, it's no secret that too many U.S. companies are reluctant to speak out on China's policies and practices, not to mention their own. I'm told that the Big Three are concerned that criticizing China in any way might result in the advantages that have been showered upon them, in order to persuade them to move their operations to China, to begin to dry up. Indeed, we've been told that already the Chinese have indicated that subsidies and preferences given to joint ventures are going to be withdrawn and that Chinese indigenous companies will begin to expand. They've learned enough from us and are ready to go it on their own.
I look forward to today's hearing to shed some light on these questions. Our nation needs some answers. Thank you.

PANEL II: LABOR PERSPECTIVES

HEARING COCHAIR BLUMENTHAL: Thank you. Thank you very much, Commissioner Wessel. We will now turn to our second panel on labor perspectives where we're very pleased to have Ron Gettelfinger, recently reelected President of the United Auto Workers Union, which has its Solidarity House headquarters here in the Motor City; Mr. Leo Gerard, International President of the United Steelworkers Union, headquartered in Pittsburgh; as well as Mr. Richard Trumka, the Secretary-Treasurer of the AFL-CIO in Washington, D.C.

So we are very pleased to have them here to give their perspectives and we are going to try to make up some time. We are going to hold you to the seven-minute presentation so we have enough time for Q&A. So without further ado, we'll start with Mr. Gettelfinger.

STATEMENT OF RON GETTELFINGER, PRESIDENT INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND ARICULTURAL IMPLEMENT WORKERS OF AMERICA DETROIT, MICHIGAN

MR. GETTELFINGER: Thank you very much, and to the men and women of the Commission, we appreciate the opportunity to be here this morning, we appreciate your taking the time to be here as well, and since I first appeared before the Commission in October almost two years ago, really things have gotten much worse instead of getting better so we do appreciate the opportunity to be here.

I'm not going to go into any of the prepared remarks. I would rather just talk, not so much off the cuff, but to try to address some of the things that have been said in the prepared remarks, and let me begin by saying that in 2005, China's vehicle sales was about 5.7 million sales. That makes them the third-largest auto market in the world and the fourth-largest manufacturer of vehicles.

Their production capacity was a total of eight million. By 2010, we expect to see that capacity between 18 and 20 million vehicles with a sale of about nine to ten million vehicles. So you can see the excess capacity is there and I would just ask you to note as you go along where these assembly plants are being located in China. They are being located clearly for exporting vehicles.

In 2003 to 2005, the trade deficit doubled to $4.5 billion and already this year through April, the deficit is up 26 percent which is led by 30 percent increase on the impact of auto parts. We've heard of companies like Chery and Geely who are going to be exporting vehicles to the United States within the next three years.

We heard a lot from the distinguished members of Congress who testified here this morning about joint ventures, and they do have joint ventures with the U.S. companies, Japanese companies, European and Korean companies, including Shanghai Automotive Industry Corporation, and they've made it clear that they're going to be exporting vehicles to the U.S. While at the same time in the past five years in the auto parts sector, we've watched the loss of about 200,000 jobs.

We talked about just briefly in the opening, Mr. Wessel, about Delphi being in bankruptcy, being in bankruptcy in the United States and continuing to invest around the world, and their worldwide operations are not impacted by that, and since 1994 Delphi has invested $500 million in China. Additionally, they've put 380 million in Poland, 300 million in

Singapore, and 100 million in India, and they have 60,000 workers in Mexico, but they're in bankruptcy in the United States.

TRW is another company that's running off to China, and there are many companies that we could list that are in that category. It is troubling, though, to see that China has been able to get around their WTO agreement where they have eliminated that 40 percent minimum local content requirement for vehicles. Their policy just simply kept it in place, the policy that they've implemented.

The Section 301 of the U.S. trade laws, China's currency manipulation specifically, which we also heard about, and their violation of internationally-recognized workers' rights, the petition was refiled. I believe it was on June 8, and again we find ourselves looking down at the very issues that we in organized labor have been talking about for so long.

Their currency manipulation, where it's now at three percent, and I think when we testified, we were talking somewhere in the neighborhood of 40 percent to make it equitable between the two countries. But at three percent, it's hardly done anything, and now China has surpassed Japan as the world's largest holder of foreign currency reserves and most of these reserves are held in U.S. dollars so China can simply retain full control over the dollar-yuan exchange rate.

Their systematic violation of workers' rights, there is no question about that. It provides serious unfair advantage to products that are made in China and again that was dramatically documented in the Section 301 petition that was filed in '04.

The administration at that time dismissed the petition saying that they would have discussions with China, but that never happened. Now the new petition that's been submitted confirms the workers' rights' violations.

80 percent of China's 1.3 billion people have no medical insurance at all. Their health and safety records in their workplaces are horrendous. And we have petitioned and long made the case for Yao Fuxin and Xiao Yunliang, two workers who haven't been paid for 18 months, didn't have their pension payments, nothing made into anything. They had a peaceful protest. One of them was seven years in prison and the other was four years. Xiao Yunliang was released 14 days I think before his four years was up on February 23 of this year on February 23 of this year. But that's the kind of abuse that workers are facing.

HEARING COCHAIR BLUMENTHAL: Mr. Gettelfinger, I just wanted to give you fair warning that you have about a minute left.

MR. GETTELFINGER: The trade deficit, 124 billion in '03. It was 201 billion in '05. We know that. Auto trade deficit doubled, as I indicated, to 4.5 billion, and both deficits are still climbing. So the administration must be willing to use the special safeguard measures included in the U.S.-China WTO Accession Agreement and strengthen the provisions of Section 201 of the U.S. trade law.

Thank you very much.

[The statement follows:]

Prepared Statement of Ron Gettelfinger, President International Union, United Automobile, Aerospace and Agricultural Workers of America, Detroit, Michigan

Mr. Chairman, members of the Commission, my name is Ron Gettelfinger. I am the president of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). I appreciate the opportunity to present the UAW's views on the impact of the development of China's automotive industry on the U.S. auto and automotive parts industries.

Since I appeared before the Commission nearly two years ago, new investment in China to produce automotive vehicles and parts has continued to grow at a rapid pace. The U.S. deficit in automotive trade with China has also grown rapidly and we expect that trend to continue unless fundamental changes in trade policies are adopted by the U.S. government. In our 2004 testimony, we presented several proposals for addressing auto trade problems with China. Unfortunately, the Bush Administration has not taken action on any of them. We are deeply concerned that the excess production capacity that is being built in China will result in a massive increase in U.S. imports that will add significantly to the already serious job losses in the U.S. automotive industry and further depress the wages and benefits of UAW members and other American workers in this critically important and productive industry.

The industrial policy for the automotive industry that was adopted by the Chinese government in 2004 has been effective in continuing the flow of investment and technology into China, while giving Chinese automotive companies greater resources to develop their own production capacity to meet demand in China and to generate exports. In the past two years, China has become a net exporter of assembled vehicles and exports of auto parts have skyrocketed, more than doubling from 2004 to 2005, while imports of auto parts fell. The Chinese government's plan to raise the domestic content of vehicles assembled in China and to turn China into a substantial exporter of automotive products is meeting its goals.

In 2005, China's vehicle sales rose to 5.7 million, making it the third largest automotive market in the world. Production of 6 million vehicles made China the fourth largest manufacturer of vehicles. But, equally important, China's production capacity in 2005 was 8 million vehicles. By 2010, the continuing parade of auto industry investments is expected to raise that capacity to 18-20 million, while sales in China are only expected to grow to 9-10 million. Excess capacity could grow over those 5 years from 25 percent to 100 percent. It is the tremendous excess capacity in China that causes grave concern about the potential for dramatically higher U.S. imports of Chinese-built vehicles and automotive parts.

The worsening trend in U.S.-China automotive trade that we identified in 2004 has continued. From 2003 to 2005, the U.S. automotive trade deficit with China doubled to $4.5 billion and it is continuing to climb this year. Through April, the deficit is up by 26 percent, led by a 30 percent increase in imports of automotive parts.

Two Chinese auto companies, Chery and Geely, have already announced their intention to export vehicles to the U.S. within the next three years. With the creation of so much excess capacity in China in the next few years, we expect the Chery and Geely exports to be just the tip of the iceberg. DaimlerChrysler has floated the idea of importing sub-compact vehicles from China and several of the Chinese auto companies that are in joint ventures with U.S., Japanese, European and Korean auto companies, including Shanghai

Automotive Industry Corporation, have made it clear that they intend to export vehicles to the U.S. and other developed-country markets.

Chinese vehicle imports, which could easily reach one million units quickly, would add to the growing U.S. automotive trade deficit with China and to the already record-setting overall U.S. automotive trade deficit. The growing share of imports in total U.S. vehicle sales is depressing employment in the U.S. auto industry and contributing to the falling market shares of the largest U.S. producers – General Motors, Ford and DaimlerChrysler.

Adding imported vehicles from China to the current mix of imports will affect U.S. auto parts production and employment, in addition to eliminating the jobs of thousands of assembly workers. Employment in the U.S. auto parts industry has already fallen by about 200,000 in the past five years and that number will grow dramatically when the many companies that have filed for bankruptcy implement their job-cutting plans. Further job losses in the auto parts industry will be devastating to many communities across the nation, as well as to affected workers.

For many of the top U.S. auto parts suppliers that have already invested in Chinese production, U.S. production and employment would be hurt by imports of vehicles from China, but their Chinese operations would benefit. These companies have followed assemblers to China, hoping to grow along with the expansion of production capacity there. With the market in China growing slower than capacity, exports to the U.S. will keep more of their own Chinese capacity viable. Delphi and TRW Automotive are among the companies that are exporting to the U.S. in order to utilize excess capacity in China. For the smaller auto parts companies that are suppliers to the Tier 1 companies, many of which have resisted moving production to China or other low-cost production sites, the loss of U.S. customers due to growing imports from China could be devastating. With much of the auto parts supply chain having moved abroad due to tremendous cost-cutting pressures from assemblers and the largest supplier firms, imports of vehicles from China could become the last straw that forces smaller suppliers to leave the business or move production abroad.

A further negative impact on U.S. suppliers will come from the benefits that Chinese-based suppliers will gain from vehicle exports to the U.S. Chinese companies that either have established joint ventures with U.S.-based suppliers or independently supply Chinese assemblers that export to the U.S. market would establish their presence in this market through those Chinese exports. As original equipment suppliers to U.S.-sold vehicles, they would be in a much stronger position to challenge all of the layers of U.S. and global suppliers for business in this country, for both original equipment and aftermarket parts. Their relationships in China with U.S. and other multinational auto companies, as partners or as customers, have given the Chinese parts companies the technology and experience to meet the quality and reliability standards that make them serious competitors for U.S. producers.

One of the ways China was able to reduce auto parts imports was by raising the effective tariff on some imported parts. In the middle of 2005, China started to apply the higher tariff for imported vehicles on imported parts when those parts account for more than 60 percent of the parts value of a vehicle assembled in China. While some countries have applied vehicle tariffs to parts that are included in complete knock-down (CKD) kits, China decided to apply the same standard to parts that were imported separately if the value of imported parts in a China-assembled vehicle reached 60 percent of the total parts value. China's WTO agreement eliminated the 40 percent minimum local content requirement for vehicles, but this tariff policy allows China, effectively, to keep it in place. The governments of the U.S., the European Union and Canada have filed a case with the WTO that claims China's policy is an unfair trade practice, but it could take more than a year to get an answer from the WTO. By then, even more global parts companies will have set up plants in China and/or transferred their technology to Chinese parts producers. Even if the WTO case forces China to stop this unfair practice, the Chinese government's policy goal of raising domestic content will have been advanced.

The remedies that we proposed in our 2004 testimony to address the growing U.S. deficit in automotive trade with China are equally appropriate today. However, the inaction of the Bush Administration in the past two years has allowed the deficit to grow, making a quick and effective solution more difficult to achieve. The Bush Administration has the responsibility to ensure that the U.S.-China economic relationship is improving living standards for Americans. But the Administration has simply abandoned this responsibility, leaving multinational corporations in charge of that relationship. The results speak for themselves – an unprecedented U.S. overall trade deficit with China of $201 billion in 2005 and a steadily rising automotive trade deficit.

Two of our proposals are related to issues that have been the subject of petitions for action by the Bush Administration under Section 301 of U.S. trade law, as unfair trade practices – China's manipulation of its currency and its violation of internationally-recognized worker rights. The Administration has rejected petitions on both issues, but a new worker rights petition was submitted last month that, once again, demonstrates the damage to U.S. production and employment that results from China's denial of the core labor standards.

The widely recognized undervaluation of China's currency remains a major advantage for parts companies seeking additional sales in the U.S. through imports from China and a powerful disadvantage for U.S. exports to China. Intense cost competition in the U.S. auto industry continues to drive purchasing decisions, for original equipment and aftermarket parts, and for all levels of the automotive supply chain. Since many U.S. companies have their own production facilities in China, they can control the quality of the components they import, as well as benefit from the low cost. While many major parts systems are assembled close to assembly plants, many of the components that are assembled into those systems are imported. The currency manipulation by the Chinese government makes the rapid growth of Chinese auto parts possible.

When China joined the WTO and agreed to reduce tariffs on imports of vehicles and automotive parts, many trade experts expected U.S. exports to grow substantially. While there has been an increase in U.S. exports as tariffs have fallen, the Chinese government's manipulation of the exchange rate, keeping it undervalued, has prevented many U.S. products from being price-competitive in China. The miniscule devaluation of China's currency that began a year ago and has raised the value of the yuan by only three percent has been far too small to make a dent in the direction of the automotive trade deficit. With China surpassing Japan as the world's largest holder of foreign currency reserves, and with most of those reserves held in U.S. dollars, the Chinese government retains full control over the dollar-yuan exchange rate. To defend Chinese producers against import competition and to stimulate additional exports, the Chinese government remains committed to an undervalued yuan and a soaring trade surplus. Automotive trade, in vehicles and parts, will be affected by this exchange rate policy and we do not expect that a change will take place until the U.S. government takes effective action.

The systematic violation of workers' rights in China also provides an unfair advantage to products made in China. The impact of these violations was dramatically documented in the Section 301 petition filed in 2004 by the AFL-CIO on behalf of the UAW and other U.S. unions. The Bush Administration rejected that petition on the grounds that it would address these violations in other discussions with China. Unfortunately, those discussions never took place. To ensure that the Administration cannot continue to ignore the repression of Chinese workers' rights, a new petition was submitted on June 8. It confirms that worker rights violations in China, and the suppression of Chinese workers' wages and incomes that result, remain widespread and continue to give Chinese products an unfair advantage in trade with the U.S. and cause massive job losses for American workers. Chinese workers are prevented from exercising the right to freedom of association, which would allow them to form independent unions, and other rights included in the Section 301 provision and covered by the International Labor Organizations' Fundamental Principles and Rights at Work. All too many Chinese workers are forced to put in excessive hours, paid less than the legally-required minimum wage, denied overtime pay and forced to wait months to receive their pay.

The social safety net that once helped Chinese workers sustain themselves and their families in the face of worker rights violations has been shredded in the past 25 years, leaving more than 80 percent of China's 1.3 billion people with no medical insurance. A tremendous increase in labor-related lawsuits and spontaneous demonstrations against abusive working conditions and violations of citizens' rights by various government entities has been one response to the attacks on millions of workers' incomes and living standards.

Combined with the dangerous health and safety conditions facing workers, including the deaths of thousands of workers in 2005 in mining accidents alone, it is clear that the situation of workers in China is bleak and that strong, democratic, independent unions are desperately needed to fight for the interests of workers. Support for this position has been voiced from unexpected sources – Washington Post op-ed writer Jim Hoagland recognized the need for independent unions in a column on March 13 this year, and MSN Money's Jim Jubak came to the same conclusion in his April 5 Jubak's Journal. The repression of workers' rights must be identified clearly as an unfair trade practice and the Section 301 petition must be used to force the Chinese government to improve the conditions of Chinese workers quickly.

In our 2004 testimony to the Commission, we cited the cases of Yao Fuxin and Xiao Yunliang as examples of the Chinese government repression that must be stopped. They received sentences of seven years and four years, respectively, for leading demonstrations that demanded the payment of wages and benefits that were owed to workers by a state-owned company. Earlier this year, Xiao Yunliang reached the end of his four-year sentence and he was released. Yao is still serving the remaining three years of his sentence, despite being in very poor health. The fact that these workers, and countless others, were given prison sentences for demanding legally-mandated payments and engaging in peaceful protests indicates the degree of Chinese government repression of basic worker and human rights.

In the past two years, the overall U.S. trade deficit with China has soared from $124 billion in 2003 to $201 billion in 2005, and the auto trade deficit doubled to $4.5 billion. Both deficits are still climbing this year. To turn around the damaging trends in U.S.-China automotive trade and investment and to make it possible for UAW members and other workers in the U.S. automotive industry to avoid serious harm from a rapidly rising U.S. automotive trade deficit in the very near future, the U.S. government will have to act quickly and decisively. We made these proposals in 2004 and, because of the Bush Administration's inaction, we must repeat them now.

China's manipulation of its currency must stop and the value of the yuan must rise in dollar terms. The Bush Administration's Treasury Department has had many opportunities since we appeared before this Commission in 2004 to identify China's government as a currency manipulator and, in bilateral meetings, to challenge it to move quickly to fix this problem. The fanfare that surrounded the two percent revaluation of the yuan last summer, and the paltry additional one percent revaluation since then, has had no impact on the ability of Chinese producers to keep the prices of their exports to the U.S. low and to undercut the prices of U.S. exports in China. U.S.-China automotive trade would look very different with a fair exchange rate and reciprocal access for competitive products in the two markets. The "China price" would be far less threatening to competing U.S. producers and workers with a fair exchange rate. That is what we seek and that is what the Bush Administration must accomplish.

The vicious repression of Chinese workers must end. The Bush Administration has a new opportunity to make a difference by accepting the recently submitted Section 301 petition and using it to open a new era of progress for millions of Chinese workers. Ending the Chinese government's suppression of worker rights and the repression of workers who try to exercise them would open the door to higher incomes for millions of Chinese workers and reduce the downward pressure on the incomes of American workers. More income for Chinese workers would increase demand in China for automotive products and reduce the excess capacity that is pushing Chinese producers to export and depressing prices in the U.S. and other countries. It would relieve some of the competitive pressure that is leading auto parts companies to declare bankruptcy and to seek to abandon pension and health care obligations to their unionized employees.

While China's accession agreement to the WTO has major flaws, the U.S. must be sure to take full advantage of the WTO commitments that China has made. Filing a case against China's unfair treatment of some auto parts imports, by applying the higher tariff for vehicles, is a small step in that direction, but it is not enough. China's actions only demonstrate that it will go to great lengths to preserve the auto policies it had in place before joining the WTO – forcing investment in local production in place of imports; compelling technology transfers to local producers; imposing higher local content requirements; and, providing export incentives. The Bush Administration must develop a full catalogue of the practices (including subsidies and discriminatory taxes) that China is using to achieve these objectives, assess their compatibility with China's WTO commitments, and take actions as needed to defend U.S. production and employment.

With the rapid growth of excess production capacity in China's automotive vehicle and parts industries, we are likely to see a surge of Chinese exports to the U.S. that would cause serious, and potentially permanent, injury to U.S. workers and producers in the near future. When an import surge occurs, the Bush Administration must be prepared to act forcefully and quickly. To prevent the industry and its workers from suffering any sustained injury, the Administration must be willing to use the special safeguard measures included in the U.S.-China WTO accession agreement and to strengthen the provisions of Section 201 of U.S. trade law. The special safeguard was included in China's accession agreement because the U.S. understood the potential for China to ramp up production for export that could rapidly overwhelm competing U.S. industries. Without justification, the Bush Administration has been reluctant to file WTO cases against China. It must not hesitate to use the special safeguard measure to stop any import surge in the automotive industry.

The Administration's half-hearted enforcement of the Section 201 case on steel products showed that greater certainty of action and less discretion in implementation must be incorporated into the law, and we urge Congress to make those necessary improvements. When facing a surge of automotive imports from China, we believe the Bush Administration must take effective actions under Section 201 to blunt its impact and put this critically important industry on a path that will make it even stronger in the future. If the Administration fails to take such actions, we are ready to mobilize intense pressure from workers, the public, Congress and the industry to ensure that the Administration takes the most effective actions permitted by the law.

Action by Congress to pass and implement the UAW-endorsed "Marshall Plan" for the auto industry would stimulate U.S. investment and production of advanced technology vehicles and their components, giving U.S. workers and producers an edge over Chinese and other foreign suppliers. A study by the University of Michigan found that this plan would create tens of thousands of new American jobs. By shifting the competitive ground in the industry to effective use of new technologies rather than minimizing costs, the adoption of this strategy would take advantage of the skills and experience of UAW members and other American workers in the automotive industry. Accelerating the development of the infrastructure for producing advanced technology vehicles would also improve fuel economy and the environment and strengthen the nation's economic and national security by reducing our dependence on imported oil.

Taken together, all of the actions we propose would alter the forces at work that are creating the foundation for a tremendous increase in the U.S. deficit in automotive trade with China and contributing to downward pressure on the wages, benefits and working conditions of workers in these industries. They would raise incomes and increase demand for automotive products in China, promote investment, production and employment in the U.S. automotive industry and eliminate several of the incentives that unfairly stimulate investment and production in China. Because of the size of the increase in Chinese production capacity that is expected by 2010, any delay in the adoption of these measures would seriously weaken their impact.

Mr. Chairman, members of the Commission, thank you for holding this hearing on the China's impact on the U.S. auto and auto parts industries and their workers. By continuing to focus on developments in these industries, you demonstrate to the public and policy-makers how important they are to the health of the U.S. economy and how the challenges they face threaten to depress U.S. living standards. We applaud the Commission's ongoing efforts to highlight what is at stake in our economic and security relationship with China and we urge you to support our proposals for government action. The UAW looks forward to working with the Commission and answering any questions you may have.

HEARING COCHAIR BLUMENTHAL: Thank you very much for your very educational and concise remarks and we'll move on now to Mr. Gerard of the United Steel Workers Union.

STATEMENT OF LEO GERARD, INTERNATIONAL PRESIDENT, UNITED STEELWORKERS, PITTSBURGH, PENNSYLVANIA

MR. GERARD: Let me just say that I'm also pleased to be here and I thank you for the work you're doing, in particular my friend George Becker and his statement.

I'm going to give you a statistic that may shock you. United Steelworkers of America has 850,000 members of which 175,000 of those members produce products that may end up in a North American automobile. We represent workers that make the steel, that make the aluminum, that make the glass, that make the tire, that make the rubber, that make the plastic, and also unfortunately that make some of the energy.

But if you think about that and what's happening to the auto industry and the number that Senator Stabenow used, the over four million, I don't think that takes into account the people that make the products that make it into the cars, and so that what happens to the American auto industry has tremendous repercussions throughout industrial America and throughout all of the manufacturing sector.

I would be less than responsible if I didn't say that it's not just China. Here you're talking about China, but it's in fact a series of rotten public policy decisions and certainly both parties are responsible for creating this mess, but the last five years in particular the Republican administration and the Republican-led Congress have been even more neglectful than they should be.

We've just in the last three weeks had three tire plants announce closure or relocation. Those tire plants and what they're announcing to close comes to about eight million tires per year that are being shut or relocated.

Simultaneously, we heard Korea announce they're going to build a 10.2 million tires per year plant in China that will probably be directed at exports. I think it's a tremendous statement when the leaders and the leading manufacturers in the country refuse to appear before this Commission. I think it's a terrible indictment of what they believe is their responsibility. They'd rather ignore American workers and American manufacturing while they bend down to kiss the feet of their Chinese lords.

I want to say the same thing for the administration. I heard the political panel talk about trying to find political remedies. The steelworkers have been co-petitioner in four cases under Article 421 against China at the ITC. We succeeded in all four cases except it gets recommended then to the administration, to the executive branch, and in all four cases the president voted with China rather than with American manufacturing.

Now, I'm not shocked by that because last year we ran a $200 billion plus trade deficit coming on the heels of $170 billion trade deficit, and if you go back since PNTR, growing trade deficits with China.

The reason I'm not surprised by that is I guess if I had a first mortgage, a second mortgage and a third mortgage on my house, I'd be worried about pissing off my banker, to be very blunt, and that's what's going on, that China is holding so much of our currency, as are other countries, that we've become subservient, and we don't want to stand up for American workers for fear that they act on that.

So I'm tremendously frustrated by what's happening to the American auto industry and its impact on our friends and brothers in the Auto Workers Union and in other unions, but in particular my responsibility is for the steelworkers that are getting devastated by what's happening in the auto industry.

To put it in perspective, again referencing what Senator Stabenow and others said about the currency manipulation and the labor rights abuses and the determination to make sure that a left wing totalitarian Stalinist regime that is in a marriage with cowboy capitalism ignores the traditional roles of the market, I'll give you a steel example, and I can point out probably if I had more time eight or nine different examples in different industries this is going on.

The steel industry and union just recently released a study of what's been going on in China. In the year 2000, China was producing 126 million metric tons of steel. By the end of 2006, they will be on the verge of producing 400 million tons of steel. You can't generate enough profit from your industry to put that much back into the industry that quickly to build those mills that quickly unless it's been totally subsidized, environmental regulation has been totally ignored, and that the country makes it as a matter of purpose to accomplish that.

Their imports into the U.S. are up 37 percent. They're doing that in glass. They're now doing it in tire and rubber and they're going to soon be doing it in auto, and in America, we're standing here deaf, blind and dumb while they do this to us.

This is not just bad policy with China. It's bad policy overall. We fall into the trap of referencing this as free trade. This has nothing to do with trade. When you take $10 billion of auto parts and you shut it down in North America and you move it to China, that's not trade; that's investment policy.

Citibank, Goldman Sachs, they love this stuff, but industrial America, industrial workers are getting killed. What we've got in China is subsidy versus bad policy in America. What we've got in China is oppression versus neglect in America. What we've got in China is exploitation versus erosion in America. And what we've got in China is a centralized economy that has decided to take us out of the manufacturing game.

We ought not to have any illusions about that and while we go through the motions of having hearings and we go through the motions, the Congress is fiddling while Rome burns.

HEARING COCHAIR BLUMENTHAL: Mr. Gerard, I am going to have to ask you to sum up.

MR. GERARD: I just want to close by making one last comment. I think that this Commission that was empowered by the House and Senate on China needs to be direct and powerful because if we don't do something, in five years, in ten years, there will be no middle class manufacturing job for our kids and grandkids and I don't want that to be this generation's legacy.

[The statement follows:]

Prepared Statement of Leo Gerard, International President United Steelworkers, Pittsburgh, Pennsylvania

Mr. Chairman, members of the Commission, my name is Leo W. Gerard. I am the International President of the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (USW). I appreciate the opportunity to present the United Steelworkers' views on how trade with China has impacted the U.S. motor vehicle and parts industries, and how that in turn has impacted and will likely impact the members of my union.

I am delighted to appear today with my colleagues Ron Gettelfinger and Richard Trumka before this Commission. I would like to take this opportunity to thank the Commission for holding this hearing today, as well as for its excellent reports and research on a wide-ranging set of economic issues related to U.S.-China relations.

Mr. Gettelfinger has outlined for you in some detail the exploding U.S. trade deficit with China in autos and auto parts, the potential for that trade imbalance to expand drastically in coming years, and the devastating consequences such expansion could have on American jobs and living standards. Certainly his members have been and will continue to be directly impacted by China's unfair trade practices in the automotive sector.

Our union represents workers who produce electronic and mechanical motor vehicle parts, rubber and tire, plastics, aluminum, leather, and glass, as well as steel. The longterm health of the U.S. steel industry, as well as these other components and raw materials sectors, depends crucially on the continued vitality of the U.S. motor vehicles and parts industries, and in particular, on their ability to survive in the United States of America. If we are to avoid further devastation in these industries, our nation's trade and industrial policies need to recognize this inter-connectedness.

While a significant amount of steel production is used in infrastructure, almost 80% is consumed in products that can be made anywhere. If steel's key customers move offshore, it will be much more challenging to sell them domestically produced steel. Our union's experience makes it clear that as America's largest consumers of steel - the manufacturers of autos, auto parts, white goods, and other steel-intensive products increasingly move their manufacturing facilities elsewhere, the logic for a large domestic steel industry will exit the U.S. with those consumers. There is little that is manufactured that does not somewhere along the line, directly or indirectly, require steel. But this means that the less we make here, the less we need a steel industry here to feed it.[1]

To prevent this dire outcome, steel producers, auto producers, and components producers, as well as their unions, must unite in demanding a coherent and integrated trade and industrial policy that doesn't seek to protect one sector at the expense of another, but rather lays out a framework of trade, tax, infrastructure, and R&D policies that will sustain a vibrant domestic manufacturing sector.

Changing our misguided trade policies with China is an essential starting point. It is crucial that we begin this conversation today, as the Chinese government lays out longrange strategic plans to dramatically increase its presence in international motor vehicle markets - rather than waiting another day - let alone five or ten years - which will be far too late.

As Ron Gettelfinger told us earlier, China has become a net exporter of assembled vehicles in the past two years. Its exports of auto parts have also skyrocketed, while imports of auto parts fell over the same period. In 2005, China became the third largest automotive market in the world and the fourth largest manufacturer of vehicles. But China's production capacity is expected to grow rapidly to 18-20 million vehicles (from 8 million in 2005), while sales in China are only expected to grow to 9-10 million. Excess capacity could thus reach 100 percent in the next five years, with the domestic U.S. auto market a key target for Chinese-built vehicles and automotive parts - exactly the sort of excess capacity that led to dumping and the steel crisis at the turn of the century.

We have more than 175,000 members whose products make it into the domestic auto industry. If China would displace 10%, that would effect more than 17,500 of our members or more than 1,750 members for every percent of erosion of domestic capacity. It is clear that these dramatic shifts in global auto production and capacity are quite relevant for the security of the jobs, wages, and benefits of our members.

This trend is more pronounced for certain sectors. Economists Dan Luria, Matt Vidal, and Howard Wial found in a recent study of component manufacturing that "the assembly plants of ... the U.S.-based automakers remain a huge market for onshore component producers. A U.S.-assembled car gets more than 60 percent of its value from component suppliers ... and nearly 75 percent of that 60 percent comes from U.S. component suppliers." 2 They found this to be particularly true for mechanical parts (as opposed to electrical/electronic components), "which tend to remain clustered in the same areas as the customers that buy them, though global sourcing is making this less and less true." 3

The Chinese government's targeting of the auto industry as a "pillar industry" eligible for special government support violates China's WTO and other international obligations in numerous ways, and our government must act swiftly and unequivocally to counter these unfair practice.
1 Ron Bloom, "Remarks to Steel Success Strategies XXI," New York, 6/21/06.
2 Dan Luria, Matt Vidal, and Howard Wial, "'Full-Utilization Learning Lean' in Component Manufacturing: A New Industrial Model for Mature Regions, and Labor's Stake in Its Success, p. 5." 3 Ibid, p. 5.

While the U.S. government has identified numerous areas where the Chinese government's actions violate WTO obligations, USTR has initiated relatively few cases ignoring some key areas such as currency manipulation, violations of workers' rights, and illegal subsidies. The Treasury Department has repeatedly failed to label China a currency manipulator, despite overwhelming evidence that the Chinese government is intervening repeatedly and one-sidedly in currency markets to prevent the yuan from appreciating. The President has rejected all of the 421 import surge cases that have been brought, even in the face of the International Trade Commission's finding of injury.

I join my colleagues Ron Gettelfinger and Richard Trumka in calling on the Administration to act decisively and swiftly on both Chinese currency manipulation and worker rights violations. Each of these contributes significantly to the competitive difficulties facing the motor vehicle and parts industries, as well as their suppliers.

On currency manipulation, we call on Congress to enact H.R. 1498, the Ryan-Hunter bill, which would allow the government to address currency manipulation as an illegal subsidy. On worker rights, we join many of our friends in Congress, on both sides of the aisle, who have called on the Administration to accept the AFL-CIO's Section 301 petition and send a message to the Chinese government that it is neither legitimate nor humane to compete in the global economy through the systematic and violent repression of workers' fundamental human rights.

The Steelworkers support the UAW-endorsed "Marshall Plan" for the auto industry. This plan would stimulate U.S. investment and production of advanced technology vehicles and their components, giving U.S. workers and producers an edge over Chinese and other foreign suppliers. By supporting the development of advanced infrastructure, this plan would also improve fuel economy and the environment, thereby strengthening the nation's economic and national security by reducing our dependence on imported oil.

It would have the added benefit of putting to rest, once and for all, the Hobson's choice that narrow interests have falsely foisted on the American public of jobs vs. renewable energy and environmental integrity.

The policies we have recommended here today must be put in place without delay, as the trajectory of Chinese production and exports in the motor vehicle sector makes their implementation absolutely urgent. Mr. Chairman, members of the Commission, I would like to express my appreciation and that of my members for your leadership in holding this hearing today and for all the excellent work you have done. I look forward to any questions you may have.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Mr. Gerard. Mr. Trumka.

STATEMENT OF RICHARD TRUMKA, SECRETARY-TREASURER AFL-CIO, WASHINGTON, D.C.

MR. TRUMKA: Thank you, Mr. Chairman, and I also want to acknowledge and thank the Commission for the groundbreaking work that you've been engaged in. As the Commission is aware from previous appearances before this body, the AFL-CIO has continuously challenged the unfair trade practices by the Chinese government, especially currency manipulation and workers' rights legislation, H.R. 1498.

Last month, the AFL-CIO together with Representatives Ben Cardin and Chris Smith filed a 301 petition charging that the Chinese government's systematic and egregious violations of workers' rights are, in fact, an unfair trade practice under U.S. trade law and give Chinese manufacturers up to a 77 percent advantage over everyone else. A copy of that petition will be submitted to the USCC for the record.

The explosive growth of Chinese manufacturing and its projected trajectory posed troubling questions for our nation's industrial base and our nation's national security.

The automotive industry is the single-most important industry to American manufacturing. It accounts for four percent of our GDP and fully 25 percent of all manufacturing. It's the cornerstone of an advanced manufacturing economy. From the glass, rubber, steel, and electronics to engines, transmissions, design, engineering, R&D and more, that result in the complex integration and assembly of leading-edge technologies, the automotive industry encompasses the critical elements of this nation's industrial infrastructure.

To have a vibrant advanced manufacturing economy, a nation must have a strong innovative, diverse and broad industrial base as a foundation. Our entire economy benefits from manufacturing because it is the leading productivity leader, the primary source of innovation, the leading purchaser of new technology, financial and technical services, and the leader in new work organization and work process, and it accounts for two-thirds of all R&D investment.

Manufacturing jobs, it is estimated, are associated with up to four additional jobs. Today these dividends and benefits to our nation are threatened. For manufacturing the past five years have been a brutal widespread and deep structural decline. Since 2000, more than 40,000 manufacturing establishments have closed, and we've lost three million manufacturing jobs. That's 17 percent of the manufacturing workforce.

Within manufacturing, nearly every sub-sector suffered double digit employment declines. Studies by the EPI and our own Industrial Union Council and others confirm that over half the job loss is trade related.

At the same time, the job growth has been the weakest on record and real wages actually declined. Our entire net job growth was in non-tradable service-provided activities. We now borrow an unsustainable $2 billion a day to pay for goods we consume, and we do not produce as a nation. And we face a debt of nearly $1 trillion with China alone, and that is a threat to the stability of the world economy.

The free market economists' response to all this is to tell us there's no cause to alarm, that all we're witnessing is the natural maturing of our economy. The process they claim is inevitable and in the long term benign. Those knowledge jobs that economists claim would take place of lost manufacturing jobs in the globalized new economy simply never appeared.

Since 2001, the information sector, telecommunications, commuter systems design and related occupations have all suffered massive job losses. Overall some 725,000 professional business and information service jobs disappeared.

At our university engineering enrollments are shrinking. Offshore outsourcing has left the U.S. with rising unemployment rates among the highly educated. For a majority of American workers, current global policies have brought deindustrialization, an attack on unions, declining real wages, vanishing pensions and vanishing health care. For manufacturing, it's become a cancer that is destroying our technical capacity to innovate and to produce.

Offshore investment in industrial capacity--domestic manufacturing investment fell nearly 17 percent in real terms between 1998 and 2004, and investment in manufacturing structures declined 44 percent over the same period. At the same time, many firms made record offshore investments in R&D, engineering, design and production jobs. The foreign direct investment flow into China reached $62 billion in 2004 and continues to soar.

70 percent of China's FDI is in manufacturing and heavy concentrations in export oriented companies and advanced technologies. Future FDI projections are more than double the actual level today. The trend in auto is just as apparent.

In the past two years, Delphi, Ford, GM have all announced major R&D to production investments in China.

HEARING COCHAIR BLUMENTHAL: One minute left, Mr.

Trumka.

MR. TRUMKA: A recently leaked memo from GM to its suppliers told them they must start doing a percentage of their business in China.

Mr. Chairman, members of the Commission, if we lose our industrial capacity, we lose far more than just those plants. We lose innovation; we lose R&D; we lose technical know-how; we lose our edge. We become less than the world's leaders and we become dependent on other nations, particularly China where major U.S. companies are relocating to take advantage of the climate that they've helped create, a climate where laws aren't enforced, where currency is manipulated, and they get a major advantage over American producers.

Our technology wittingly and unwittingly is leaked and sent to those countries so that we continue to lose ground nationwide. That, Mr. Chairman and members of the Commission, simply can't exist if our nation's security and our nation's economy are to proceed and be the world leaders.

Thank you.

[The statement follows:][1] and [2]

Panel II: Discussion, Questions and Answers

HEARING COCHAIR BLUMENTHAL: Thank you very much to all of you for your very insightful testimony. I'm going to lead off with a question for all of you sparked in part by comments by Mr. Gerard in terms of who is actually benefiting, and also, Mr. Trumka, in terms of work coming back to the United States, particularly in the auto industry.

I'd like all of you to comment, if you can, on the benefits to American workers from the opening of plants by Japanese and Korean manufacturers in some of the states outside of Michigan, the benefits particularly to American workers. I would imagine that some feel that this is a positive thing, and I'd like to get your comments on that, each of one of you, please.

MR. GETTELFINGER: First of all, if you go back in time when Doug Frazier was the president of our union, Doug made a trip to Japan and he said if you're going to sell vehicles here, you should build vehicles here. And we're pleased to see that we do have manufacturers of foreign-name plate vehicles in this country.

And we're also pleased that because of our contracts, those workers are making a decent wage. The question becomes though how much actual investment have they made in comparison to the traditional Big Three automotive industry? And that's where the investment is and it continues

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1 **Click here to read the prepared statement of Mr. Richard Trumka**

2 **Click here to read the supplemental appendix of Mr. Richard Trumka**

to be. I think it's over 90 percent of the auto workers in this country are employed by the Big Three.

You have 80 percent of the parts, if you count the parts that are manufactured in Canada, are included in the content of the vehicles that are manufactured by the Big Three. So they purchase 80 percent of the parts. They assemble about 75 percent of the vehicles that are sold in this country here, and in addition to that, they operate, and I'm not sure now that we've had some closings, but it was 20 states. I think we're probably down now to 18 states.

So there is a benefit to having the foreign name plate operations here, but again we're closed out of those markets. In Korea, I think we have two percent of the sales of vehicles in Korea. In Japan, it's about five percent, and in Europe it's around 20 percent. So we're catching it on both ends.

MR. GERARD: I would add to what President Gettelfinger said by saying that I think the foreign name plates have added to the erosion of economic stability in the auto sector, and one of the ways that they've done that is that they have managed to escape having any pension obligations and they put tremendous pressure on that system because in the countries in which they come from, they have a different form of health care that's not employer based.

Their health care costs per vehicle is substantially, substantially lower than the health care cost per vehicle in America, and in fact I was once at a meeting where there was a vice president of Toyota and we're standing around talking, and he said I can do the same thing as GM. I can build a new plant. I can put the same equipment in as GM. I can man it the same way. I can pay the same wages. I can do the same thing.

But because I have no legacy costs and I have no pension obligations, I can sell the car for 1,500 bucks cheaper and still make a profit.

HEARING COCHAIR BLUMENTHAL: Isn't that the kind of competition that we like here in the United States?

MR. GERARD: No, I think that's the kind of competition that's unfair. How do you get to that competition if your obligation to get there is to do away with your workers' health care and pension benefits. I think the competition we ought to like is the kind that says you're not going to have an advantage by removing social infrastructure from the country, and if you want to be in this country, we're all going to be in the health care position, we're all going to be in the same pension position.

You're not going to get an advantage by exploiting your workers and not providing health care, not having decent pensions. So I don't think that's the way America was designed to compete. You and I aren't on the same wavelength about that.

HEARING COCHAIR BLUMENTHAL: Mr. Trumka.

MR. TRUMKA: I will be very brief because I think most everything that needs to be said has been said. I think it is much preferable to have a foreign producer locate their manufacturing production facilities here than it is for us to locate our facilities elsewhere. The reason I say that is most foreign investment in this country-- we're told that it washes out with our investment that goes overseas--but most foreign investment in this country is a change of ownership rather than in the investment of production capabilities and facilities and capacity. So them producing here would be good. It's a good thing.

However, it could be a lot better because unlike us, they don't bring their R&D. They don't bring their innovative processes over here. They keep them primarily at home. They keep their engineers at home and send the products over here. As a result, they buy processes, they buy parts from a closed market rather than everybody, and we don't get the real benefit that we should. If the trade laws were fair and they were enforced fairly, there would be a much greater benefit for them locating here than we're currently receiving.

HEARING COCHAIR BLUMENTHAL: Thank you. We have Commissioner Wessel with a question.

HEARING COCHAIR WESSEL: Thank you and thank you to all our witnesses and to my cochair. While his last statement was posed as a question and not a view, let me respond to the question myself as well, which is we're not well served by having our companies cherry-pick where they produce and who they employ, and pitting one worker against another either by doing it here versus China or doing it here versus a right-to-work state or some other place where they can find cheaper workers, younger workers with lower pension costs, and find that not only are we engaged in a race to the bottom with our competitors overseas, but we create a structure here at home that also makes us engaged in a race to the bottom.

Mr. Gettelfinger, I'd like to understand a little bit more about the competitive challenge we face. I know you were deeply involved in the rise of Japan's auto industry in the 1980s, and it seems to me that at that time Japan which did invest here had to pay billions of dollars to create its own infrastructure in the U.S., its own distributor network, et cetera.

Are we facing a dramatically different problem here today in that because the Chinese auto production is happening with joint ventures, that we're going to see those coming in under U.S. name plates meaning that a GM joint venture car in China is going to be able to come into our distribution network?

MR. GETTELFINGER: Daimler-Chrysler has floated the idea of bringing in small vehicle manufactured in China and I'm sure other manufacturers are taking a look at that, so I think that that is a real possibility. Again, if you just note where these plants are being located in China and you can see there's no question about the excess capacity that's going to exist, those vehicles are going to come here. They're going to come here whether it's through Malcolm Bricklin and his company, they are going to come here. There is no question about it.

Now, the other piece of this is while there's unrest in Thailand, there's an effort by the administration to negotiate a free trade agreement with Thailand which would have a major impact on the pick-up truck market in this country, and Thailand would then become a launching pad for other countries, but again if you note, 75 percent of the vehicles that are sold in this country are manufactured by the Big Three here.

So that means we have a number of vehicles that are being imported in addition to what is being manufactured here by the foreign name plates. We cannot, and, look, I don't mind taking on anybody. Go out and talk about the auto plants as far as technology goes, about the quality, about productivity. I'd like to take you, just like Congressman Dingell made an offer to you, I'd be glad to take this Commission to anyone of these facilities.

But we do have some challenges. Leo mentioned the legacy costs and we're proud that a union and a company believes in taking care of their workforce. We're pleased with that. Now we are at a bit of a disadvantage if I'm a foreign name plate operation and I'm going to come into states and start bidding one state against the other on where I'm going to locate and which state will give me the most breaks and how long do these tax incentives or whatever it is that they offer them last.

That puts us at a bit of a disadvantage, but we're out there struggling with them, with that kind of competition. The big issue becomes at some point in time, at some point in time, we have to realize the U.S. really doesn't have an industrial policy and the countries with which we compete have policies to take care of their workers.

HEARING COCHAIR BLUMENTHAL: Thank you very much. Chairman Wortzel had a question.

CHAIRMAN WORTZEL: Gentlemen, I appreciate your being here. We have heard from you before. You do a great job arguing for your workers and advocating their positions. I'd be interested if, as a group, your unions have funded studies or conducted any research on the safety of Chinese vehicles, of their auto glass? I know we've heard some testimony on parts and the problems with parts.

It seems to me that one of the major arguments against China's manufacturing is that vehicles just kill people, they fall apart. You ride down the road in China and —there are people just bleeding all over the place; vehicles flip, brains fall out on the highways. Those aren't the kinds of automobiles we want running around the roads of the United States. We have enough problems.

Very little research has been done on that sort of thing, and such research by your group might be a useful way to protect the health and lives of American citizens.

MR. GETTELFINGER: We have not done a study on that. I am sure that the standards that are required before a vehicle can enter the marketplace here are rigorous enough that I think it would take care of that problem. Now what they can do in China and get away with, that's something totally different.

But we're talking about many products here that have not even been developed yet that are not even in production yet. So obviously we couldn't do a study on those.

MR. TRUMKA: We do have studies on various industries. We know in the mining industry, for instance, the level of health and safety is so far below that of every other industrialized country. They kill thousands of miners every year, 26,000 estimate last year, because we don't have good statistics. They don't keep good records over there.

In addition to that, our 301 petition that we filed and was rejected two years ago outlines the lack of health and safety compliance by the Chinese and their failure to enforce their own health and safety rules, and that results in the killing and crippling and injuring of hundreds of thousands of workers in China and gives them a significant advantage. That is included also in the 301 petition that we just filed, the lack of health and safety concerns. So that is submitted for the record and you can take an accurate look at it.[3] and [4]

MR. GERARD: We're very much like Rich in that we don't--and Ron--we haven't done any specific studies but we're aware of statistics about workplace accidents and fatalities with what are very imperfect records. That record is atrocious relative to what we would find acceptable anywhere in the rest of the industrialized world.

But I was listening carefully to the testimony of political panel, and I think it would be appropriate for the Commission to recommend that for any manufactured Chinese good that they submit all of their specifics, they submit their plans, they submit the finished product for inspection, and we ought to treat their products like they treat ours, and that their vehicles ought to come over here at least a year before a sale for a thorough inspection and safety testing because I don't have the same degree of trust in the system at the borders that Ron does.

I think that the degree of piracy, the degree of fraud, the degree of

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[3] **Click here to read the Section 301 petition referenced by Mr. Trumka**

[4] **Click here to read the Executive Summary of Section 301 petition against the Chinese government referenced by Mr. Trumka**

pirated and less than adequate parts that will make it into that. I don't want to be driving around in my North American-made car and have some Chinese wheel fall off in front of me, and I think if that's what's going on, we ought not to put faith in the border inspection system, but we ought to demand that we treat their equipment just like they treat ours.

CHAIRMAN WORTZEL: Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you very much, all three of you, for being here, and for your very helpful testimony. Here's my understanding of what is happening here.

China had a bad two centuries. They used to be a major center of the world, and they had a bad two centuries. Their government has a strategy to move them back. President Hu was recently at a meeting in China of their National Academy of Sciences, and he talked about China needs to move up the food chain technologically, not to raise the standard of living of people. He said he wanted that because they need to, quote, "build China's comprehensive national power."

Now, Commissioner Becker, in his opening statement, which was read here, he notes that our companies aren't here, and they're acting as if China is their future. Let me just tell you we were just in China. We traveled around. We had this dinner in Shanghai, a working dinner with the representatives of a lot of American companies, and there were two things that struck me in that dinner.

One, representatives there said, quote, "the economic pendulum is swinging to China; two, the other thing that was very clear is how afraid they are of the arbitrary treatment that the Chinese government can put on them. So it's like a schizophrenia. They're wanting to be moving the economic power to China, but yet they're afraid of the Chinese government because it can treat them rather arbitrarily. I think that's one reason they're not here today because if they say anything, they could be subject to arbitrary treatment.

Now, Mr. Gettelfinger, on page three of your testimony, you note that the United States has left the multinationalists in charge of our China policy. I made that point in our very first report in 2002. I said our government has subcontracted our China policy to the multinationals, and the more I understand what is going on here, here's my take on it. The corporations under their charge are after shareholder value. That's what they're going to be judged on, shareholder value.

They're not out there representing the national interest of the United States. So here's what we've got. We've got these guys who are representing shareholder value; yet, they lobby for policies that are harmful, I think, to the national interests of the United States but good for short-term shareholder value. And the more I look at it, and we have recommended policies on exchange rates, on using the safeguard, and we can't get them implemented by the administration, and I think one reason is because the corporations focused on shareholder value have all these lobbying and law firms and everyone else pushing this idea that this is all free trade, which it isn't.

So it seems to me we've got to go back and say how can we incentivize a system that has the corporations' shareholder value tied in with the American national interest, somehow or other, and I know it would deal with--you have to go after exchange rate policy, enforcement of our trading laws. I think there's need to look at corporate governance. I'm not quite sure how. And tax policies. But I think it's an integrated system, and what I would ask, do you guys think of it in that way, and secondly, do you have think tanks out there working on this kind of vision of how to go after this problem?

Maybe I'll start with Mr. Trumka and then go across quickly.

MR. TRUMKA: Thank you, Commissioner Mulloy. First of all, we do. And it's sort of a schizophrenia that they have. They get a triple whammy, if you will. When you look at the totality of the circumstances, an employer who moves overseas gets a benefit in a number of ways.

First, they get benefited by the tax code here in the United States. It actually rewards them for moving jobs overseas. They escape the legacy costs. And then they go overseas or they go to China from specifically here, and they have a vested interest in not seeing the currency manipulation issue addressed. They have a vested interest in not seeing the Chinese live up to their own minimum wage, child labor, prison labor, health and safety laws, because they benefit there, and they increase the amount of money they make.

If you look at it, they take two or three tacts actively. They actively exploit the business environment that's created by the U.S. trade policy, for which you mentioned they lobby hard, that encourages them to supply the U.S. market for highly sophisticated manufacturers from low cost facilities, and then they respond to the foreign government of carrots and sticks.

If you're in one of their industries that they have targeted, which autos is one of the industries that China has targeted, they get federal funds, they get federal help. They suck all of that in, and it makes more, it's more of a benefit for them.

I think you might be gracious when you say it's for shareholder value. I'm not so sure it always translates out into shareholder value because the shareholders of most of those corporations are losing their jobs. They're losing their benefits. The shareholders of those corporations are also paying the price for the lack of R&D. Their country is less secure. So ultimately they pay the price both ways. I apologize for the length of my answer.

HEARING COCHAIR BLUMENTHAL: Thank you.

MR. GERARD: I will segue into Richard's answer by saying that I think you're being overly generous by saying that it results in shareholder value. The last time I looked at it, the largest single source of investment capital in America was workers' deferred wages in the form of pension plans, and we all know what's happened to workers' pensions plans as the result of this, so it hasn't translated in that way.

But I'll tell you that I think there is one group that has benefited substantially from this deal, and that's America's financial community, Citibanks, and the Goldman Sachs who are moving money back and forth and helping these deals come together. I think that you're absolutely right, that it's an integrated response. We've got, as I said in my comments, we've got bad public policy.

We've got benign neglect. We've got lack of enforcement and we've got substantial myopia. I don't know how you can sit there, no matter what party you belong to, and think that having a $4 trillion trade debt is in any way going to benefit this country, and the trajectory going like this. There's no sign that this trajectory is going to change. It's 720 billion last year, and we're looking for 800 billion this year. It was 202 or 220 billion with China last year. We're looking at 270 billion this coming year.

That means simply that they're holding our currencies. They're our banker, and I know what I'm like when I'm late on a payment and when they call up and say pay me Monday, what will happen? The dollar will plunge, interest rates will go up, and these so-called shareholders will all take it in the neck again because those shareholders are our members whose pension funds are being invested.

So we need an integrated public policy response. We need a manufacturing strategy. We need an investment strategy. We've got to start to hold corporations accountable. A corporation doesn't exist for one stakeholder. A corporation is an entity that was created by public policy. This doesn't happen to this degree anywhere else in the world. There's no other country that ignores its manufacturing base the way America does.

HEARING COCHAIR BLUMENTHAL: Thank you.

COMMISSIONER MULLOY: Thank you very much.

MR. GETTELFINGER: Let me just say that in northwest Indiana, there's a plant, was a plant called Magnequench International. Magnequench International is represented by the United Steel Workers. They made the magnets that guided the smart bombs. That work is now being done in China.

We as citizens when we open a meeting, we pledge allegiance to America. I guess my question is who do corporations pledge their allegiance to? They're not willing to come here and testify for reasons you've given. I'm not sure how they would respond to that. We've got some very serious issues here.

HEARING COCHAIR BLUMENTHAL: Thank you. Chairman Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you very much and thank you to all of our witnesses, both for your interesting testimony today and for your leadership on behalf of American workers. I put my own political affiliations out there, but it's certainly been through a lot of your efforts over the years that so many American families have been able to live the American dream, and I think as we all move forward working to make sure that that continues, your work continues to be very important.

Mine is a thought as much as a question, and I offer it up actually to my colleagues as much as to all of you. It's relating to this issue of how the past relates to the future, and the investment, the potential investment in this case of Chinese companies here in the United States, what that means for American workers. Obviously we know that the Chinese government has an industrial policy.

We know that they have a centrally controlled economy. We know that their structure, their corporate structure is different and that the companies themselves are often either controlled by members of the Communist Party or highly influenced by members of the Communist Party. A number of our colleagues up here have raised concerns about that very issue when it has come to the Lenovo and some computer sales to the State Department.

So my questions relating to is a possible solution that Chinese companies would start investing here and producing here are twofold. We know the role that the multinational corporations have had in determining U.S.-China policy, U.S.-based multinational corporations whose interests they have been looking after in terms of U.S.-China policy.

What does it mean to our policymakers if they have state and local government officials going to them on behalf of Chinese companies because the companies are producing in their districts and do we want an American workforce to ultimately end up looking closer like the workforce it had been or the workforce that the Chinese government currently has? That's one piece of it.

The second piece of it is when there is overcapacity in China, do we actually believe that Chinese-owned companies producing in the United States would be allowed to sell their product or will the Chinese government decide for domestic purposes that domestic production in China should be what's being sold in the United States?

Thoughts?

MR. GERARD: I can start with that by saying to you that in the steel industry, we've already started to see it. As I've said, we've filed four cases under Section 421 at the ITC. We won them all. They all have some degree of steel in them, and the administration has unanimously voted with China against us four times in a row.

It's projected that when the figures come in for '05 that China will have increased its exports from 20 million tons to 37 million tons, a 75 percent increase. There was once a company quite a few years ago--I wasn't an officer yet--called China Steel that they came and bought a small steel mill in the United States that was represented by the Steelworkers.

They didn't like being called China Steel because it was too obvious, so they changed their name to City Steel, and in the next round of negotiations, they forced an illegal lockout. While we fought the illegal lockout, they dismantled the plant and shipped it back to China so that I have no illusions that we're dealing with a totalitarian regime, that its commitment is to strengthen its domestic base, and its long-term commitment is not to become more democratic. We seem to have forgotten Tiananmen Square.

And we seem to forget that workers are jailed everyday. We seem to forget that if you want to practice your religion, you go to jail. We seem to forget that they have forced abortion. And we get the so-called Christian right in the Congress who get amnesia over this.

Now, I think that it's tremendously important that this Commission, and in some ways you're our only salvation, you're the only group that can come out and issue a public document that tells the truth based on hearings about what's going on in China.

Let me close lastly by saying somebody has to explain to me at what point this rubber band breaks? At what point can you no longer sustain a growing trade deficit? And it's not just like the money is going somewhere. This value that we're transferring of our wealth to China is going to come back and they're going to buy our assets. They're buying our toll roads now. They're going around the world trying to buy oil from Iran. They're going to buy timber wherever they can get it.

They're going to buy iron ore. They're going to buy all the resources and they're doing it with our money. And we're sitting here pretending that this is innocuous. When they come back and they buy American plants, will they buy General Motors? And if they do, will their loyalty be to here or will it be to China? If they buy U.S. Steel, where will that loyalty be? And I think that people need to get a little bit of a shake.

MR. TRUMKA: First of all, I just want to make clear that one strategic element of China's development is to build export platforms across manufacturing, not import, exports.

The second thing is, is a designation of several industrial sectors, most notably electronics and telecommunications, and automotive industries as pillar industries. That's their pillar industries. They're not going to do anything that hurts their pillar industries at home regardless of where they may locate stuff. It's going to stay there.

The third thing I really have to speak about, and we haven't emphasized it enough, is the message that this administration has sent to China and elsewhere by its total inaction, by its absolute adamant refusal to enforce the trade laws that we currently have, let alone do something to improve the trade laws, has said to China that what they're doing is okay.

The mockery that they've made of the annual review, for instance, tells the Chinese that what they're doing, they can continue to do. It's in their best interests. They only understand, I think, one thing. That's when you come at them in a direct position and say that can't happen.

This administration, our government, has said to them what you're doing is fine, continuing it. Until we get a clear concise determined policy and an administration that says not only is this the policy of the United States, but it shall be enforced, you'll continue to lose more manufacturing, more R&D, and we will continue to lose our edge when it comes to metals, alloys, composites, R&D and everything that goes along with it.

So I don't think you could relocate a couple of plants here and think that it would cause the Chinese government to abandon its pillar industry policy and its export platform policy. You have to understand that their design is to take those markets, not share them, take them.

MR. GETTELFINGER: And I think the fact that we have touched on excess capacity says clearly what they're after, but let me just switch from China a minute and go to Sweden and go over here to Greenville, Michigan, a company called Electrolux, profitable company, good product, great relationship with the workforce, the 2,500 UAW members that work there, and the 200 salaried workers that work there. The government of this state offered Electrolux $120 million over 20 years to stay.

The local community offered them $30 million. We offered over $30 million a year in concessions, and they simply said we can make more in Mexico. They're already talking about leaving Mexico and they've just started production there. So I can't see China being anything but more ruthless. And again, we're not against trade. We're for fair trade.

We're for them, the people of China, having a better standard of living for what they're doing. We want them to build products over there and sell them, but that's where we want them to keep them is over there.

HEARING COCHAIR BLUMENTHAL: Thank you. Before I turn it over to Commissioner D'Amato, I just want to make one statement, and that is that although I appreciate the sincerity of your remarks, of course, we have to remember that this is a bipartisan issue. This was negotiated, PNTR and WTO Accession were all negotiated under the Clinton administration, and so I just want to state that for the record.

MR. GERARD: Two sets of traitors rather than just one.

HEARING COCHAIR BLUMENTHAL: As to the Christian right comment, of course, Senator Brownback and Representative Smith have been leaders in trying to get legislation effected on both of those issues. So I just wanted to state that for the record as well.

MR. GERARD: Can I respond to that? I think you're making an important point, and I'd like to engage you in it. I think it would be important to have a recommendation come from you then and from the panel about what we do about that. I think that if we have a policy about abortion, then we ought to enforce it; right?

The reality is that if it comes to a choice between those folks--look at their voting record--they voted for PNTR. They knew what was going on. And I'm not going to let that just pass.

HEARING COCHAIR BLUMENTHAL: I don't know if Senator Brownback did. We'd have to check that. Anyway, Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you, Mr. Chairman. I'd like all of you to comment on this. You made a comment about fair trade. Now in terms of the auto trade, it seems to me we have here something coming at us that is so big for our economy and for the Chinese economy, so wide a range of our manufacturing industries, that how the car trade is handled just seems to me we have an opportunity to handle it correctly. Importing Chinese cars is not going to come in in a wave as far as I understand it for a couple of years.

We have an opportunity to fashion the kind of policy on car trade that would conform to the ingredients of the PNTR agreement which we brought the Chinese into, the WTO mechanisms, the viability of trade policy per se, and speaks to the integrity of globalization. It's kind of a testing point, it seems to me.

And my question is, should we hold the car trade hostage to getting it right in terms of enforcing the principles that the Chinese signed up to? For example, if their cars that are coming in here are going to be full of IPR violations, substantial IPR violations, stolen technology, not to say that the possibility of substandard safety questions--put that aside--but just a question of their conformity to the principles they signed up to in this international trading system. If those cars violate those principles and we let that trade proceed, does that represent a tipping point in terms of the viability of the international trading system or should we use that as a mechanism to enforce that trading system?

In other words, do we go to the WTO first when we know they're coming in and bring a case in terms of these violations or do we hold up the trade coming into the United States until the Chinese goes to the WTO complain and join the issue that way?

In other words, do you think that we ought to be using the car trade because it's so important as a mechanism to finally come to some kind of an understanding as to whether this international trading system is going to work or not with regard to the Chinese?

MR. GETTELFINGER: First of all, I'm not sure that it would, and let me tell you why. If you take a look at Japan, over the past 20 years, the Japanese governments made numerous commitments to eliminate barriers to imports of automotive products. Nothing has basically happened there.

The distribution system that they've got set up, the inspection systems, the development of technical product standards and numerous other areas keep their market basically closed. We go to Korea in 1998, the U.S.-Korean Memorandum of Understanding. That's been the basis of ongoing talks about opening the Korean market now to the automotive imports. And though there has been some progress made there, very little. Korea continues to impose excessive taxes on imported vehicles and they basically discriminate against imports by assessing a tax that's based on engine size.

I do believe, to use Leo's term, we're at the point where the rubber band is going to break. We are at that point, and all we have to do is go out and buy any kind of a product. We're talking about automotive now, but go out to the Wal-Mart store and see where the products are coming from.

We're in trouble in this country without having an industrial policy. I think we have to do something to keep them out. I would hope that we would have the same standards as Leo indicated awhile ago that they hold us to, that we simply hold them to the same standards. That's the best thing we could do.

MR. TRUMKA: I would just add this, that we have to get it right because if we lose this industry, and they are bent on taking this industry from us--we have to realize that if we lose this industry, American manufacturing, American technology from composite superalloys, metals and everything down the line goes. Once that happens, this country ceases to be a superpower. We will cease to be able to, one, defend ourselves without the help of others; two, we won't have the internal capability to work ourselves out of it.

So I think we need to do, use every tool at our disposal to get it right, every tool, every last tool, every trade law, everything that we can do at the WTO, the IMF, through legislation and everything else to get it right. We cannot afford as a nation to let this industry go the way of other industries that have been claimed. It is too important to the manufacturing sector and the integration of those manufactured processes.

HEARING COCHAIR BLUMENTHAL: Thank you.

MR. GERARD: I want to share the same point of view as my two colleagues, and to add to that. Not only would we lose what is a very high tech industry. An automobile is a high tech piece of equipment. I'm always amazed of all the things it can do when you're driving down the highway. It can all work well for a terrific amount of time, but take yourself back to the steel mill.

It is a high tech workplace now where you can roll steel within one-ten thousandth of an inch, never touched by human hands, aluminum tires, glass, plastic, all of that, that without the base of the auto industry, it becomes noncompetitive as well.

And when Ron talked about Magnequench, that was a Steelworker facility. I can't believe that America would let the guidance system in their missiles be made in China. Bridgestone/Firestone tires, Japanese owned now. Just last week announced that it was moving its plant, closing its plant substantially in Oklahoma. Oklahoma offered Bridgestone/Firestone $100 million over ten years to keep their plant in Oklahoma. Bridgestone/Firestone said no, we're moving out.

The bipartisan betrayal of America on these investment deals has shown people the road map out of American manufacturing and left us being a low wage industry if that's where we end up. My last point about it, when you talk about what could we do, I don't think that they're actually making glass for the auto industry, but they are making glass--is also told this is the China price, and if you can't meet the China price, you don't get to be on the shelf at Wal-Mart.

To meet the China price means they've got to come back and try to beat the hell out of their workers, and I understand it, and if we're a legitimate union, we have to fight back, and we said to them why don't we go together to the ITC, you know what their answer is, if China finds out we're doing that, we won't get nothing on the shelf at Wal-Mart. Welcome to my reality.

COMMISSIONER D'AMATO: Thank you very much. Just as a comment, Mr. Chairman, that we have about two years before this becomes too late in terms of the viability of this trading regime with regard to autos. I think it's the tipping point for the system. If we don't get it right, I think the system goes; the rubber band breaks. If we do get it right, maybe it's a turning point for our making the system work for the principles under which we signed up for it in the first place.

MR. GERARD: By the way, if the Commission does a bit of research, you could find out if my research is right. I'm told that our two largest exports to China are waste paper and scrap metal. Third largest export to China is empty containers.

MR. GETTELFINGER: If I may, just real quick, we really don't have two years. We have two years on the Chery and Geely, bringing in the vehicles, but the parts, the parts are coming in, the companies are investing over there, they're required to go over and do joint ventures. They're going to come in the backdoor, so time is of the essence.

Thank you.

COMMISSIONER D'AMATO: Thank you.

HEARING COCHAIR BLUMENTHAL: We now have statements that both Chairman Bartholomew and Chairman Wortzel would like to make.

COMMISSION VICE CHAIR BARTHOLOMEW: Larry, can I just--

CHAIRMAN WORTZEL: Go ahead.

COMMISSION VICE CHAIR BARTHOLOMEW: Just briefly, again, thanking you all, and noting that unfortunately the failures in the U.S.-China policy go back 16 years and they are indeed bipartisan and what we all hope is that we can move forward with a more sane policy brought to us by whomever will do it.

CHAIRMAN WORTZEL: Mr. Gerard, you've asked us in your testimony and in your comments to address some issues relating to human rights, forced abortion, and labor conditions in China. We all deplore those things. I want to point out, however, that in its infinite wisdom Congress created two commissions. Ours is the Economic and Security Review Commission. The Congressional Executive Committee on China was established with a legislative mandate to look specifically at those three issues you raised on human rights. So the fact that you don't see those things reflected often in our report is not because we don't care about them; it's because we have a specific legislative mandate. I'll try and get you in front of that other commission where you can raise those matters

MR. GERARD: I'd love to be there, but I also think that there's an economic component to that kind of behavior. That we've tried collectively through the Industrial Union Council, we've tried, I think, two or three times now to demonstrate that there's a substantial economic benefit that China receives from that kind of inhumane treatment of its citizens.

CHAIRMAN WORTZEL: I appreciate it.

HEARING COCHAIR BLUMENTHAL: Thank you all very much for your obviously very heartfelt and sincere testimony. I think we've benefited from the exchange and thank you for taking the time to be with us today.

MR. GERARD: Thank you.

HEARING COCHAIR BLUMENTHAL: We're going to take a break for about five minutes and then reconvene.

[Whereupon, a short break was taken.]

PANEL III: PERSPECTIVES OF EXPERTS, TRADE ASSOCIATIONS AND ANALYSTS

HEARING COCHAIR WESSEL: Thank you to our witnesses. Our next panel is composed of three experts who have closely followed the ups and downs of the auto industry and the parts industry. They are Dr. Susan Helper, an economist from Case Western Reserve University; Mr. John Moavenzadeh, Executive Director of the MIT International Motor Vehicle Program in Philadelphia at the University of Pennsylvania; and Bruce Belzowski, Senior Researcher at the Office for the Study of Automotive Transportation at the University of Michigan in Ann Arbor.

If we can take the panelists in the order in which they were introduced, we will put your written testimony into the record, and if you could limit your comments to seven minutes so that we can have a good give and take, we'd appreciate it.

Please.

STATEMENT OF DR. SUSAN HELPER, PROFESSOR OF ECONOMICS, CASE WESTERN RESERVE UNIVERSITY, CLEVELAND, OHIO

DR. HELPER: Thanks very much. I'm pleased to have this opportunity to testify before the Commission, and I'll focus my remarks in two areas. First, I'm going to briefly discuss the state of the U.S. auto parts industry focusing on second tier suppliers and the role of competition from China; and second, I'll provide a framework for thinking about when such competition is and is not a problem and should be addressed by public policy.

So the findings I'm going to discuss are based on two sources. First, I've conducted interviews among auto suppliers for over 20 years, and then also in 2003 and 2006, I conducted surveys with the Michigan Manufacturing Technology Center.

The 2006 results are hot off the press. In fact, data collection is still underway so they're preliminary. The firms we surveyed are part of a national panel organized by the MMTC, and they're primarily small and medium-sized firms with employment less than 500.

They're second-tier suppliers and they sell largely to the auto industry. Several trends are apparent in the data. The first is that competitive pressure from China is very strong. In a 2003 survey, 87 percent of the respondents said that they had lost work to firms in low wage nations. In 2006, 57 percent reported that their largest customers were relocating more of their manufacturing to China, specifically to China.

The second-tier suppliers themselves are only beginning to experiment with offshoring. In the 2006 survey, we found that fewer than one-third of firms offshore any work to China at all, and even within this group, only 11 percent of purchase inputs come from China.

However, this percentage is growing fast. It's doubled in two years, and the offshoring is not concentrated in what might be thought of as low skill tasks. For example, a lower percentage of component assembly is sent to China than are more complex tasks such as tooling build and test.

So many firms are in trouble, but there's a great dispersion of productivity even among firms in the same narrow market segment. For example, metalworking firms, the mean plant as a value-added per worker of $60,000, so that's barely enough to pay a modest wage and reinvest in equipment, but the top ten percent have a value-added per worker of more than $160,000.

Which small suppliers do better? Dan Luria analyzed the same data and is arguing that the most successful companies follow a production model called "busy lean," that they use the full toolkit of lean manufacturing methods in the context of high demand that permits expensive high precision machinery to be kept busy. Keeping busy is you need to be able to design unique products or processes, not just produce commodities that can be made by many firms.

Suppliers in the top ten percent of productivity are making sustainable profits. We should also note that they also pay higher wages than their less productive and less profitable counterparts.

To turn to my second point, should we be concerned about the role of China in the U.S. auto parts industry? According to many economists, competition from China is generally beneficial for the U.S. Competition, in their view, spurs U.S. firms to get better and/or to focus on areas where they're more competitive.

However, there are several instances in which U.S. interests are not well served by the current way that competition with China is structured. So I am actually an economist, and so I want to discuss three such instances that I think are quite important.

One is that firms often choose a location of production using an incorrect accounting framework. Second, that they don't always consider the long-term consequences of their decisions. And third, that firms often don't take into account the social costs of moving their supply chains.

So the accounting framework, many of the firms I interviewed or most of them, even the large multinationals, use accounting techniques that focus on accounting for direct labor costs, even though they're quite a small percentage of total costs. So typically direct labor is only five to 15 percent of total costs in manufacturing.

And they ignore many other important costs and there are some hidden costs of having suppliers far away, such as distraction of top management. So setting up a supply chain in China is a very difficult and time-consuming activity. It takes time away from introducing new products or processes at home. Others, increased risk from long supply chains. There's increase handoff costs between U.S and foreign operations. In particular, more difficult communication among product design, engineering and production hinders serendipitous discovery of new products and processes.

The second point about the long-term consequences. In many segments of the automotive parts industry, a McKinsey study has found that the China price is 20 to 30 percent lower than the U.S. price for a similar component, but several factors could actually shrink this differential substantially such as exchange rate fluctuations or increased transportation costs due to increases in price of oil.

If the differential shrinks after many U.S. firms have gone out of business, it may be difficult to reestablish the lost capabilities. Even in the medium and the short-term, the challenges of dealing with a far-flung supply base make it difficult for firms to innovate in ways that require linked design and production processes.

Just to give one example, one Ohio firm had based its competitive advantage on its ability to quickly add features to its products. So one example is they did a focus group and found that, gee, we could put cup-holders in our riding lawn mowers, they made a last minute change, put them in and they were a big seller. This kind of thing doesn't work when you have a long supply chain to China. You have to freeze your designs much earlier.

HEARING COCHAIR WESSEL: You have about one more minute.

DR. HELPER: So I want to say then that not all trade with China is bad. Trade with China has the possibility of raising the standard of living for both Americans and Chinese, and I guess I want to disagree a little bit with some of the approaches taken by previous commentators, that trade doesn't have to be a zero sum game.

We could imagine a trade structure so that both U.S. and Chinese people benefit, so we should promote policies that benefit both people, first, because it's the right thing to do; second, because it can also increase their demand for our exports. So a similar approach used by the U.S. Marshall Plan, and so from this point of view, I'm not sure that local content regulations in China are actually so much of a big problem.

What should we do? A lot of changes to trade laws have been discussed. I would also suggest government policy to help companies achieve the productivity of the top ten percent and also to educate managers about the hidden costs of offshoring.

And just to conclude, I think our findings suggest that devoting resources to raising laggards to best practice would have at least as great an effect on auto makers' costs as devoting resources to establishing a foreign supply chain.

[The statement follows:][5]

HEARING COCHAIR WESSEL: Thank you. Please.

STATEMENT OF JOHN MOAVENZADEH, EXECUTIVE DIRECTOR MIT INTERNATIONAL MOTOR VEHICLE PROGRAM, PHILADELPHIA, PENNSYLVANIA

MR. MOAVENZADEH: I'd like to thank the Commission for inviting me to speak on this important subject. The International Motor Vehicle Program is a research consortium focused on the global automotive industry. Since its founding at MIT over 25 years ago, IMVP has evolved into a network of professors and researchers based at universities around the world.

Before discussing China, I'd like to provide some context on the overall globalization of the auto industry. American firms were pioneers of globalization. Ford opened its 16th assembly plant outside of North America in 1924. Since the 1960s, when the automotive world mostly consisted of national car companies selling vehicles to national markets, there has been a tremendous acceleration in this globalization process.

In the 1970s, international trade in motor vehicles increased with the oil shocks. In the 1980s, foreign direct investment in manufacturing facilities increased. In the 1990s, the world's automakers formed a complex web of alliances, outright acquisitions and equity relationships.

Globalization has blurred the distinction between national and foreign automakers. The world's auto parts suppliers, a critical component of the value chain, have also been transformed by globalization. Nowadays, vehicle manufacturers shop at the global mall--they source components from locations around the globe and regardless of the headquarters location of the supplier. Globalization has been disruptive for several automakers and parts suppliers. However, it had generated tremendous benefits for U.S. consumers.

Following China's accession to the WTO in 2001, the Chinese industry and market have undergone a radical transformation. The WTO Agreement combined with the lure of China's huge potential market spurred the global automakers to flood China with investment as each vehicle manufacturer sought a Chinese partner to form an international joint

5 **Click here to the prepared statement of Dr. Susan Helper**

venture.

Today, China is a huge and growing automotive market in terms of the numbers of vehicles sold. China emerged last year as the second-largest automotive market in the world, almost six million units versus roughly 17 million in the United States. The Chinese market exploded in 2002 and 2003 with grow rates surpassing 60 percent.

Just to put this in context, growth rates in the U.S., in Japan, and in Western Europe have been zero over the past five years. And the growth seems to be reemerging recently.

The Chinese automotive industry is uniquely fragmented and complex. Most of the roughly 120 Chinese automotive firms have insignificant volumes. In 2004, there were only 12 Chinese automakers with production greater than 100,000 units, including many of the names we've heard today, SAIC, First Automotive Works, Dong Feng.

These automakers have entered into a complex web of partnerships with foreign manufacturers. There are also a few indigenous Chinese companies who are developing cars with out the help of a joint partner such as Chery and Geely.

Vehicles sold from the joint ventures account for about 80 percent of the Chinese market and most of these joint venture produced vehicles are sold under foreign brands such as Ford and Buick. In terms of geography, there are six geographic clusters of the industry in China distributed across the country so there's really no "Detroit" of China.

The role of government, or perhaps I should say governments, is very significant in the Chinese auto industry. The central government has actively shaped the development of the automobile industry, which Beijing views as a pillar industry, critical to China's national interests. With few exceptions, China's automakers are owned by various governments.

For example, FAW and Dong Feng are owned by the central government. SAIC is owned by the Shanghai municipal government, and even upstart Chery is owned by the Wuhu municipal government. The fragmented structure of the Chinese automotive industry is largely attributable to the fact that government agencies and municipal governments in China have relatively independent political power and political influence with the Central Planning Commission.

Despite the best efforts of the central government's NDRC to encourage consolidation in the industry, the policy has mostly failed because of the distribution of political power in China. In terms of capabilities development, Beijing has tried to systematically develop the upstream research and development portion of the automotive value chain rather than relying purely on manufacturing advantage.

The 2004 policy sought to cultivate technology in the industry through tax breaks for companies active in R&D, government funded research centers and encouragement of technological cooperation with foreign automakers.

In fact, one of the key objectives of China's 11th Five Year Plan is to develop indigenous technological innovation capability.

U.S. vehicle manufacturers have benefited from the exploding Chinese market. Ford was a late entrant to the Chinese market, partnering with ChangAn, a former supplier of military equipment based in Chongqing. Ford's first half China sales this year are up 102 percent. GM strategy and progress in China has been remarkable and GM is now the sales leader in China. Their first half sales were up 47 percent and the company made 2005 profits of approximately $327 million in China.

All of the large tier one suppliers have also profited handsomely from China's explosive growth as they have followed their customers into China, but several smaller suppliers of low-end products or services have suffered to compete with China's low wages.

Several of our IMVP researchers were involved in a project that interviewed tier one supplier executives to understand how they make location decisions. Several executives told us that they had felt an internal pressure from senior management to view a China location favorably in order to achieve the benchmark China price that Sue just talked about.

HEARING COCHAIR WESSEL: If you could begin to sum up, please.

MR. MOAVENZADEH: Yes. Just in terms of research and development capability, we've discussed a couple key findings. First, Chinese R&D capability is far behind non-Chinese competitors. Second, the management capability of the R&D process is less advanced. And third, a tremendous amount of R&D performed at the international joint ventures is localization.

That is it's a process of making changes on the basic design of a vehicle so that it's compliant with local emissions and safety regulation and customer preferences, et cetera.

So despite the best efforts of the government to develop indigenous R&D capability, China is still heavily dependent on foreign design and technological know-how.

I'll conclude my remarks by addressing the question of China as an exporter of vehicles to the U.S. I don't see any chance that the United States will emerge as a significant market for Chinese exports over the next five to ten years. There may be a few Chinese cars imported to America that fill a special low-end niche, but these products will have to overcome the stringent U.S. regulatory standards, appeal to sophisticated American consumers and develop viable distribution channels. This is a tall order.

I think it's even more unlikely that we'll see high-end Chinese imports over the next ten years because the labor cost advantage for high-end vehicles is much lower than for low-end vehicles. On the other hand, over the long term, I don't see any reason why we shouldn't expect Chinese imports. We've witnessed a clear pattern of increased imports from Japanese and Korean manufacturers, and in this sense, the question is not whether we will see Chinese imports, but when?

Honda last year exported about 11,000 vehicles to Europe from China, which is a drop in the bucket, but it's still a drop. And I'll conclude with that. Thank you.

[The statement follows:]

Prepared Statement of John Moavenzadeh, Executive Director MIT International Motor Vehicle Program, Philadelphia, PA

I would like to thank the Commissioners for inviting me to speak on this important subject. The International Motor Vehicle Program is an international research consortium focused on the global automotive industry. Since its founding at the Massachusetts Institute of Technology over 25 years ago, IMVP has evolved into a network of professors and researchers based at universities around the world. In preparing my remarks, I coordinated closely with several of our researchers with expertise in China, especially Eric Thun from Oxford University, Jane Zhao from the University of Kansas, and Jianxi Luo from MIT.

I would like to discuss five items with the Commission today:

First, I would like to provide some context on the overall globalization of the automobile industry.
Second, I would like to outline the rise of both the Chinese automotive market and the Chinese automotive industry and explore the impact of this growth on US vehicle manufacturers and automotive suppliers.
Third, I would like to explore China's automotive industrial policy and the implications for US industry.
Fourth I would like to explore the question of to what degree China's auto industry has developed capability to conduct sophisticated research and development.
Finally I would like to address the question of China as a potential export base to the United States and other countries.

Globalization in the Auto Industry
The automotive sector has undergone a radical transformation over the past several decades. Globalization has blurred the distinction between national and foreign automakers. American automotive firms were pioneers in this process of globalization. Ford Motor Company opened their 16th assembly plant outside of North America in Port Elizabeth, South Africa, in 1924. Beyond some notable exceptions (such as Ford and GM's European operations and Volkswagen's Latin American operations), the automotive world of the early 1960's consisted mostly of national car companies selling vehicles to national markets. In the 1970's, international trade in motor vehicles increased with the oil shocks. In the 1980's, foreign direct investment in manufacturing facilities increased. In the 1990's, the world's automakers formed a complex web of alliances, outright acquisitions, and equity relationships.

This evolution has blurred the distinction between domestic and foreign automakers in all countries, including America. Ford owns Jaguar, Volvo, and Land Rover and owns a controlling stake in Mazda; GM owns Saab and Daewoo and has only recently divested equity stakes in several Japanese manufacturers; and Chrysler is owned by DaimlerChrysler AG, a company based in Germany with 74% of its capital stock owned by European investors and whose single largest shareholder is the Kuwait

Investment Authority. Some of these international relationships are viewed as great successes (e.g., Renault-Nissan), while others are viewed as failures that destroyed shareholder value (e.g., GM-Fiat, Ford-Jaguar).

The world's component suppliers – a critical component to the automotive value chain – have also undergone a relentless process of globalization since the 1990's. We have witnessed the emergence of "mega-suppliers" through merger, acquisition and spin-off. Nowadays, vehicle manufacturers "shop at the global mall" – that is, they source components from locations around the globe and regardless of the headquarters location of the supplier. Increasingly, foreign suppliers sell to domestic vehicle manufacturers and vice versa.

This process of globalization has been disruptive for several automakers and parts suppliers; however, it has generated tremendous benefits for US consumers. Americans have more vehicle model choices than ever before. Manufacturing productivity and quality levels have improved and converged among all automakers. Vehicle prices have fallen in real terms at the same time that significant product enhancements have occurred (such as advanced safety, environmental and performance features).

The Rise of the Chinese Auto industry

As recently as 1985, the Chinese automotive industry was completely insignificant from a global perspective (total passenger car production of 5,200). During the early 1980's, three foreign automakers were allowed to enter the Chinese market through joint venture agreements with Chinese partners: American Motor Corporation (subsequently bought by Chrysler), Volkswagen, and Peugeot. Volkswagen's China partnership, based in Shanghai, proved to be very successful, whereas the French and Americans were less successful. Even with these early joint ventures, the Chinese government limited foreign automakers to a maximum 50% ownership in the joint venture. Chinese import duties on passenger cars were 260% in 1985.

Following China's accession to the World Trade Organization in December 2001, the industry and market have underdone a radical transformation. The WTO agreement combined with the lure of China's huge potential market spurred the global automakers to flood China with investment, as each vehicle manufacturer sought a Chinese partner to form an international joint venture. Chinese import duties on passenger cars fell from roughly 90% in 1996 to roughly 75% in 2001. With the WTO agreement, China's duties were reduced to 25% as of July 1, 2006.

Today, China is a huge and growing automotive market. In terms of the number of vehicles sold, China emerged last year as the 2nd largest automotive market in the world (almost 6 million units versus roughly 17 million units in the United States). The Chinese market exploded in 2002 and 2003 with growth rates surpassing 60% both years. Just to put this in context, let's consider that the vehicle sales growth rate in all three mature automotive markets – the United States, Western Europe and Japan – has been essentially zero over the past five years. There has been some upgrading in terms of the value of vehicles sold, but for the most part, the developed world markets are mature, replacement markets. After a slight slowdown around 2004, the torrid growth in the Chinese market continues: passenger car sales increased 47% for the first half of 2006 over first half 2005.

The Chinese automotive industry is uniquely fragmented and complex. The number of vehicle manufacturers in China has remained steady – about 120 – for the past fifteen years. Many of these 120 firms have insignificant volumes. In 2004, there were only 12 Chinese automakers with production capacity greater than 100,000 units. The names are probably familiar to the people in this room and the people in this city: Shanghai Automotive Industry Corporation (SAIC), First Automotive Works (FAW), Dongfeng, Beijing Automobile Industrial Corporation (BAIC), are some of the leading Chinese automakers. These Chinese automakers have entered into a complex web of partnership arrangements with the foreign manufacturers. SAIC, for example, has a joint venture with both Volkswagen and General Motors. There have also been a few so-called independents – indigenous Chinese companies who are developing cars without the help of a joint venture partner: Chery, Geely, and Great Wall are a few names that come to mind.

Vehicles sold from the joint ventures account for about 80% of the Chinese market. Further, most of these joint-venture produced vehicles are sold under the foreign brands, such as Ford and Buick. In terms of geography, there are six geographic clusters of the auto industry in China: Shanghai, Beijing, Changchun, Chongqing, Wuhan and Guangzhou. There is no "Detroit" of China, although Shanghai is both the largest and fastest growing automotive center in the country.

Finally, it is worth considering the social and environmental impacts of China's rapid motorization. The air quality in several Chinese cities remains among the poorest in the world. The face of the country has transformed as bicycles have been replaced by cars and a massive road and highway infrastructure project has been implemented. China is now the world's second largest consumer of petroleum, and the largest consumer of coal. The central government is clearly concerned about energy security, and we should all be concerned about the implications of emissions of CO2 in China as the country continues its remarkable economic development.

The Role of Government in the Chinese Automotive Industry

The role of government – or perhaps I should say governments – is very significant in the Chinese auto industry. I would like to highlight three areas in particular:
Industry structure: policy that determines who can be an automaker in China, how many automakers, where they can sell, etc.
Environmental protection: policy for air quality standards and fuel economy standards
Capability development: policy that aims to develop China's internal capability to design, build and market cars and trucks – in other words, to learn how to make cars from foreigners

The central government has actively shaped the development of the automotive industry, which Beijing views as a "pillar industry" critical to China's national interest. China's National Development and Reform Commission issued its most recent version of the China Automobile Industry Development Policy in June, 2004. The policy serves as a framework for fostering the automotive industry and addresses issues such as ownership restrictions, environmental standards, traffic safety, brand strategy, foreign investment, and energy security. The 2004 industrial policy continued the policy of restricting foreign vehicle manufacturers to 50% ownership in joint ventures with a maximum of two Chinese partners, but allowed existing joint ventures to merge or collaborate with domestic companies. Foreign suppliers are not required to form a joint venture to enter China, but many have chosen to work with a local partner.

With a few exceptions, China's automakers are owned by various governments. For example, FAW and Dongfeng are owned by the central government; SAIC is owned by the Shanghai municipal government, and even upstart Chery is owned by the Wuhu municipal government. The fragmented structure of the Chinese automotive industry is largely attributable to government policies. First, the protectionist policies of the pre-WTO regime made inefficient enterprises profitable. Second, government agencies and municipal governments in China have relatively independent political power and political influence with the central planning commission of the central government. It's not just that the Chinese central government sought to establish a viable Chinese automotive industry: it is also that an array of municipal governments and even military agencies of the central government sought to develop a regionally concentrated automotive industry. Despite the best efforts of the central government's NDRC to encourage consolidation in the industry, the policy has mostly failed because of the distribution of political power in China. There have been some important acquisitions – most notably FAW acquiring Tianjin Auto Corp. However, as I noted before, the number of auto companies in China remains well over 100.

One of my IMVP colleagues from MIT, Jianxi Luo, analyzed the performance of the three different types of automotive firms in China: international joint ventures, domestic-branded vehicles sold by the large groups, and domestic branded vehicles sold by the independent players. He found that for many dimensions of performance – ratio of new vehicle models to total production, production value per employee, capacity utilization –the international joint ventures consistently outperform the domestic firms.

In terms of capabilities development, China has followed an infant industry approach toward the auto industry – protecting local players until they can compete against the global manufacturers. Specifically, Beijing has tried to systematically develop the upstream research and development portion of the automotive value chain, rather than relying purely on manufacturing advantage. The 2004 policy sought to "cultivate" technology in the industry through tax breaks for companies active in R&D, government-funded research centers and encouragement of technological cooperation with foreign automakers. The key objectives of China's 11th 5-year plan relevant to the auto industry include: developing indigenous technological innovation capability and self-controlled intellectual property; reducing overcapacity and overheated investment; and encouraging energy-efficient vehicle technology. In my view, the policy of promoting technology capability development has largely failed, for reasons I will describe later in my statement.

Environmental policy has factored prominently into the five year plans and the automotive industrial policy. For example, the 9th 5-year plan (1996-2000) included a phase out of leaded gasoline. China implemented the first serious vehicle emissions standards in 1999. More recently, they adopted the European emissions standards phased in roughly ten years behind Europe. Presently, China lacks the capability to fully enforce or implement these standards. China also recently approved fuel economy standards, which a Pew Center study estimated were more stringent than the US fuel economy standards, but less stringent than Japan and the EU. Enforcement of the new fuel economy standards also remains to be seen.

Impact of China on US OEMs and suppliers

What does this remarkable transformation of the Chinese automotive market and automotive industry mean for the US vehicle manufacturers and suppliers? US vehicle manufacturers have benefited from the exploding Chinese market. Chrysler, through its acquisition of American Motors, was actually the first foreign player in China entering back in 1983. Although Beijing Jeep was not a success, DaimlerChrysler has been developing an aggressive China strategy over the past few years through its joint venture with BAIC. Ford was a late entrant to the Chinese market, partnering with ChangAn, a former supplier of military equipment based in Chongqing. At the Ford-ChangAn plant that I visited in May, I was impressed with the mix of vehicles rolling down the line: Ford Focus, Ford Mondeo, Volvo S40 and Mazda 3. Ford's first half China sales this year are up 102% (while their first half US sales are down 4%). GM's strategy and progress in China have been remarkable, and GM has now emerged as the sales leader in China. GM's first half China sales are up 47% (versus a 12% decline for US sales in the same period). GM made $327 million in profits from its China operations in 2005.

All of the large tier one suppliers have also profited handsomely from China's explosive growth as they have followed their customers into China. I don't have specific data to demonstrate this, but my opinion is that some smaller suppliers of low-end products or services have suffered. Several of our IMVP researchers were involved in a project that included interviews of tier one supplier executives to understand how they make production location decisions. Several executives told us that they had felt an internal pressure from senior management to view a China location favorably, in order to achieve the benchmark of a "China price". Such price comparisons frequently highlight big differences in direct labor costs. One of the other main conclusions of this study is that suppliers frequently underestimate the costs to relocate production. Production ramp up times were longer and more costly than originally anticipated.

In general, Chinese domestic suppliers are better positioned to supply low-end parts to the Chinese JVs and vehicle manufacturers, and foreign suppliers are better positioned to supply complex modules and sophisticated components. Fourin, a Japanese-based research firm that analyzes the Chinese automotive market, measured the percent of foreign (i.e., non-Chinese) penetration into the production of automotive parts in China. The data for chassis-related parts are revealing. In 2003, several parts categories were manufactured entirely by Chinese firms, including wheel bolts, wheel rims, steel wheels, rear axle housings, axle shafts, etc. The common characteristic of all these parts is that they are low-end mechanical components. The three parts categories with the highest degree of foreign (non-Chinese) production were suspension systems, brake calipers and ABS systems, which are all more sophisticated components. The data for engine-related components reveal the same trend. In 2003, 100% of the engine managements systems manufactured in China were produced by foreign (non-Chinese) firms. These data focus only on automotive components produced in China, not imported components.

The US-China trade deficit in auto parts has steadily increased to $4.8 billion in 2005. US auto parts exports to China grew from $225 million in 2000 to $623 million in 2005. Some of the top categories of parts flowing from the US to China include seats, airbags and gearboxes, which are all more sophisticated components. US exports to China are dwarfed by auto parts imports from China, which grew from $1.6 billion in 2000 to $5.4 billion in 2005. Some of the top categories of auto parts flowing from China to the US include radios, brake components and aluminum wheels, which are less sophisticated and/or more modular components. (Many of the aluminum wheels are aftermarket products.) A closer look at the data show that a large proportion of this China to US auto parts trade are made by the Chinese operations or joint ventures of US suppliers, for example, Shanghai Delphi exporting automatic door systems.

The important question that the Commission has posed is: will US part makers that relocate production to China subsequently export parts back to the United States (thereby possibly eliminating American manufacturing jobs?) This has already happened to some extent, although it is difficult to quantify. The follow up question is: to what degree will this trend accelerate? I don't pretend to have an answer, but I can provide a framework to think about the question. There are five important factors that I think make it less likely for a US supplier to import parts from its Chinese joint venture (in order from most immediate to most distant):

Reduced Chinese import tariffs on automotive parts. Following its WTO commitments, China lowered the import tariff on auto parts from 25% to 10% in July 2006. This essentially makes it less costly for a US supplier to maintain production in the US for a given part that is sourced to vehicle manufacturers both in the US and China.

Transport and shipping costs will continue to increase. Many experts view the long-term trend for oil prices as upward, adding to total cost for importing parts from China.

Increased modularity in the vehicle architecture. Modularity is essentially a measure of how the vehicle is arranged into "chunks," the more chunky the less transaction cost required between the vehicle manufacturer and the supplier. IMVP has studied the question of modular architectures for years. The results can be summarized that cars have an inherently integral (non-modular) architecture. In other words, cars are not like Dell computers, which can be easily snapped together from smaller modules. However, the vehicle architecture is likely to become slightly more modular over the next decade. Large modules (like a vehicle cockpit module) generally need to be supplied locally, so as the modularity trend continues, US assembly plants will source more parts locally through large modules.

Chinese labor costs – especially in the industrial centers – will trend upward over time, also making Chinese-sourced parts more expensive
Exchange rate pressure will eventually result in a stronger yuan, which will make Chinese-sourced parts more expensive.

On the other hand, I think there are at least two trends that make it more likely for the US to import parts from China:
Reduced international transaction costs due to telecommunications and IT. A tremendous amount of transaction is required between vehicle manufacturers and their suppliers. As technology facilitates this communication, as language barriers slowly are overcome, this cost will reduce and, therefore, so will the cost of Chinese-sourced parts.
Increased automotive R&D capability in China. As I will discuss next, China has failed to significantly develop its R&D capability. An advanced R&D capability would reduce the costs developing and even manufacturing parts, especially sophisticated parts, in China. China's R&D capability will develop with time, but the question is how quickly.
Chinese R&D capabilities

One of my IMVP colleagues, Jane Zhao at the University of Kansas, conducted extensive interviews and survey data from Chinese automakers and suppliers focusing specifically on R&D capability. She had three key findings from her work:

First, Chinese R&D capability is far behind non-Chinese competitors. The automotive development process, the process of conceiving, designing, engineering, planning a vehicle from concept to customer, is a highly complex process. The Chinese automakers have not optimized this process to the extent that their foreign joint venture partners have. It will take time to learn. Further, refining and optimizing the product development process is the source of vigorous competition among mature automakers – the vehicle manufacturers that can bring product to the market faster have a significant advantage over their competitors. Chinese vehicle manufacturers generally have a strong mechanical product development capability, but are quite weak in high-end electronics and software. As discussed, this is consistent with the foreign trade data for China.

Professor Zhao's second observation is that the management capability of the R&D process is less advanced. This is consistent with media reports of a shortage of management talent in certain regions and industries in China. During her interviews, the R&D manager of a well-known Chinese automotive company confessed "we don't know how to spend our R&D budget." Recently, there have been some high profile executive hires of foreign managers in Chinese automotive companies. The most notable of these is the June 18 announcement that SAIC has hired Phil Murtaugh, a tremendously talented and well-respected manager who used to run GM China. Chery has hired executives from Ford and DaimlerChrysler. Brilliance hired a former DaimlerChrysler executive to manage its R&D center, while Geely hired a former Hyundai executive to run its R&D operations. Given the remote locations of some Chinese automakers and, more importantly, the unique cultural requirements for success in China, it remains to be seen how successful Chinese companies will be in both attracting and retaining talented R&D managers of global caliber.

Her third observation is that a tremendous amount of R&D performed at the international joint ventures is localization, that is, the process of making changes on the basic design of a vehicle so that it is compliant with local emissions and safety regulation, local fuel quality and availability, and local customer preference. Although localization can be technically sophisticated, it is not as sophisticated as designing a full vehicle from concept to customer. Some engineers claimed that they "dumbed down" by working with the joint ventures (due to focusing more on localization and less on up-front design). Again, this may be changing to some extent. I was surprised during my visit in May to PATAC in Shanghai – which is the R&D joint venture for GM and SAIC – to talk to engineers working on hybrid-electric vehicle systems. The Shanghai municipal government has mandated that 60,000 hybrid vehicles must be sold by 2010. These Chinese engineers were trying to meet the challenge. Surely they were not leveraging the extensive research program to develop a dual-stage hybrid that GM is investing in partnership with DaimlerChrysler and BMW, but they are still engaged in advanced engineering. I was also surprised at the design capability at PATAC. Designers – the clay modelers and CAD modelers that design the aesthetics of the vehicle (the exterior surfaces, the interiors materials and design) – require creativity and highly-specialized talent. GM employs 1200 people at their design centers around the world – and 80 are located in Shanghai. These are the people responsible for the fact that the Buick Lacrosse sold in China by Shanghai GM looks strikingly different from the same vehicle sold here in America.

Despite the best efforts of the government to develop indigenous R&D capability, China is still heavily dependent on foreign design and technological know-how. The Chinese government's rationale for promoting international joint ventures was to develop R&D capability. One idea was that engineers from the Chinese domestic company would spend a few years working with the joint venture's R&D center where they would acquire knowledge. Eventually, the domestic company would hire back the engineer and his or her acquired knowledge. That has not happened. The backflow from the joint venture to the home company is much lower than expected due to the high salary differentials between the domestic companies and their associated joint ventures, which in some cases is a factor of ten.

Although the joint venture model for technology transfer has largely failed, there are emerging mechanisms for developing China's automotive R&D capability. Strategic outsourcing to foreign knowledge centers is now a popular model. Chery has outsourced engineering to AVL (an Austrian high-tech powertrain engineering firm), special noise and vibration testing to Mira (a British engineering and test firm) and design to Pinanfarina (an Italian design, engineering, and manufacturing house). Chery and AVL successfully collaborated on a line of new, advanced engines, and Chery gained engine technological know-how through the process. Learning is unlikely to happen from pure contractual outsourcing, but learning from collaborative outsourcing seems to be working. Another new mechanism for developing China's R&D capability is simply buying the technology from foreigners. The best example is SAIC's stakes in Korean automaker SsangYong and failed British automaker MG Rover.

Chinese Export Potential

I would like to conclude my remarks by addressing the question of China as an exporter of vehicles to the United States, Europe, and other developed markets. This is certainly a highly contentious and emotional issue, as manifest by the volume of press generated with every hint that the US may some day face Chinese imports or – more recently – Chinese transplants.

In a bid to encourage exportation, the Chinese government waives the 50% joint venture requirement for plants that build vehicles for export only. Exports from China reached about 240,000 units in 2005, surpassing imports for the first time, but both exports and imports are very small compared to the overall vehicle market. For the most part, vehicles produced in China are sold to Chinese customers. Most of the vehicles exported from China last year were destined for the Middle East and Southeast Asia.

I don't see any chance that the United States will emerge as a significant market for Chinese exports over the next 5-10 years. There may be a few Chinese cars imported to America, such as a Chery or a Geely that fill a special low-end niche, but these products will have to overcome the stringent US regulatory standards, customer acceptance and develop viable distribution channels. This is a tall order, and the Chinese have much progress to make. I think it is more unlikely that we will see high-end Chinese imports over the next ten years, because the labor cost advantage for high-end vehicles is much lower than for low-end vehicles.

For China to emerge as a true threat to America in the automotive domain, they will need to develop R&D capability on par with America, Germany, Japan and Korea. This is why is focused so much on R&D capability. Achieving success in America and other key export markets is the ultimate test of an automaker's capabilities and a huge symbolic achievement, so this is definitely a high medium-term priority for the Chinese OEMs.

On the other hand, over the long term, I don't see any reason why we shouldn't expect Chinese imports. We've witnessed a clear pattern of increased imports followed by increased production capacity (the rise of the transplants) for Japanese, German and Korean manufacturers. In this sense, the question is not weather we will see Chinese imports but when. Honda last year exported about 11,000 vehicles to Europe from China, which in automotive terms is a drop in the bucket – but still a drop.

Conclusions

We can view the rise of the Chinese automotive industry and market as a threat or as an opportunity. My personal view is that American industry is fully capable of competing against the Chinese industry, despite the large differential in labor rates. There will be some labor intensive work that shifts to China, but if American industry focuses on creative design, outstanding technology, innovative business models, and productive working relations between vehicle manufacturers and suppliers, then the opportunities of a growing Chinese market outweigh the threat of a strengthening Chinese automotive industry.

HEARING COCHAIR WESSEL: Thank you. Mr. Belzowski.

STATEMENT OF BRUCE BELZOWSKI, SENIOR RESEARCHER OFFICE FOR THE AUTOMOTIVE TRANSPORTATION ANN ARBOR, MICHIGAN

MR. BELZOWSKI: Thank you again for inviting me to speak on China's impact on the U.S. auto and auto parts industries. Even before the Asian monetary crash of '97, automotive manufacturers and their suppliers were designing and implementing global strategies for their companies. But since the opening of global markets triggered by the WTO, manufacturers have sped up the process of globalizing their companies. Their suppliers followed suit, and today, 42 percent of the sales of the top 13 global suppliers are outside their home region.

Our research over the past 15 years at the Automotive Analysis Division of the University of Michigan Transportation Research Institute has followed this development and today we see globalization causing two major problems for automotive suppliers in particular.

The first is our recent supplier globalization research found that as manufacturers globalized their operations, they expect their suppliers to follow them wherever they build a plant. This makes it difficult for suppliers to develop their own global strategies because they are constantly building plants wherever their customers demand instead of strategically locating plants globally to support a variety of global customers.

The second is that manufacturers continue to demand significant price reductions on the components or systems the suppliers develop based on global pricing where the benchmark price for a component becomes the lowest price the manufacturer purchasing departments can find anywhere in the world.

Manufacturers strongly suggest that suppliers consider buying or building their components in these low-cost countries in order to match these prices. But what these prices do not include, and Sue has touched on some of these, are significant export duties and transportation, warehousing and obsolescence costs that suppliers must absorb, not to mention the cost of training a completely new workforce both labor and management and integrating them into the companies' global systems.

These are important challenges that some suppliers are able to overcome while others find overwhelming. In our recent study of the automotive industry in China where we examine China's future market structure, its industry structure and its external challenges, we discussed how the previous Five Year Plan and the automotive industry policy focused on the formation of joint ventures between Chinese and foreign automotive manufacturers and suppliers in order to develop knowledge and technology transfer opportunities.

Foreign companies, fearing that they will create their next global competitors, have resisted sharing core technology and product development and R&D processes with their Chinese partners. The Chinese are very aware of the situation, as shown in our study, where they report product development and R&D as the only two activities where collaboration with their foreign partners have been unsuccessful.

In order to remedy the situation, the Chinese auto experts in our study report that the government and Chinese companies are using four different ways of reaching their desired goal of Chinese innovation. They will first buy companies that already have the experience and learn from them. They will hire engineering service firms to help them design and teach their local engineers the product development and new technology development processes.

They will attempt cooperative development of non-competing, completely new products with their foreign partners. Rick Waggoner from General Motors suggested this in the spring of '05. And they will also collaborate with major global suppliers who will supply crucial components and systems for their vehicles.

Now, the 11th Five Year Plan tries to directly address this problem by naming Chinese innovation, as John said, as one of the key areas where the government will try to provide support. The Chinese do not seem to be focused on internal expansion of the industrial sector but rather see structural upgrading as the goal over the next five years.

They see five major supporting mechanisms to support this goal, many of which have a direct impact on global suppliers and manufacturers. They are: accelerating establishment of technological innovative system; improving the market environment for technical innovation; implementing policies related to finance, taxation, banking and government procurement for supporting independent innovation; making proper use of global resources of science and technology; and strengthening the protection of intellectual property rights.

Now, the 11th Five Year Plan also acknowledges the need for readjusting the government's stance on imports and supports its manufacturers and suppliers in, quote, "going global."

The plan calls for optimizing the mix of import and export commodities and striving to bring about a basic balance of imports and exports; continuing an active and efficient use of foreign capital; and supporting qualified enterprises in going global and investing abroad in accordance with common international practices.

Just last week China signaled its willingness to negotiate with the EU, U.S. and Canada over Beijing's import policies. China's import market for automotive components is about $19 billion.

From the export perspective, according to China's Ministry of Commerce, auto parts exports last year reached 8.9 billion with foreign enterprises and joint ventures making up 56.4 percent of those exports.

Now, for auto suppliers, Chinese competition is primarily on less sophisticated components, though this will change as they become more highly developed countries with stronger R&D departments.

So much of the competition today, as Sue said, is in the tier two supply base that manufactures parts and components for complete systems. Capacity will not be an issue when China, India, and Russia develop as automotive economies, though the battle over oil will be intense when this comes to pass.

HEARING COCHAIR WESSEL: If you could begin to sum up, please.

MR. BELZOWSKI: I'm just about there. In the meantime, competition will force some suppliers, either Chinese or foreign, out of business rather than add to the capacity because there are only so many components that need to be made today.

The 11th Five Year Plan makes a point of the need to strengthen intellectual property rights. Now, this is a first step in actually enforcing these laws. What is interesting is that the focus of the plan on Chinese innovation plays directly into IP enforcement because as soon as the Chinese innovate and create their own intellectual property, the sooner they will begin promoting and enforcing laws to protect it.

In terms of preserving jobs in the U.S., the redirecting of workers from automotive jobs today is difficult to do because so many plants are facing closure. One of our recent studies showed how the government can invest in these types of jobs in the area of advanced power trains. It showed how investment tax credits by the government to manufacturers and suppliers would allow them to transition their internal combustion engines to hybrid and advanced diesel engines in their current factories and keep these jobs from being performed outside the U.S.

By developing more high tech jobs, the U.S. can keep ahead of the technology curve and keep jobs in the U.S. The catch is that once these processes become standardized, they too become targets for foreign competition. Only by constantly developing new high technology components or processes does it seem that manufacturing jobs can remain in the U.S.

In conclusion, China represents both a threat and an opportunity for U.S. workers and business interests respectively. Workers are threatened by the transfer of manufacturing jobs outside the U.S. and this includes Mexico and Canada as well while business sees the market opportunities that countries such as China represent.

The Chinese in their 11th Five Year Plan are trying to move up the evolutionary scale of manufacturing. They state that they want to develop the innovation capability of their workers and companies and move away, actually move away from low wage manufacturing.

Now, this may be more of a goal than an actuality within the next five years, but it sends a message to the world where the government is aiming the economy.

[The statement follows:][6]

Panel III: Discussion, Questions and Answers

HEARING COCHAIR WESSEL: Thank you. And thank you to all the panelists and apologize for the brief time frames we've given you, but we do want to engage in a good give and take.

I'd like to ask the first question about the hypothetical scenario we're all looking at. We heard from President Gettelfinger on the last panel that the overhang of Chinese capacity may be twice as much in terms of demand within just a matter of years, three or four years.

Number one, do you agree with those projections? I believe he said 18 to 20 million built-up unit capacity sometime around 2010, somewhere in that range, as opposed to demand. What happens to al that excess capacity? You've talked about innovation. Several of you have talked

[6] Click here to read the prepared statement of Mr. Bruce Belzowski

about innovation and essentially we have to run a little harder and we can stay ahead. If we're seeing the R&D expenditures from some of our parts manufacturers as well as continuing joint ventures, are we going to see an acceleration of R&D?

Is this overhang and the Chinese desire to have a strong economy and hire as many people as they possibly can going to simply swamp our market?

MR. BELZOWSKI: I think on your first point about the capacity issue, I don't know whether those numbers are correct or not. I know that there is a lot of capacity that's being built, some of it for export, as Honda is doing in China right now. As I said in my remarks, as some of the other economies develop, some of that capacity in China could be shipped to India or Russia.

HEARING COCHAIR WESSEL: Will that displace any of our production either regionally or here in the U.S.? Are we, by China building up, essentially diminishing opportunities for a manufacturing footprint here in the U.S.?

MR. BELZOWSKI: If you're talking about an export footprint, yes, yes. Right now the capacity that's built up in the U.S. is supporting pretty much the U.S. demand--

HEARING COCHAIR WESSEL: Right.

MR. BELZOWSKI: --which is 17 million a year, which is the largest automotive economy in the world. That's why everybody wants to come here. But it also makes it more competitive as more capacity gets built up.

One of the interesting things about reducing capacity, for example, from a China perspective, is that if they really cannot sell enough vehicles in their local market, well, they'll just lay people off and people will go away. They'll reduce shifts. They won't have the social safety net that the unions provide for the workers in the United States.

HEARING COCHAIR WESSEL: I don't know that we've seen in many of their industries--steel is one of them--that they're soaking up much of the capacity, but I think it's hard to see that from the hand the government has in this that they're going to accept massive layoffs of their people if their capacity doesn't have an outlet.

MR. BELZOWSKI: We shall see.

DR. HELPER: Yes. I think one way to think about this is that demand doesn't have to be fixed. One could imagine some policies that would actually lead this overcapacity problem to be less of an issue. It seems to me the big problem in China with the Chinese workers is that they create supply but they don't create demand because of the low pay.

So that instead if we focus on policies that sort of increase the buying power of the Chinese workforce, that that actually can have a kind of positive sum game. I'm thinking of sort of the Marshall Plan in Europe kind of approach as I mentioned before. If I may respectfully disagree with my two colleagues--I think there's a danger in this idea that we want to retreat to the higher value-added processes and products, and just sort of in the literature on this, there's two schools of thought that might be summarized as, one, as the triage school that says that we can outsource or offshore the low skill parts to keep the high skill parts.

The other school is a kind of hollowing out school that says, well, actually, if we lose some of the skills in these, quote, "lower skill" areas, these things are tightly linked, for example, production and design, and that's going to make us, if we lose production, we also become less skilled at design.

I worry, I guess, that autos is a highly, what was called a highly integral industry in which one of the successes of Toyota has been its tight linkage between production and design, and that if we're not careful, or if the companies aren't careful about how they do this sort of offshoring, we could find a great loss of capability.

I'll have some data. The data that I've cited will allow us to actually look at that fact, but not yet.

MR. MOAVENZADEH: I think the capacity question is a very interesting question. I would just say that I guess my perspective is to look at capacity more from a micro level than from a macro level. So in the United States, we've had consistently about 20 percent overcapacity in the automotive industry here for a number of years.

Now what's happening? Some plants are closing, but at the same time new capacity is being added in places like Alabama. So it very much depends on the particular manufacturers. It very much depends on the particular types of vehicles and how popular those vehicles are with customers. In China, I think because of the fact that we're looking at an industrial structure of 120 manufacturers, there will inherently be tremendous excess capacity built into the system.

It's not an efficient system. It's highly fragmented. So on the one hand, I think there is this pressure to rationalize which I believe the central government has very much been trying to encourage that rationalization, that consolidation in the Chinese automotive industry, but for reasons that I tried to point out, because of the fragmented political structure, they have not been very successful in doing so.

On the other hand, you have this incredible market lure and that's bringing in the global automakers, and there is this great risk that we will see a major, let's say, capacity glut in China, similar to what we saw in Brazil, you know, 20 years ago where there was just way, way too much investment into the Brazilian automotive sector.

COMMISSIONER WESSEL: But if I recall, in the South American situation, the Brazilian production has begun to serve the rest of the

Mercosur, meaning it's become an export platform, if you will, for the rest of those nations. The question is what does it displace for us? If China grows, has excess capacity, are we going to see any opportunities for our footprint here?

Commissioner Mulloy.

COMMISSIONER MULLOY: Having experts like you here is very important for us so thank you for being here. I've been thinking about this question that was raised earlier about the value added in terms of the American economy between a traditional American company like Ford or GM and a transplanted company like Toyota and Honda.

Mr. Moavenzadeh, you mentioned that plants are closing, but then we're opening other plants like in Alabama. I think the ones that are opening are foreign plants.

MR. MOAVENZADEH: That's right.

COMMISSIONER MULLOY: Can you help me understand the value added in terms of our economic health as a nation between a regular American manufacturer, say Ford and GM, and a transplant company? Is there a difference in terms of the health and wealth of the American economy and the American people between the sale of a Honda car here and a sale of a GM car here? And let me start with Mr. Belzowski and then go right down. I think it's important for us to get that.

MR. BELZOWSKI: On the real economics of that, I'm going to leave that to my economist friend at the end of the table here. But some of the issues that have to deal with that surround the transplants versus the domestic. An interesting one is the labor issue where most of the transplant if not almost all the transplant manufacturers are non-union plants.

What's interesting is that their workers make almost the same amount of money as the UAW workers make in our domestic plants, though one could argue, and I've tried to argue this a number of times, that if the UAW did not exist in those plants, those workers would not be making the kind of money they're making in these transplants. So that's kind of an interesting way of looking at it on the labor issue in terms of transplants.

Profits usually get expatriated to the home country, so in Japan and Korea's case, or in Germany or BMW's case going back to their home country. Now those can be reinvested because they're multinational companies. They'll be reinvested, some in those plants. If the volume demands it, those will be reinvested back into that plant, but not necessarily.

They provide jobs, they provide external jobs for the supply base, and some of it U.S. supplier, some of it foreign suppliers, but U.S. companies have U.S. and foreign suppliers as well. So I don't know what the tradeoff is on the supplier perspective, but I'll hand it off to John on that one.

MR. MOAVENZADEH: So I think the answer to the question is there a difference in value added between a Toyota investment in the United States and a Ford investment, the short answer is yes, I think there is a difference. As Bruce pointed out, profits Toyota made, about $10 billion in profit last year, and presumably we see this flow back of those products to Nagoya, to Toyota City.

I'm actually a little bit skeptical that it's that simplistic though. I think that something has to pay for this vast expansion of the Toyota Technical Center in Ann Arbor, Michigan, and I think that's this repatriation and then a second repatriation point. So I think that there clearly is a value added coming from the foreign, what we think of as the foreign brand manufacturers, their presence, their production presence in the United States, and increasingly what we've seen is the foreign brand manufacturers increasing their R&D presence in the United States.

So right now, the figure is somewhere between 5,000 and 6,000 engineers, scientists, technical people, high value-added people, who are working for companies like Honda, Hyundai, BMW, Toyota here in the United States. And we've seen that number increasing over the years and I think will continue to increase.

COMMISSIONER MULLOY: Dr. Helper, did you?

DR. HELPER: Yes. No, I just second everything that's been said so far, and I guess add I think one important benefit actually of the Japanese manufacturers has been a kind of teaching effect around diffusing quality control methods, continuous improvement, et cetera.

So I think there's been a balance. There have been some positive effects and some negative effects. One could think about policies that would maximize the positive, reduce the negative, and so one of them might be policies that allow workers really to choose fairly whether they want to be unionized or not, policies around health care, et cetera, that reduce the sort of legacy costs and make it very expensive for a company to shrink in the U.S.

Finally, political pressure that I think has been in part one of the reasons that Toyota and Honda have increased that part of the value chain that they add here, that they do here. So I think that's actually quite valuable. In general, I think we've talked a lot about the footloose multinational, and if we could think about policies, both in the U.S. and in China, that kind of align the interest of the multinational with the countries where they do business, that then social welfare, both of people in the U.S. and in China, can increase.

HEARING COCHAIR WESSEL: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Thank you very much. Mr. Moavenzadeh, I was impressed by some of your testimony. Relating to

Commissioner Mulloy's point, it doesn't really seem like there is a normal car company anymore. Ford owns Jaguar, Volvo and Land Rover and Mazda. I was very impressed by the way you described the sort of globalization effect.

But one thing that might help us understand specifically with respect to how Americans and American workers and America as a country is benefiting from say, just give us a sense of the money flow. When you say that the GM has made $327 million in China operations, can you give us a sense of how that sort of flows back, to whom that flows back, how it actually benefits Americans, if it does at all, and American workers, and I'd just like to get a sense of how that works?

MR. MOAVENZADEH: Again, I think this is probably a question that Dr. Helper can address better than me. But I will just say that transfer pricing mechanism within multinational corporations is notoriously opaque so thinking about how that $327 million ends up back in let's say to the benefit of GM employees in the United States I think is a very difficult question to answer, other than simply to say, well, it must have some benefit because it makes GM a stronger company in the larger broader overall sense. As we all know, GM lost over $10 billion last year, so to be able to have some profit stream coming from their automotive operations I think makes the company stronger from an overall corporate perspective.

HEARING COCHAIR BLUMENTHAL: And that benefits shareholders or?

MR. MOAVENZADEH: It certainly benefits the shareholders.

HEARING COCHAIR BLUMENTHAL: But not necessarily the workers back here?

MR. MOAVENZADEH: I would say indirectly it does benefit the workers back here, but I think it's very difficult to quantify that question. Sue.

DR. HELPER: Yes. I guess what I would say is that it definitely benefits shareholders. I think this globalization is one of the features leading to the increased disparity in distribution of income in the U.S., that shareholders can benefit regardless of where the company goes. Workers on the other hand are kind of fixed in where they can work, and so the bargaining power that multinationals have of being able to be much more fleet of foot than workers allows I think a kind of global reduction in wages for workers.

So some of the money from these profits presumably goes to shareholders who are pension funds. So that probably offsets some of the loss of money due to wage income. But I bet that it's not a full replacement.

HEARING COCHAIR BLUMENTHAL: I understand it's beyond the capacity of your testimony--but to zone in on some of the more speculative comments you made, the indirect benefits and the pension plans, how would we go about doing that?

DR. HELPER: I think one thing you'd want to look at is the local content, the U.S. content of cars sold in China, which maybe you know about, so there are probably some parts that are actually made in the U.S. and exported to China. So we'd want to know about that.

We'd want to know something about I guess where GM's profits flow and who GM's shareholders are and the extent to which it is actually pension funds, and then I guess you also need, and this would be the tough part as a counterfactual, so what are we comparing it to? Are we comparing it to a situation in which there's no investment in China? Especially given that right now most of the cars that GM produces in China are sold to China. If you think of this as a new market, then it's maybe all beneficial.

If we see some of these overcapacity issues that some of the commissioners have mentioned, in the future, there may actually be a tradeoff where one more car made in China means one car less made in the U.S. So I'd be happy to work with you on that, but I think it's quite a complicated issue, but quite an important one.

HEARING COCHAIR BLUMENTHAL: Thank you very much.

HEARING COCHAIR WESSEL: Commissioner Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you very much and thank you to all of our witnesses for being here today. It's very interesting. One issue I would put on the table, and I think that Chairman Wortzel might also ask about this, but remember the nonconvertability of the Chinese currency probably means that repatriation of profits back here to the United States is a rather complicated situation if it happens at all.

I'd add another question that should be looked at. What is Ford doing with the profit that it made in China? Is it just plowing the profit back into Chinese factories? That probably would help answer some of the questions.

But actually I have a different issue, which is I was a little surprised that IPR theft did not play a role in or a bigger role or any role at all in some of your testimony. Mr. Belzowski, you at least mentioned IPR, but we heard when we were in Shanghai two weeks ago from a U.S. businessman, who, of course, would never want to be cited on this, that up to 40 percent of Chinese exports are counterfeited or knocked off.

We have heard from Senator Levin about the problem with some brake pads, sparkplug wires. The brake pads he was talking about are actually made out of woodchips and compressed grass or compressed wood or grass chips or whatever. There are safety issues certainly that go along with that. But there are also some people who believe that you can't look at the R&D issue in China without looking at all of the costs that they have saved by simply stealing patents and stealing plans, stealing or requiring, of course, that American companies turn their plans over in order to be able to operate there.

So I just would like some sense from you about what role you think IPR theft is playing, both in auto parts and ultimately in the auto industry itself and how we're going to deal with it if it is a problem?

MR. BELZOWSKI: It's definitely a serious issue. When we, in the study that we did about China, we were actually asking the Chinese themselves what they thought their automotive future was going to be like. So the responses that we got were from the Chinese themselves.

So we asked them about this issue of intellectual property, and in general they tried to sidestep it a little bit. But basically they were saying, and there is some truth in this, in developing automotive economies, for example, in Korea or in Japan in the '50s and '60s, they call it imitation, and it wasn't unusual at that time to see the Koreans or the Japanese copying U.S. or European designs and pushing them off as part of their process.

So the Chinese see it as part of their evolution. They feel that they will get over this. They will stop doing this and eventually it will work out once they are able to develop their own intellectual property. And that's why I think they try to focus on trying to develop their own innovation so that they do not have to get to this point because I think they see it as a real problem in the future from WTO. It just becomes something that is unmanageable if it continues in that direction.

MR. MOAVENZADEH: Yes, I agree with that, that it's not sustainable, this strategy of counterfeiting and pirating, and I thank you for pointing out that there is a glaring omission in my statement on IPR, and that's not by design; it just happened that way.

It certainly is an important and a real problem. I have found that it's very difficult to quantify, to find some reliable data. There's an ocean, though, of an anecdotal data and I've talked to many, many automotive managers who have encountered the same exact types of nightmare stories that you just referred to.

This issue of reverse engineering like stealing a car, taking it apart and trying to figure out how to engineer it, it's not a very efficient process and it doesn't actually lead to substantial development of engineering design capability. So, yes, you can get sort of a cheap counterfeit as we've seen with Chery and Geely and many of the other Chinese automakers, but it's really difficult to then use that as a base for developing a sustainable competitive advantage with respect to product development, and product development, being able to engineer cars, is a huge differentiator in the automotive industry.

So I guess there are two sides. Yes, it's a huge problem, but I don't see it as a sustainable problem.

DR. HELPER: Yes. I think those are really both very insightful comments and I would just add I think the distinction between sort of imitation that builds capability and stealing that deprives people of intellectual property and creates unsafe products and doesn't develop capability is an important one and one that perhaps we should think about how to develop policies to promote the one without the other.

I'd also just point out that to some extent, the U.S. industrial base is built on stolen intellectual property from the Slater textile mills in the 18th century and the German die patents of World War I, so that we're not entirely innocent on this, and thinking about, again, policies that promote Chinese development, I think, is something that we should work on, although not in a way that disadvantages our own manufacturers.

COMMISSION VICE CHAIR BARTHOLOMEW: For what it's worth, when we were in Beijing prior to being in Shanghai, we had a deputy at the Ministry of Commerce deny that there were even intellectual property thefts taking place. So you've got to take a lot of these things with a grain of salt.

HEARING COCHAIR WESSEL: Commissioner Houston.

COMMISSIONER HOUSTON: Thank you very much, and I also thank my fellow commissioner, Ms. Bartholomew, for bringing up the IPR issue. It's very, very important in this context as well, and I would argue that one of the reasons they want to have their own intellectual property is so that they can actually get ahead in the world market of that which they would have normally stolen, but we'll just have to see how that works out.

Dr. Helper, I would like to credit you for having what I think is probably one of the most foundationally important quotes of the day, which is that Chinese workers create supply but not demand. Certainly workers in the U.S., particularly in the auto industry, create supply and demand.

I would also like to hear what you and the other panelists would have to say about a labor economy/labor behavior question. While we were in China, I developed my own economic theory called the "Global Starbucks Initiative," which basically means that everyone in the world wants to be able to afford to pay $4 for a cup of coffee.

There are Starbucks everywhere. They're at the point now that they're across the street from each other and we met with the president of Starbucks in China who noted that there would be more Starbucks in ten years than there would be in the United States. So in order to create that kind of individual prosperity, the prosperity has to accrue to the individual, and in China right now for the workers in the automotive industry or anywhere else, that prosperity is accruing to the Chinese government either directly or through the joint ventures that it has.

I would argue that here in the United States we have also some existing infrastructures that a lot of that prosperity accrues to and we have infrastructure that workers, particularly in the auto industry, are beholden to for a number of things that it would be nice if they had some individual choice for.

In China, you have coerced labor to a great extent and I would guess in the automotive industry there as well, both the legitimate and knocked off products.

From an economic historical standpoint, is there a labor tipping point? Instead of receiving below world value wages and certainly below U.S. standard wages, is there a point where the laborers in China are going to see what's going on in the rest of the world as far as labor costs go and start demanding that they be paid for more?

I realize that the political infrastructure there tamps that down considerably, but in your estimation, historically has that happened or can we extrapolate from other experiences? If that did happen in China, would there be any kind of impact on the world market and certainly as we're discussing today the auto workers here in the United States?

DR. HELPER: Yes. I think that's a really important question and I think a lot of my colleagues in the economics profession tend to assume that when the productivity of the worker increases, that that is going to automatically be reflected in wages. That kind of ignores the effectiveness of repressive structures that are currently in place in China and other countries as well. So I think there's nothing automatic about rising Chinese wages.

We are seeing rises in wages, although it still is not commensurate with productivity. But I think it's very important that policies and institutions matter a ton in whether this evolution of higher wages will continue. If we just look in the U.S. for example, unions have been one of the pillars, I think, of more equal wage distribution--in the U.S., unions are shrinking now.

So there isn't this kind of idea that always and everywhere wages rise as productivity rises. So that I urge then that some of these policies that have been mentioned around, to the extent that the U.S. can urge support for labor rights and democratic rights in China, I think that's very important toward this evolution continuing to occur.

I'd also say so then if the Chinese people then are richer, then they're able to demand more. I think that raises an issue that we haven't talked about too much, which is the whole environmental issue around cars. I think that one of the things that the world industry needs to figure out is a sustainable transportation network that gets people around without, you know, throwing too much carbon into the air.

One of the things that we may need to think about is how are we going to translate--let's say the sort of good scenario of increased demand from China happens. How are we going to translate that into an environmentally sustainable form of demand? I think that sometimes that could actually be beneficial to the U.S. because it requires a lot of R&D to think about how we're going to redesign processes to pollute less.

There may be, in fact, be an opportunity there, but again policy is going to need to promote that.

HEARING COCHAIR WESSEL: Commissioner Wortzel.

MR. BELZOWSKI: Can I weigh in on that?

HEARING COCHAIR WESSEL: Please.

MR. BELZOWSKI: When we were looking at the GDP per capita from 2004 to 2005, it already has risen within China, which is significant because they actually have 1.4 billion people. For any rise in GDP to be--I think is almost like 500 to $1,000 per person, just within one year. So it shows you that there really is being transferred to individuals. Of course, you don't know what parts of the economy are getting it and which ones aren't. But I think that really shows that some of this money is flowing back to the workers.

When you think about that, and the reason that the manufacturers and the suppliers are in China right now, because it has a two-pronged opportunity, something that not all emerging markets have, because actually a lot of times when manufacturers and supplies go to emerging markets, they're going there to take advantage of low wages, but they're not really there to take advantage of the market.

Mexico is an example of this. In China, it has both sides going to for it, so not only do you have the outsourcing opportunity if you really want to take advantage of it, but you also have the market there that's growing. And six million vehicles, the largest, second-largest country in the world, and they have less than two percent of the people have vehicles, which is really great for the environment, but from a market perspective, the manufacturer is saying this is going to be a huge market opportunity for us. That's why they're all there.

COMMISSIONER HOUSTON: It's interesting that you say that because when we were there, I think we would all remember that most of the businessmen we talked about did focus more on the size of the market than the labor costs while we were there.

MR. BELZOWSKI: Right.

HEARING COCHAIR WESSEL: Commissioner Wortzel.

CHAIRMAN WORTZEL: I'd like to follow up on what this market and these profits do for the United States. I know profits from business in China supports a globalized corporation and I think Dr. Helper's argument that if such money flows back into the corporate coffers and average Americans or employees in that corporation have that particular stock in their portfolio, that might help a retirement plan.

But both of you referred to the repatriation of profits, both Mr. Belzowski and Mr. Moavenzadeh. Is that it?

MR. MOAVENZADEH: Yes, that's right.

CHAIRMAN WORTZEL: Thanks. In every experience that we have had as a commission in China, and I have had for five years working in China and more than 30 years studying China, when I talk to corporate managers, corporate executives, about repatriating capital, I get a flim-flam answer about how the company goes to swap markets can get some money out. For the most part, however, I have yet to have anybody document in a place that has a closed economy, a closed banking system, and a currency that does not trade on the international market, how you repatriate or distribute your profits.

As much as I like China and have enjoyed the time I spent there, I don't much care about working to develop China. Our focus here is on the United States. Can you help me understand how we can learn how and whether this capital comes out of China and where it goes in a globalized corporation? I haven't heard that from you.

MR. BELZOWSKI: From my side, I never said that we were going to repatriate profits from China. It's the Japanese who repatriate profits from the U.S. to Japan and the Germans from the U.S.

CHAIRMAN WORTZEL: Okay. So how are they doing it from China?

MR. BELZOWSKI: I don't know. I have no idea--if you had this kind of market and you had this kind of market opportunity, I would assume you would plow it back into your own--I don't know if they're doing this--you would plow it back into your operations there to expand your operations there, if there was that kind of market.

CHAIRMAN WORTZEL: Even if the currency was convertible, you would plow it back in there?

MR. BELZOWSKI: Depending on how much you already have involved in.

DR. HELPER: International finance is not my area. First of all, let me say that I am not a proponent of making lots of profits in China and sending them back, that's how we're going to all fund our retirements.

But just to explain what I think might be going on in areas you might look at. It seems I think that one of the things that China is trying to do with its policies on repatriation of the currency is stability. They don't want to have the sort of Asian financial crisis with speculation build up the currency and then there's a rush away from it as happened in '97.

My sense, and this could be wrong, so I'm reluctant to say it, but I think part of their currency problem, part of their currency policy, is they actually need to buy a lot of U.S. dollars because they need to keep the demand for the U.S. dollar high so that they can therefore suppress demand or lower the rate of their renminbi, and so that's going to actually make them affect their policy on the repatriation as well.

MR. MOAVENZADEH: Yes. I would just say it's a tremendously complex question and I think that you've helped me to define one of our future research topics. So thank you.

CHAIRMAN WORTZEL: Thanks.

HEARING COCHAIR WESSEL: Commissioner D'Amato.

COMMISSIONER D'AMATO: Yes. I want to get the question of R&D costs clear in my mind. In terms of being able to sell on the American market, you seem to be more sanguine than I am in terms of our ability to compete.

Putting aside the currency differential, which is 30 or 40 percent, we believe there's a substantial cost that's included in American autos in terms of all the R&D that is not a cost to the Chinese. How do you factor the R&D differential into Chinese ability to penetrate the American market despite the fact that they may not be coordinated? There may be a lot of manufacturers, but still if a couple of them merged and are able to take advantage of American R&D, and not factor that cost into their production, then it seems to me we're talking about a substantial cost advantage for the Chinese to build a competitive position in the American market.

Have you done any work on that? How do you evaluate the importance of that differential?

MR. MOAVENZADEH: There's two I think important differentials. One is the wage rate difference and the other is the R&D capability, and it seems to me that both of these are quite different with respect to lower end econobox vehicles, if you will, versus higher-end luxury type vehicles.

I suggested in my statement that I can imagine in a five to ten-year time frame that China will export some lower-end vehicles to the U.S. market if they can overcome the regulatory hurdles.

For these lower-end vehicles, the lower labor wages in China have more of a competitive advantage, they're less R&D intensive in that China has already learned a lot about manufacturing the lower-end vehicles through its experience with joint ventures, through the reverse engineering process, but more importantly through some of the elements that Bruce talked about, which is what they're really doing now to effectively develop their R&D capability.

That is things like SAIC buying Ssang Yong, which is a Korean manufacturer, basically buying in the knowledge, or things like Chery, an indigenous Chinese manufacturer, working with AVL, which is an Austrian engineering design firm, to jointly develop a line of high-end sophisticated engines. So these types of mechanisms are ultimately going to improve the R&D capability in China, whereas the original intention of the joint venture policy, which was to do so, largely has been a failure.

DR. HELPER: I'd just add that I think in looking at the possibility of Chinese exports, we shouldn't forget that parts overcome several of the hurdles that John mentioned more easily.

First, the cost differentials. When you ship an entire car, you're shipping a lot of air. If you ship parts, the shipping cost per part is less. Second, you can focus your R&D efforts and just look at a few parts, and so I would imagine that we're going to see more Chinese parts before we see Chinese completed vehicles.

MR. BELZOWSKI: I thought one of the interesting points, the way that the government has things set up now, is that originally they demanded that every manufacturer and supplier have a corresponding Chinese company as a joint venture partner, but within the last couple of years, they have changed that in terms for the supply base. So suppliers can go into China now and set up their own companies without having a Chinese joint venture, whereas the manufacturers still have to do that.

And that really opens up the world to these manufacturers, the suppliers, because they can now export without sharing their profits with their joint venture partner, which is one of the reasons that we said in our report that we really don't see the joint venture companies, say the GM and SAIC, the Ford and ChangAn, as exporting vehicles that were already designed in, say, North America or Germany to the United States or Germany because they would end up having to share those profits with their partners.

That's why their focus tends to be on the Chinese market where, if we're going to sell vehicles here, we'll share the profits here as well. That's fine with us, but we're not going to design a vehicle in Detroit, build it in China with one of our joint venture partners, and then ship it back to the U.S. and share the profits with our joint venture partner.

Right now it seems like a little insulation by the U.S. economy from exports from the joint venture companies. Now, the Chery's and the Geely's, which are not joint venture companies for them to ship over, they have lower wages, they have an advantage there, and which they'll probably try to take advantage of, but they really don't have the R&D capability that the global manufacturers have. So they're trying to catch up in a number of different ways.

When we asked the Chinese themselves, how long do you think it's going to take you to be up to be a world-class manufacturer/supplier, the minimum was ten years, but some said 20 to 30 years. That's how far away they themselves felt they were in terms of their product development and R&D capabilities. John talked about this--where just because you have the part in front of you, and you reverse engineer it, you didn't have the engineering time that went into developing that, you had engineers who learned and said, don't do it this way, we've tried it that way, it doesn't work.

You don't have those people on board and it takes awhile to build up that competency especially because vehicles are so complicated. There's thousands, 20,000 parts in a vehicle, and have them working together and the increase in complexity because of electronics has just made the whole vehicle so much more complicated than it used to be, and it makes it hard for people to enter into the automotive industry.

Now, it doesn't mean they won't, and the Chinese will be here. They're coming and they will be here. Don't pretend that they're not. But it may take a little longer than people think.

COMMISSIONER D'AMATO: Thank you.

HEARING COCHAIR WESSEL: Thank you to our panel. I'd like to follow Commissioner Blumenthal's request to understand more about the competitive model, what we should be looking at, stranded costs, SAG, incidence of all these costs in the long term, and how we understand what the issues are as we look at our two markets. So in the coming days, hopefully, we can get some more advice from the panel.

DR. HELPER: If I can, I just had one thought on that.

HEARING COCHAIR WESSEL: Yes.

DR. HELPER: I think we've mentioned a number of laws and how this is a systemic approach that is needed, but think about bankruptcy law. In the Delphi case and a number of other cases, you're allowed to sort to take only your U.S. operations bankrupt, into bankruptcy, and so I think what happened is Delphi has been able to use some profits in the U.S. to fund Chinese operations and so you might call that a stranded cost, et cetera.

HEARING COCHAIR WESSEL: Yes, that was my point about stranded costs and looking at SAG and everything else and how the incidence of all those costs which have to go into a competitive model.

COMMISSION VICE CHAIR BARTHOLOMEW: Just another thought, which is I think we look backwards to try to predict forwards. We hear about Japan and we hear about Korea, and I think that one of the issues, one of the questions that the whole China's economic growth and economic development has really raised is do the old models even apply anymore?

I think there was a panel in Washington relatively recently about Ricardo's theory and whether this is just even a paradigm that we can use for thinking about trade moving forward?

This Commission is unusual, in a sense. It was the first commission to focus on a bilateral relationship like this, and I think that there are some fundamental questions about how both the extent, the size of China and the impact that it's having on the world and will continue to have on the world, and how quickly it's happening.

So I'm very interested, Mr. Belzowski, to hear that the Chinese themselves are saying ten, 20 years. I don't know if you agree with them, if you think that that's realistic or not, or if things are moving more quickly than anybody expected. Or are we moving into a world that we just really don't understand and can't predict?

MR. BELZOWSKI: I agree, things are moving much quicker than they ever have in the past, and when I do a slide show, I show the Industrial Revolution, how long it took for that to develop, how long it took for Japan to develop after the Second World War, and what's happening in China, and it's exponentially faster.

There are issues surrounding that that support it--the use of information technology, which wasn't available in the past, and that has sped things up in the auto industry as it is, but it also allows this newer industry to move faster than it did in the past.

The free flow of trade between countries, which in the past probably was not as open, so there's much more free-flowing of trade between the countries, a variety of countries, and when you think about your company nowadays, you don't think about it as here I am in China, I need to sell in China. I'm actually an international global company; where can I sell my products?

If markets are open, I can sell them anywhere in the world, and it really makes it more challenging, but it makes--it gives the companies an opportunity to actually balance their companies' portfolios across different regions and countries that I don't think in the past was ever available.

DR. HELPER: I'm involved in some of the research that was presented on that panel, and I guess my take would almost be that perhaps what we need to do is, in fact, return to some older models of trade. That there's been a kind of tendency of neoclassical economics in the last, say, 20 years, that promotes kind of static efficiency. So let's look at who has got the cheapest product now rather than looking at things like dynamic efficiency, how do we build capabilities, innovation for the long term, how do we create macroeconomic stability.

If you think about, in fact, some of the U.S. post-World War II policies where we both kind of promoted domestic R&D and capability building and also democratic institutions and economic recovery abroad, that that might actually be a good model.

COMMISSION VICE CHAIR BARTHOLOMEW: Wonderful. I think one of the key questions that you mentioned was the if markets are open question, which we haven't--of course, in the previous panel, there was some talk about non-tariff barriers and things that the Chinese government is doing to protect its industries and how we deal with those. So thank you all very much.

HEARING COCHAIR WESSEL: Commissioner Mulloy for a quick question.

COMMISSIONER MULLOY: Dr. Helper, you're an economist. My understanding is that a car that is made by a transplant has more imported parts in it than a car that is made by GM or Ford, and that more of the higher value-added parts in a transplant are imported than it would be in the case of an American made car, and that that has significance for an economy. Am I correct in that assumption?

DR. HELPER: That's something that is changing. There are actually some car models now made by Toyota and Honda, I believe, that have more local content than models made by the U.S. I would also say, yes, I guess I would go back to some of the discussion, some of the points made by Bruce, I think the issue is how dowe promote long-term capability development in the U.S.

That sort of encouraging, I think, foreign companies come here. Particularly, I think, there's a real difference between the Japanese and the Chinese challenge. Sometimes the Japanese challenge looks in retrospect quite easy because, on the one hand, the wages quickly became quite similar and so it was a competition not based so much on wages as on superior technique. That's the kind of competition that I think benefits consumers.

In the Chinese case, I think there's more difficulty because it is really a competition based on low wages, exploited labor, poor regard for the environment. So I think it's important to look at how do we increase capability in the U.S. and skills and things like that?

Also thinking about how the role of export, demand for our exports in Japan. So I think then some of these issues about non-tariff barriers come back.

COMMISSIONER MULLOY: Thank you.

MR. BELZOWSKI: I think the issue having to do with if you're looking at what's the value of the components that are being made by U.S. suppliers and non-U.S. suppliers, if you look at the transplants themselves, they tend, you look at the higher value things, something like the engine, well, that tends to be made here in the U.S., and sometimes it's made internally by the company itself. It's not even outsourcing it, so that's probably the biggest part of the vehicle.

The stampings, they tend to be done by the companies themselves rather than by their suppliers. So I think that the supply base is not--there's definitely--and the Japanese suppliers, for example, that follow their manufacturers to the U.S., but they're employing U.S. workers, and the U.S. workers have--and there are decent wages, so it's not that big a differential I think as you may think.

COMMISSIONER MULLOY: Thank you. That's very helpful to me. Thank you.

HEARING COCHAIR WESSEL: Thank you. We will break until 1:15. I appreciate all of your help and I look forward to seeing everyone back here shortly.

[Whereupon, at 12:45 p.m., the hearing recessed, to reconvene at 1:20 p.m., this same day.]

A F T E R N O O N S E S S I O N

[1:20 p.m.]

PANEL IV: NATION SECURITY PERSPECTIVES

HEARING COCHAIR BLUMENTHAL: Welcome back. We are going to start our fourth panel on National Security Perspectives. We have with us today Dr. Sheila Ronis from the Walsh College and Vice President of the National Defense University Foundation, who also does a lot of consulting with the Office of the Secretary of Defense and other elements at the Pentagon; as well as Mr. Brian Suma, who is a Program Manager for the U.S. Army, who is tracking the effects of the decline in the civilian and military supply chain on America's military readiness; and Mr. Randal Gaereminck, who is the Deputy Program Executive Officer for Ground Combat Systems, and he has worked on all major Army ground combat systems from the Abrams battle tank to the new Striker.

We have a very distinguished panel to discuss the national security perspectives of what's going on with our auto industry and auto parts industry vis-à-vis our trade relationship with China. So if we can start with Dr. Ronis, please go ahead.

STATEMENT OF DR. SHEILA RONIS, DIRECTOR MBA/MS PROGRAMS, WALSH COLLEGE; VICE PRESIDENT, NATIONAL DEFENSE UNIVERSITY FOUNDATION, TROY, MICHIGAN

DR. RONIS: thank you very much for inviting me here. I'm really honored to be here to share some of my ideas as a systems scientist, which is really how I approach most of the issues that I am asked to study. Today, the United States is in an economic war, at least the way I view it. Our industrial base, including the automotive sector, is also seriously eroding.

This situation has national security implications because we're dependent on foreign countries for critical components and systems and we're losing our ability to design, engineer and manufacture products as well as control our supply chains.

The defense portion of the industrial base cannot be separate from the overall base. The offshoring of the U.S. auto industry alone is exacerbating the situation. When it erodes, it takes most of the defense capability with it.

The United States is dependent on other countries for critical auto and weapons technology. It's conceivable that at some time in the future, a government could tell its local companies not to sell critical components to the United States because they don't agree with our foreign policy.

If we were ever to have a war with China, we could experience difficulty simply by having them cut off shipments to the United States and hurting our economy without even firing a shot.

The federal government doesn't manage the country's industrial base as a system, but it needs to at least understand system behavior. We need the Department of Defense to understand its key weapon system supply chains down to raw materials. In many cases, we're unable to manufacture critical military equipment.

This situation isn't officially documented or monitored, but it needs to be. Knowing industry averages, I suspect that there is a significant presence of Chinese parts in our weapon systems today, but we don't know where they are, and this risk is significant.

U.S. corporations increasingly act as large social systems with a global focus, as they should. Ask the CEOs of the Fortune 500 to describe the issues on their minds and more than likely national security or the disintegration of the U.S. industrial base would not be among them.

Under the American financial and regulatory system, public companies are supposed to rank their shareholders at the top of the loyalty scale except in times of emergency. I think today's situation may be a national emergency. The very ability of the United States to remain a superpower is truly at stake. General Motors, Ford, Delphi, Northrop-Grumman, Boeing, Lockheed Martin, they all share the bottom of the industrial base.

Globalization and the intense pressure applied by Wall Street to U.S. companies encourages indiscriminate cost cutting, a measure that frequently works in the short term, but can be disastrous in the long term. The cheaper, cheaper, cheaper mentality sometimes sacrifices long-term gains by forcing a company to offshore work in low-wage countries such as China in the near term.

These decisions can come back to haunt a company when the work acquired is of inferior quality, a critical core competency of the company is lost or stolen, when intellectual property completely disappears or the accessibility of an essential item is put in jeopardy.

There are many stories that we know in the auto industry, but rarely will anyone come forward for fear of Wall Street reprisals and certainly for fear of losing customer confidence.

Global purchasing organizations in industry as well as the military are not sufficiently looking at the risks of potential disruption because of foreign sales or supply lines. They tend to be rewarded for getting everything less expensively and nothing else. Just look at the results of the brief longshoreman situation a few years back on the West Coast and the billions of dollars it cost this nation per day.

You will hear from my colleagues in the Department of Defense right here who are experts in the Diminishing Manufacturing Sources and Material Shortages, or DMSMS, community. Mission capable systems and readiness are put at risk when DMSMS issues are left unresolved.

What isn't understood is the reality that the auto industry affects DMSMS because the industrial infrastructure that supports the Department of Defense is shared by the auto industry. When a tier supplier to the auto industry goes under, whether it is a machine tool company or in microelectronics, it reduces DoD's ability to function whether we say so or not.

I think we might as well say so. When government R&D investment in an industry deteriorates, it's only a matter of time before an industry is in trouble. Manufacturing R&D by the federal government has almost disappeared. Young people no longer view working in manufacturing as a possible career so we're losing our ability to train the next generation of scientists and engineers.

We're losing critical to defense industries from shipbuilding to machine tools, high performance explosives and explosive components, cartridge and propellant actuated devices, welding and even the nuclear industry. All of these industries share the bottom of the base with the auto industry, and that is what has become a national security issue.

We need to maintain a capability to be globally competitive in both product and process innovation. We must regain our manufacturing prowess and leadership. We need to reinvigorate the Manufacturing Extension Partnership Program at NIST.

We need to prioritize those technologies that are critical to regaining and then maintaining leadership and competitive advantage in the overall industrial base so China does not become the world's leader in technologies we need to be a superpower.

China is rapidly becoming the manufacturing capital of the world. For example, Chinese officials have very publicly stated that they want to become the foundry capital of the world and have a worldwide monopoly on cast parts. They have a plan to win. And we don't.

We need to increase our investment in R&D to produce the leading edge knowledge, capabilities and patents the country must have to remain an economic, diplomatic and military superpower. We must increase funding to the national laboratories across the board, especially at the Departments of Energy, Commerce and Defense.

We need to rethink our trade, offset and CFIUS policies to encourage the maintenance of high value-added jobs inside the country. And we need to reform those national systems that are keeping our industry uncompetitive including pension and health care particularly in the auto industry.

The bankruptcy of Delphi is only the first of many dominoes to fall if nothing changes. CFIUS must be completely rethought. Having General Motors under the control of foreigners is not the answer. Many foreign entities buy U.S. assets, not to use them, but to dismantle them. Even Daimler's takeover of Chrysler removed serious capabilities to Germany, though, of course, no one will go on the record with specifics.

Cooperation between government and industry is essential. Unless we look at the industrial base as a system, we don't even see the problem or the possible military implications. We're also not even asking whether or not a U.S.-owned industrial base matters, and we need to explore this issue as a nation.

The White House, Congress, and the entire spectrum of the agencies and departments of the federal government need to understand these issues. I applaud your efforts because unless something changes, the U.S. will cease to be superpower and soon.

Thank you for listening and I look forward to your questions.

[The statement follows:]

Prepared Statement of Dr. Sheila Ronis, Director, MBA/MS Programs, Walsh College; Vice President, National Defense University Foundation, Troy, Michigan

Erosion of the U.S. Industrial Base and its National Security Implications

Mr. Chairman, members of the Commission, ladies and gentlemen. I'm honored to be here to share the outcome of my many years of systems scientific research on both the auto industry as well as the military industrial base. The U.S. industrial base including the automotive sector is eroding, and this situation has enormous national security implications. It has made the United States so dependent on foreign countries for critical components and systems that it may have lost its ability to control its supply chains. The defense portion of the industrial base cannot be separated from the overall base. The offshoring of the U.S. auto industry alone is exacerbating this situation – the auto industry has such an enormous footprint on the overall U.S. industrial base, that when it erodes, it will take a great deal of defense capability with it.
The United States has also become dependent on countries such as China, India, Japan, Russia, France and Germany for critical auto *and* weapons technology. It is conceivable that at some time in the future a

government could tell its local suppliers not to sell critical components to the United States because they do not agree with U.S. foreign policy. If we were ever to have a war with China, we could experience difficulties simply by having them cut off all shipments to the United States and hurting our economy without even firing a shot.

The federal government, and in particular, the Department of Defense, does not manage the country's industrial base as a "system," but it needs to at least understand system characteristics. We need DoD to understand its key weapon system supply chains down to raw materials. In many cases, the United States is unable to manufacture critical military equipment. This situation is not officially documented and monitored, but it needs to be. Knowing industry averages, I suspect that there is a significant presence of Chinese parts in our weapon systems, but we do not know where they are. This risk is significant. China is becoming the manufacturing capital of the world.

U.S. government agencies are fiefdoms that rarely compare notes to see how their collective policies might affect a company or an industry. Interagency cooperation is among many things that need to change in the future.

U.S. corporations increasingly act as large social systems with a global focus. But ask the CEOs of the Fortune 500 to describe the issues on their minds and, more than likely, national security or the disintegration of the U.S. industrial base would not be among them. Under the American financial and regulatory system, public companies are supposed to rank their shareholders at the top of the loyalty scale, except in times of emergency. A new vision of national security is needed that includes cooperation between government and industry and includes the economic element of national power merging with diplomacy and defense. National security requires a healthy market-based economy, with a strong industrial base of globally competitive industries continuously improving quality and productivity including the auto industry in its entirety.

The very ability of the United States to remain a superpower is at stake.

Offshoring the *auto* industry could make the U.S. military industrial base in the United States completely unable to comply with American preference legislation because the erosion of the auto industrial base also erodes defense. General Motors, Ford, Delphi, Northrop-Grumman, Boeing, Lockheed Martin – they all share the bottom of the industrial base.

The United States cannot sustain the kind of growth it has enjoyed for the last several decades if the industrial base continues to steadily erode. Increasingly, a number of U.S. companies in specific industries find it impossible to compete in world markets. This is of particular concern for the industrial base that supplies the U.S. military, automotive and aerospace.

According to Alan Tonelson of the U.S. Business and Industry Council, import penetration rate data is a critical metric that the U.S. Government needs to track, but does not. According to Tonelson and Peter Kim in a *Washington Times* article, "in recent years most industries producing goods in the United States have been steadily losing their home market – the world's biggest, most important and most competitive – to products from overseas. In other words, numerous U.S. industries are facing the kind of import tide that has pushed General Motors and Ford dangerously close to receivership. Moreover, this weakness shows up in so-called smokestack and high-tech industries alike. Unless this rising import penetration is reversed, the nation's long-time global industrial leadership and all the benefits it has generated will be irretrievably lost."

The import penetration data that USBIC has looked at by NAICS industry codes indicates that the import penetration has steadily increased across the board for many industries and dangerously fast from 1997 to 2004. From 1997 to 2004, the import penetration of aircraft (traditionally an American manufacturing powerhouse) increased from 15.24% percent to 24.51 percent. Aircraft engines and engine parts suffered a greater increase—from 39.99 percent to 51.62 percent.

In the same 8-year period, import penetration rates for relays and industrial controls increased from 24.07 percent to 46.0 percent, for analytical laboratory instruments from 29.88 percent to 44.67 percent, for metal-cutting machine tools from 58.56 percent to 72.03 percent, for metal-forming machine tools from 62.72 percent to 88.97 percent, for special dies and tools from 7.70 percent to 12.53 percent and for turbine and turbine generator sets from 25.42 percent to 49.39 percent. Speed changers, high speed drives and gears, from 38.53 percent to 63.10 percent.

Many of these specific increases in import penetration over the eight year period are stunning for such a short period of time.

USBIC has written extensively on these trends and I would encourage the Commission to look at their body of work.

Globalization and the intense pressure applied by Wall Street to U.S. companies encourages indiscriminant cost cutting, a measure that frequently works in the short term, but often creates losses in the long term.

The "better, faster, cheaper" mentality sometimes sacrifices long-term gains by forcing a company to offshore work to low-wage countries in the near term. These decisions can come back to haunt a company. This is especially the case when the work acquired is of inferior quality, a critical core competency of the company is lost or the accessibility of an essential item is put in jeopardy. Many stories are known in the auto industry, but rarely will anyone come forward with their story for fear their customer will demand increased or costly inspections.

The United States does not have control over foreign shipping. Enemies can easily disrupt the economy just by sinking ships that feed the industrial base and consumer culture. The United States is vulnerable because of its dependence on foreign parts, services and fuel to maintain economic growth, not to mention military capability.

Global purchasing organizations in industry and the military are not sufficiently looking at the risks of potential disruption of supply lines. They tend to be rewarded for getting commodities less expensively, and nothing else.

In a global economy, the rules of engagement are different. Just look at the results of the brief longshoremen's strike a few years back on the West Coast and the billions of dollars per day that it cost the nation.

A Specific Military Issue

The Defense Department's Diminishing Manufacturing Sources and Material Shortages (DMSMS) program, monitors spare part shortages regardless of cause.

DMSMS is the loss or impending loss of manufacturers or suppliers of critical items and raw materials due to production discontinuance. DMSMS can be caused by rapid changes in item or material technology, uneconomical production requirements, foreign source competition, federal environmental or safety requirements, and limited availability or increasing cost of items and raw materials used in the manufacturing process.

The problem is further complicated by a reduction in the industrial base dedicated to production of military equipment. In fact, the Defense Department now accounts for less than one-half of 1 percent of total microelectronic component sales, for example. In addition, aging fleets of ships and aircraft have lost their original supplier-base of constituent mechanical, hydraulic and other components.

The DMSMS database is an example of how badly the industrial base is deteriorating. According to the Government Industry Data Exchange Program (GIDEP), in 2002, "1,523 manufacturers reported 253,832 DMSMS parts.

According to the Air Force DMSMS Guide, "In today's high-tech Air Force, the ultimate performance of aircraft, missiles, and numerous other weapon systems depends on a multitude of important and often complex components. When one of these components (e.g. a microcircuit) becomes obsolete or unavailable, the impact can extend throughout the weapon system affecting cost and system readiness." The services are all trying to "lessen or eliminate the risks caused by parts non-availability before the weapon system is adversely affected."

The commercial manufacturers increasingly lose interest in supporting the military market because it is so small. Many manufacturing companies find that it is not economically feasible to support very small volumes over long periods of time.

All the services have DMSMS issues.

As an example for the DMSMS effort at the Air Force Research Laboratory at Wright-Patterson AFB, "DMSMS impacts every weapon system in the inventory – past, present and future…."

The Air Force has said that DMSMS is driven by many factors but one reason is the extended weapon system's life in the Air Force inventory. For example, B-52s may be used more than 94 years, C-130s, more than 79 years, C-135s, more than 86 years and the F-15, more than 51 years. None of these planes was designed to fly that long.

So, mission capable systems and readiness are put at risk if DMSMS issues are left unresolved. What is not always understood is the reality that the auto industry affects DMSMS at DoD because the industrial infrastructure that supports the Department of Defense is shared by the auto industry. When a tier supplier to the automobile industry goes under whether it is a machine tool company or in micro-electronics, it reduces DoD's ability to function and solve its DMSMS problems.

Manufacturing

When government R&D investment in an industry deteriorates, it is only a matter of time before an industry is in trouble. Manufacturing R&D by the federal government is declining. According to *Manufacturing News*, "in the mid 1990s, the government was spending $1.5 billion on manufacturing related R&D, including such programs as Technologies Enabling Agile Manufacturing at the Energy Department and $500 million in electronics manufacturing programs at DARPA. Both of those programs have been discontinued."

Shipbuilding and Repair

In May 2001, the U.S. Department of Commerce's Office of Strategic Industries and Economic Security, in partnership with the Carderock Division of the Naval Surface Warfare Center, completed a three-year national security assessment of the U.S. shipbuilding and repair industry. Some of the findings were disconcerting though related to both DMSMS and the auto industry.

According to the study, employment in the industry has "dropped sharply since the early 1980s, when total private employment was close to 180,000 workers. Survey estimates indicated that employment would decline to about 83,500 in 2000." In addition, "orders for U.S. warships have declined 60 percent during the 10 years since the end of the Cold War."

Young people no longer view working in a shipyard as a viable way to make a living. Consequently, according to DOC, "survey responses indicate that labor shortages have reduced profits, impacted construction costs, and delayed project completion for most shipyards."

According to the study, the basis for U.S. ship-building superiority has been the research and development expertise that currently resides in Navy's laboratories, acquisition commands, and certain shipbuilders and universities. "Collectively, these organizations have conceived and designed most of the state-of-the-art hull, mechanical, electrical, power projection, air defense and undersea warfare capabilities that are operational today. With reduced research and development budgets, some of that capability now is becoming fragmented." Many lower tier companies supply to both the auto industry and shipbuilding, but the auto industry is much larger.

This situation in shipbuilding also exists in other industries, such as machine tools, the high performance explosives and explosive components industry, cartridge and propellant actuated device sector and welding and ***all of these industries share the bottom of the base with the auto industry.***

We need to maintain a capability to be globally competitive in product and process innovation – we must regain our manufacturing prowess and leadership. We cannot become a country that manufactures little. We need to reinvigorate the Manufacturing Extension Partnership program at the National Institute of Standards and Technology.

We need to prioritize those technologies that are critical to regaining and then maintaining leadership and competitive advantage in the overall industrial base so China does not become the world's leader in technologies we need to be a superpower. China is becoming the manufacturing capital of the world. A small example is that Chinese officials have publicly stated they want to become the foundry capital of the world to have a world-wide monopoly on cast parts. The Casting Emissions Reduction Program (CERP) of the U.S. Army is an excellent example of ways that Congress can provide mechanisms for industry and the military to work together to stem the erosion of the industrial base to everyone's benefit.
We need to increase our investment in R&D to produce the leading edge knowledge, capabilities and patents the country must have to remain an economic and military superpower. This means we must increase funding to the national laboratories not only from Energy, Commerce and Defense but across the board.

We also need to rethink our trade, offset and CFIUS policies to encourage the maintenance of high value-added jobs inside the country and we need to reform those national systems that are keeping our industry uncompetitive including pension and health care, particularly in the auto industry. The bankruptcy of Delphi is only the first of many dominos to fall if we don't do something dramatic about this situation. CFIUS must be completely rethought. Having General Motors under the control of foreigners is not the answer. Many foreign entities buy U.S. assets not to use them, but to dismantle them. Even Daimler's takeover of Chrysler removed serious capabilities to Germany, though no one will go on the record with specifics.

The Department of Defense regularly implies that the U.S. industrial base is healthy. DoD does not take into consideration all the systems that compose their piece of the industrial base, nor how their systems interact with others such as autos.

Cooperation between government and industry is essential because there are elements of the U.S. industrial base that are disintegrating, and are putting the national security of the United States at risk. Unless we look at the industrial base as a system, we do not even see the problem or the possible military implications. We also are not even asking whether or not a U.S. "owned" industrial base matters, and we must explore this issue as a nation.

The White House, Congress and the entire spectrum of the agencies and departments of the federal government need to understand these issues. At the moment they do not. Unless something changes, the U.S. may cease to be a superpower.

Thank you for listening, and I look forward to your questions.[7]

HEARING COCHAIR BLUMENTHAL: Thank you very much, Dr. Ronis. Mr. Suma.

STATEMENT OF BRIAN SUMA, U.S. ARMY, TACOM, MANAGER ARMY DMSMS INFO SYSTEM, WARREN, MICHIGAN

MR. SUMA: Good day, members of the Commission, ladies and gentlemen. I'd like to thank you for this opportunity to address the Commission on our small part in supporting the warfighter.

I currently manage a Diminishing Manufacturing Sources and Material Shortages, which we use the acronym DMSMS, or DMSMS, knowledge management system for the Army known as the Army DMSMS Identification, Notification and Flagging Operation, good old Army acronyms. This system currently supports the Army and the Department of Defense DMSMS programs.

The basic definition of a DMSMS issue is a loss or impending loss of manufacturers of items or suppliers or items or raw materials. DMSMS issues can occur at any point in the life cycle of an acquisition program. Current Office of the Secretary of Defense policies on DMSMS are contained in DoD 4140.1-R, the DoD Supply Chain Material Management Regulation.

These current policies prescribe that DoD components, i.e., the Army, Navy, Air Force, et cetera, shall proactively take timely and effective actions to identify and minimize the DMSMS impact on DoD acquisitions and logistics support efforts.

Minimizing DMSMS impact is important in that a DMSMS issue can interrupt the manufacture, fabrication, production or repair of any item required by warfighters from a major end item down through the components and subassemblies to the individual parts, and even to the specific processes, raw materials and chemicals required.

If you can't find it, can't get it, or can't support fielding or repairing it, you have a DMSMS issue and the warfighter has a problem.

The goal of the current Army DMSMS INFO system is to support the Army's resolution of DMSMS issues. It aims to provide a knowledge management approach to resolving DMSMS issues and to be a repository of DMSMS case data. We provide a comprehensive and coordinated program that supports efficient and effective resolutions of obsolescence, nonavailability and single source problems that affect the Army.

As we have developed and used this system over the last few years,

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[7] **Click here to read supplemental material submitted by Dr. Sheila Ronis on issues to be considered by the Commission.**

we have seen a marked decrease of domestic sources of manufacturing and processing and of suppliers of items, chemicals and materials that support our automotive needs and other areas where the Army has requirements.

For our purposes, a domestic source is a source that is located in the U.S. or its territories and provides items or materials comprised of U.S. content only. Availability of domestic sources is critical in assuring the Army's needs are met in a timely manner. Several legal authorities are predicated on availability and use of domestic sources.

The services have additional leverage in obtaining items from domestic sources under the Defense Production Act of 1950.

Under Title I of the DPA, the president is authorized to implement the Defense Priorities Allocation System when necessary to require preferential acceptance and performance of contracts or orders supporting certain approved national defense and energy programs, and to allocate materials, services and facilities in such a manner as to promote those approved programs.

Additional priorities authority is found in Section 18 of the Selective Service Act. I won't go into that at this point.

Obviously, the DPA and the DPAS apply only to domestic sources which point out the risk incurred by the erosion of domestic suppliers. As the number of domestic suppliers decreases, so too does the pool of domestic manufacturing capacity and capability that can be reliably called upon to support the military and the nation. Instead, we find ourselves relying on sources which may be responsive to foreign national interests and not our own.

Another piece of important litigation regarding DMSMS is the so-called "Berry Amendment." The Berry Amendment only applies to DoD. As implemented in the Defense Federal Acquisition Regulation Supplement, or DFARS, it generally restricts DoD's expenditure of funds for supplies consisting in whole or in part of certain articles and items, including textiles and certain metals, not grown or produced in the U.S. or its possessions.

Accordingly, we have seen increased use of components of non-domestic origin in DoD systems in violation of the Berry Amendment.

It is generally DoD policy to use commercial off-the-shelf items in acquisition wherever feasible. As the military selects more COTS items, it becomes increasingly more resource intensive to determine the lineage of an item. That is it becomes more challenging to track what it is made of and where it is made.

This, of course, affects availability, obsolescence and compatibility with existing systems. This is quite evident in the automotive sector where there is significant use of assemblies and black boxes in the industry produced by third tier or below subcontractors.

It is also evident in recent reports from the Defense Contracting Management Agency, DCMA, of potential violations of the Berry Amendment and of the increased concern over counterfeit parts and lack of data on how an item was actually created and where the item will be used.

It is our experience that the suppliers that DoD and Army used for procurement and sustainment have sizable non-defense businesses that make up their product mix. For example, under the tracked and wheeled sectors, there are a host of suppliers supporting both the automotive and DoD programs, providing parts such as engines, transmissions, axles, wheels, tires, brakes, et cetera. Almost every one of these corporations needs to have a sizable civilian production base in order to either remain profitable or maintain their revenues high enough to support their size.

It is my observation that the risk inherent in diminishing sources, whether they be auto parts, semiconductors, or machine tool suppliers, or tool and die manufacturers, is ever increasing. This is affecting our ability to tap into domestic sources of production especially in the event of a national emergency.

I can also state that I have received numerous inquiries from local automotive suppliers looking for military work, due to decreased orders from the automotive industry as well as the loss of military suppliers, due to their loss of commercial work. We are also witnessing partners between the organic, military, and private, commercial, sectors to enable the preservation of the U.S. industrial base as a whole.

At TACOM LCMC, we continuously witness numerous DMSMS issues that emanate directly from the loss of domestic manufacturing capability, many of which are directly related to the automotive parts industry.

Finally, I would like to thank the Commission for this opportunity to make you aware of our mission and concerns, and as a member of the Army Materiel Command's Research-Development and Engineering Command Tank-Automotive Research Development, I thank you for helping us to support the warfighter.

[The statement follows:][8]

HEARING COCHAIR BLUMENTHAL: Thank you very much and over to you, Mr. Gaereminck.

STATEMENT OF RANDAL GAEREMINCK, ASSOCIATE DIRECTOR ENGINEERING, TANK-AUTOMOTIVE AND ARMAMENTS, R&D AND ENGINEERING CENTER (TARDEC), WARREN, MICHIGAN

[8] **Click here to read the prepared statement of Mr. Brian Suma.**

MR. GAEREMINCK: I do not have a prepared statement. I'm Associate Director for Engineering, and Brian works on one of my teams, so we collaborated on the prepared testimony, but I do want to make one point. We mentioned the acronym TACOM and TARDEC. TARDEC is the R&D arm on the campus, but as TACOM, we collectively manage about 3,200 pieces of equipment. A lot of folks refer to us as "the Tank Plant," being as we had a tank plant there years ago, which we don't build anymore. TACOM manages tanks, trucks, trailers, construction equipment, watercraft, material handling, food and feeding, anything you see with wheels, track, anything on the ground. You turn on CNN at night, TACOM manages it unless it flies in the sky.

We manage a lot of contracts, a lot of suppliers. TACOM doesn't build anything. We rely on the industrial base. So it plays completely to what my colleagues here say.

Panel IV: Discussion, Questions and Answers

HEARING COCHAIR BLUMENTHAL: thank you very much to all of you. All very rich and alarming testimony. I would like to try to try to get a little more concrete in the sense of when you look at let's say a Striker or a tank or something that you can see a real direct connection to the automotive industry, do we have any idea how much today those components are Chinese made?

DR. RONIS: I have an idea. I have no data. I have discussed with the Deputy Under Secretary of Defense for Industrial Policy the fact that industry averages are probably ten to 15 percent in anything manufactured in the United States today, and they have said our ability to monitor this only goes down to about the third tier tops. We can't go any deeper because it becomes foreign so quickly, and we can't ask.

And I said, I think you really need to try to ask more. Because, the Berry Amendment tends to be enforced down to tier two, maybe tier three, but rarely below that, and I think what's happened is we don't know the answer, and DoD privately, of course, would admit they don't know the answer.

I've been in some discussions with them since I made a recommendation to the Small Business Committee in March saying they need to have a program where they start finding out the answers because what if we have to fight these people one day, how are we going to do that without any weapon systems because it doesn't take much to take down the system?

HEARING COCHAIR BLUMENTHAL: On that question, what are you or any of you most concerned about, say we need to surge in any one of these ground combat vehicles and China wants to make our life difficult, even if we're not fighting them directly, but say we need them in current operations? What are you most concerned about right now if you could think of your nightmare scenario that China can do to cause us real problems in terms of disrupting our supply chain?

MR. GAEREMINCK: I don't know if it's as much as disrupting our supply chain, but our industrial base has been shrinking for years. We build vehicles today to a peacetime Army. We're at war today, but we're recap, resetting at a tremendous pace, but we're not ramping up production as we did in previous wars, in World War II.

So if we had to ramp up to that kind of capability, I don't see the capability that we could do it in the U.S.

HEARING COCHAIR BLUMENTHAL: Do you have something to add?

DR. RONIS: I'd like to add a little bit to that. The other thing I don't know that we're thinking through is the very fact that almost all global shipping is not in U.S. hands, and much of it is in the hands of the Asians. Increasingly the Chinese themselves are buying shipping lines. And because our consumer economy and our just-in-time delivery systems in almost every manufacturing area is dependent on those shipping lines, it doesn't take much to simply stop bringing in critical parts.

It doesn't have to be a high tech part to be critical. It can be a low tech part, but without it the whole weapon system is of no value. In a project I did for the U.S. Marine Corps not too long ago in Jacksonville, Florida, I saw their bone yard filled with weapon systems. I said why are they in the bone yard, and they said, well, because we can't get the parts. So we've put multimillion dollar weapon systems into a bone yard so that we can supply the stuff coming back from Iraq with parts.

I'm sorry, but that has to be amongst the most inefficient way of ramping up because we're not even investing in low volume technologies to manufacture parts.

HEARING COCHAIR BLUMENTHAL: So the reason we can't get the parts is we can't make them here; is that right?

DR. RONIS: The original people who made those parts are out of business or gone.

HEARING COCHAIR BLUMENTHAL: And we have to buy them from overseas somewhere or?

DR. RONIS: Or try and find a way to make them, but we don't have the mechanisms in place yet to do that.

HEARING COCHAIR BLUMENTHAL: Thank you very much. I think Commissioner Wessel had a question.

HEARING COCHAIR WESSEL: Let me follow up on that because it's exceptionally troubling. If we had to expand a ground-based presence at this point--the items are in the bone yard and we don't have the ability to service them. Has what's happened with the auto industry, which is why we're here about today, but even more broadly, are we at a critical point in terms of the ability to source our military needs?

MR. GAEREMINCK: If I go back historically, post-World War II, defense was an influencing partner and industrial base. Today, we're not. We've been at relative peacetime for so long that the defense industrial base, as my colleague said, the military doesn't influence it anymore.

So, from my perspective, if we had to ramp up considerably, we go to the industrial base, private sector, to ramp up for parts, for capability, for plants, for facilities, and we're all seeing it shrink around us and disappear.

MR. SUMA: We can talk about our old numbers. One of the numbers that has been around for a bunch of years is that in the electronics industry, which is in a major move offshore, the Army or the DoD’s total use is less than one-half of one percent of that business.

We no longer have a real say in which way they're going to go. What we have to do is rely on what's there and then either as it has been brought up before, we try to reverse engineer and/or find another source or in some other way try to come up with that part because the industry has said, you're not enough business for us to worry about. So trying to come up with the source for those items is a big problem.

A long time ago there was a big controversy about grade 8 bolts, just going to buy bolts, that we got shipments of bad bolts in that were sent to a supplier here who said they had gotten the parts and that they were good parts. We bought from an American supplier. He bought them in the Pacific Rim.

We ended up with a lot of bad vehicles that were down because transmissions suddenly came out of vehicles, engines were breaking, and that’s because these bolts were not up to the standard, and this was just a standard, you know, bolt item.

There's been a bunch of stuff just recently on the Berry Amendment related to materials in our electronics items and other items, especially assemblies that are being put in at the third, fourth, fifth, sixth, seventh level tiers, vendors are putting these items in, and the manufacturer we're buying from has no idea what's in there at that level and where they got it.

HEARING COCHAIR WESSEL: So you have no ability to disaggregate a system and look at, because we're now doing commercial off-the-shelf, to be able to determine sourcing patterns and have any confidence in either where it's being sourced or at times the quality of the product that's being delivered to the military; is that correct?

MR. SUMA: For some items and some systems. Again, it's based on, at the level that you're looking at, like if you're talking aviation, there's probably a lot more than there is on what goes into a trailer.

HEARING COCHAIR WESSEL: Are you trying to as I understand the DMSMS reports, to disaggregate and do a better job of understanding or are you just hamstrung because of the way we're now procuring the items?

MR. SUMA: We make a concerted effort to find every source of information we can about an item or the pieces of item on the piece of equipment and then try to identify where that is going and where that industry is going and where that technology is going because a lot of times if you don't find out now where the engineering and technology is, when you actually need it, there's not going to be anybody there.

And that's been a big problem. We buy when we need it, and a lot of times that may be two years from where we're at now, and in those two years, that company is no longer there and when we need them. So we're trying to identify sooner what's going away and what's not available so that when we do need them, there's somebody out there, or we try to hold on to a technology that we need that we anticipate is going to be a problem.

HEARING COCHAIR WESSEL: Are you brought in under the CFIUS process? In any transaction, is there a DMSMS component to look at this? Magnequench was raised earlier today, but, going to current transactions as well, or is that it doesn't always trigger a CFIUS review? Where do you fit in that process?

MR. SUMA: At our level we're a little farther down in that process. At the DoD level, there is another group that handles stuff at that level, and at each of the individual service commands, there's someone that covers that item. DMSMS, as we like to say, is one small part of the industrial base. We're basically the ones that are looking for the hits; we're looking for the stuff that's happening right now that's going to cause a problem. One of the examples we like to use is watching that plant go down the Mississippi because of the floods, we go “there goes our plant,” we've got to do something because that was our source for that part, that item, that type of thing.

We're trying to get on top of those problems, the reactive, also trying to get into the proactive. But handling those reactive issues that are out there everyday, the guy that suddenly shuts down his small firm, we use a small business for this item, and he suddenly has a heart attack, and his wife says, “I don't want to keep the business going, we're selling it!” We've also had cases where they won the lottery and everybody quit, what do you do about that?

You've got to get that information out to everybody as quick as possible so that we can try to find another source, and the problem gets to be is, as we get less and less sources, it becomes more and more time dependent. We need to be ahead of time in order to find somebody that can do it for us, because if we're suddenly looking for something, a lot of these items, you talk a major engine effort, it may be a year to get the materials that you need to make that.

So if the manufacturer is gone, even if we get the materials, we now have to find another source to make it, it's probably going to take another year from there. So when you're talking two years before we can get something to the warfighter, he's not going to wait.

HEARING COCHAIR BLUMENTHAL: Commissioner Mulloy.

COMMISSIONER MULLOY: Dr. Ronis, you have on page two of your testimony a point that I was talking about this morning about the shareholder value, and you make the point that the CEOs of the corporations are focused on shareholder value and you say that they're not thinking about the disintegration of the U.S. industrial base.

But people who are concerned with the well-being of the United States and the national security of the United States have to be thinking about the deterioration of our industrial base and what it means both for our national security and our standard of living.

DR. RONIS: I couldn't agree with you more.

COMMISSIONER MULLOY: I understand what goes on in that the corporations are caught in a system where they're judged on shareholder value and their stock goes up. Of course, the CEO's compensation is tied to shareholder value, so they have an interest personally in increasing shareholder value, and not thinking about these other issues.

But then you get into public officials in the United States government. Why do you think in the interagency debates, thinking about trade policy, industrial-based policy, CFIUS, why is it that DoD is not playing a bigger role in making these issues that you're talking about more into the trade policy debates and understanding of what this means for our country when we have a current account deficit of $800 billion and growing annually? And then I'd ask the DoD witnesses.

DR. RONIS: I wish I knew the answer to that, but all I can tell you is it has been my observation that politics plays more of a role than the long-term interests of the nation, and that is very difficult for me to sit here and say to you.

I have watched the Department of Defense acquisition strategy basically reward people for getting anything on the planet as long as it was not illegal, flagrantly, though it might be okay if it wasn't flagrant, as long as it was cheaper. We do need to provide our warfighters the very best that the world offers them because our adversaries will, in fact, have that.

What we don't know how to do as a country is figure out how to provide a free trade environment for all companies, whether they are in the defense industry or not, without destroying our own base. Every other country on the planet has figured that out except us, and so we have been very arrogant, I think, in our approach to thinking nothing is going to take us down as a country. I think some of that is in the Pentagon. There is a lot of arrogance in the Pentagon, and yet they are my greatest friends and my greatest supporters, but I worry that we as a nation have no mechanism to do grand strategy.

We never look at all of the elements of national power and step back and say what really is in the long-term best interest of the country, and acquisition strategy inside the Pentagon is very much bounded by what Congress permits them to do or not do, and the interagency process frankly from my point of view, as a student of it, is quite broken.

CFIUS is just one of many things that need to be completely relooked at. It's chaired by Treasury. Treasury has never denied a foreign investment. Are you kidding? They love it, but then the foreigner comes in and what do they do? They just take us out and that is unfortunately too often the case.

COMMISSIONER MULLOY: Do you gentlemen have anything?

MR. GAEREMINCK: I wouldn't want to comment on Army or DoD leadership thinking. But what I can say is the last couple of years, Army, in particular, has been focused on some lofty issues. One, BRAC, base realignment. TACOM was even potentially a target; all bases were a target. And now we're at war. So, I've seen workload go up in the past couple of years. Our focus is on the soldier fighting the day-to-day war so we're doing whatever we can. I see our senior leadership, too, supporting us all they can with the necessary resources because the Army is structured, financially we're structured for peacetime.

Our budgets are peacetime. Our soldiers trained during peacetime. So this is, when we're at war, it's an increased ramped-up pace for us, and that's our focus, our only focus.

COMMISSIONER MULLOY: Thank you.

DR. RONIS: Can I add one more thing?

HEARING COCHAIR BLUMENTHAL: Go ahead.

DR. RONIS: Because he mentioned BRAC, to give you an example of one of my concerns, this issue of the people in China saying we expect to be the manufacturing capital of the world, we're going to start with just foundries and cast parts. Well, we are almost always "BRACing" low-tech bases such as Rock Island Arsenal. They are our last organic foundry other than our nuclear hulls on the east coast and they make all of our Howitzers. I would hate to be dependent on China for our Howitzers when we have to be at war with them.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you very much and thank you to this panel. Dr. Ronis, in particular, I have to say in a lot of ways you've made me and probably some of the others of us speechless, which is not an easy thing to do, but it seems to me that everything that needs to be said you've said.

The question is why are people not paying attention and what can we do to try to make people realize the extent of this problem and its consequences for us?

If I can just tie it in. Ten years ago, we started experiencing some changes in our defense industrial base and in our manufacturing base. Of course, the past ten years has seen China moving on to the stage in a scale that I think has been hard for some people to comprehend. Could you specifically talk to the particular challenges that you think that China poses to us in these issues?

DR. RONIS: Indulge me just for a few minutes. Let me explain why I think people don't pay attention. They don't pay attention because this country is not very strategic in almost anything that it does. We are a reactive mode people. Some of the spontaneity of the American people, some of the best characteristics of America are served by that.

On the other hand, we have to learn how to take a long-term view. That's very hard. Our Founding Fathers could not have possibly understood the kind of nation that we would inherit in the 21st century, and we have no mechanism in the interagency process, even at the national security level, to do long-term strategy.

The closest we come are places like the Office of Net Assessment at OSD. Occasionally, the Department of Energy will put out a forecast for 50 years, but by and large we don't have what I call the national strategy center where we inside, and I would prefer it be in Congress, not in the executive branch, we actually have people who every single year have to look out 20 to 50 years, year in, year out and say that policy isn't going to work.

But part of it is that we don't look at the second, third, and fourth order effects of any one single decision inside the Congress or how it's going to interrelate with all the other decisions because we never see the big picture, and other countries try and look at least at their big picture, where they want to be 20 to 50 years hence, and map out a strategy to get there that is integrated.

Can you do that within our federal government system? Absolutely. But the Congress has to want to.

Now, in terms of the specific challenges with China, we have to understand that the economy and the economic piece, the diplomacy, and the diplomatic piece, and the military piece are all interdependent elements of one system. You can't pull them apart anymore than you can pull apart the defense portion of the U.S. industrial base or its automotive components. The sooner we understand this interdependence, the sooner we're going to be able to develop viable public policy.

HEARING COCHAIR BLUMENTHAL: Thank you. I will ask another question or I'm going to start calling on commissioners here.

Commissioner Brookes.

COMMISSIONER BROOKES: Thank you.

DR. RONIS: Challenge me. Tell me why I'm wrong.

COMMISSIONER BROOKES: I'm not telling you you're wrong, but I was reading through your testimony, and I appreciate what you've written out here, and it's very conceptual. I wanted to know, perhaps add a little bit more flesh to the skeleton you've given us here and giving us some specifics. If the defense industrial base were to keep you up at night or concerns about it, and it might--

DR. RONIS: It does.

COMMISSIONER BROOKES: --give us, if you can, some real specifics. In the security environment we're living in today, that the policymakers in Washington should have a hard time sleeping about, like, for instance bolts on our Humvees in Iraq or strategic system or something where because you did hit that one thing that really caught me, is you said that you believe that ten to 15 percent of the general manufacturing--this is general manufacturing, not military--is of foreign origin.

DR. RONIS: Yes.

COMMISSIONER BROOKES: So what things keep you up at night? I'm pressing you here for a little bit more specifics. What weapon systems do you think are at risk, significant weapon systems, and I'll open this up to the panel if they have anything that they're really very concerned about? So we can give an example other than this sort of conceptual framework because a lot of it is not in specifics and that kind of bothers me because you always want to back up something with this is the concept and this is an example of it other than these weapon systems that are going to fly for 94 years or whatever, and I certainly wouldn't want to fly in one of those planes.

Thank you.

DR. RONIS: Clearly, some of the issues of having new equipment to our warfighter are amongst them. I'll give you one example that certainly bothers me. I wrote an article called "Transformational Recapitalization" that was published in Defense AT&L a couple of years ago. I said, the Air Force is telling us they don't have enough money for new airplanes.

They don't have enough money for the C-17s, for example, that they know they need to deploy, all of the things that they need for global logistics using that aircraft. And I said, well, here's an example where industry and government should be working together specifically. We have, and the Air Force has actually invested some money in looking at studies, the fact that there is emerging a need for a commercial C-17 use for a variety of different industries around the world.

How about if we take the first ten C-17s that were made, sell them to industry, and plow that money back into the Treasury to buy the new stuff, so the guy who is going out to Iraq has a new C-17, not an old C-17? I don't think this is rocket science, but this is something that is very doable. All we need is some congressional language. This is an example of something I think we should be doing or considering.

But we have to get out of our box in terms of that sort of thing. Things that keep me up at night, though, really have a lot to do with the covert Chinese response to many, many things in that yes, we're going to be willing to talk about import issues with regard to China parts with the EU and the U.S. and Japan and that's a great way for them to say, yes, of course, we're going to deal with it but not now. I think it's that sort of thing that really makes me nervous.

I would look at import penetration rates. In my formal testimony, not what I said, because you only give me a few minutes, I actually gave you some very specific areas where import, the federal government doesn't even monitor import penetration rates, and yet they're alarmingly, you know, they're moving at an accelerated pace. This is scary to me.

COMMISSIONER BROOKES: Can our witnesses from the Army give us any specifics in terms of weapon systems now that have a significant portion of their content that are of foreign origin? And I'm not even sure what percentage would make it significant? I suppose at what percentage? But can you give us any examples of things that you're particularly concerned about in terms of U.S. weapon systems that might be held hostage to foreign supply chains?

MR. SUMA: I can address one that has been addressed outside in another forum so it's open. There's a chemical called liquid polysulfide. It's used to hold airplanes together. It's used also to hold glass, ballistic glass together. It's also used in automobiles to hold fenders on. There was only one company in the United States that was still making it. It was bought up by a French company who basically said if you want this chemical any more buy it from our Japanese subsidiary.

That has been an issue. That was taken by the SAE Committee on Adhesives up to Congress complaining what are we going to do about holding on to these types of materials which controls all of these industries?

COMMISSIONER BROOKES: What weapon systems does that affect? Can you name some?

MR. SUMA: No.

COMMISSIONER BROOKES: Is that because it's classified or you don't know? If it's classified, I'm not asking you to divulge. I don't want you to divulge classified information. We can go back and look at these things back in Washington, but I'm asking you whether you don't know or whether it's classified information?

MR. SUMA: It's used in a lot of Army equipment.

COMMISSIONER BROOKES: It's used in a lot of Army equipment.

MR. SUMA: And a lot of other service equipment.

COMMISSIONER BROOKES: Okay.

MR. SUMA: Anybody who has got airplanes is probably using it.

COMMISSIONER BROOKES: But you alluded to the fact that there are probably other things that the Commission should look into in a classified environment back in Washington that you cannot divulge here at the witness table?

MR. SUMA: Yes, there's--

COMMISSIONER BROOKES: Okay. If we should go back and do some more homework, that's fine.

MR. SUMA: Yes There's been a couple that have been in the press lately that we--

COMMISSIONER BROOKES: I don't want you to go any further in that obviously, but I just wanted to know if there are things you think we should perhaps look at? That there might be other things out there in the classified environment which are not in the public environment that we may want to look at?

HEARING COCHAIR BLUMENTHAL: Perhaps we can actually follow up.

COMMISSIONER BROOKES: Yes, that's what I mean. We can follow up. We have clearances. We can go to a secure facility and get briefings, but it's good for us to know that we might want to do that.

MR. SUMA: Yes. A lot of the stuff I deal with is considered procurement sensitive.

COMMISSIONER BROOKES: So it is classified.

MR. SUMA: Yes.

COMMISSIONER BROOKES: Okay.

MR. SUMA: Because if I talk about it, about what one manufacturer is giving another, that has an effect on other manufacturers and who's doing what.

COMMISSIONER BROOKES: No, I understand completely.

MR. SUMA: So I tried to couch my remarks to stuff that has already been out in the environment that's everywhere and I think those are enough to get you started on the kind of things that are going on.

COMMISSIONER BROOKES: Yes, I'm not trying to press you to divulge anything you shouldn't. Thank you.

HEARING COCHAIR BLUMENTHAL: We had Chairman Wortzel and then Commissioner Houston.

CHAIRMAN WORTZEL: Mr. Suma, Mr. Gaereminck, you described a system in the U.S. that can only replace worn out items or manufacture at very low levels; enough to keep a basic force functioning, training, and perhaps minimally in combat.

You've painted a picture that says that because the United States defense industrial base has changed significantly, we no longer have a surge capacity. If we went into a major war, we are left with a one-time use military. When it gets broken or runs out of equipment, we cannot rebuild it. Is it your view that in the event of a major war, the United States could not sustain a large force on the battlefield because in critical areas, we don't have an industrial base left and because we are relying on other countries that we might be at war with?

And then for Dr. Ronis, I would be very interested if you could give us examples of the countries that have this 50 year or 25 year strategic plan that you advised that the United States should emulate?

MR. GAEREMINCK: Yes, I wouldn't want to speculate on our industrial base from my perch at Tank Automotive Command. I think that would have to be addressed levels above me in the Pentagon.

CHAIRMAN WORTZEL: That's the picture I got from your testimony. You said we can't surge. You can barely supply the forces in the field.

MR. GAEREMINCK: Yes, for those that we deal with in the automotive sector, we have limited capability. Currently, being in the engagement we're at today, we go to our arsenals and depots, which as Dr. Ronis mentioned, we've "BRACed" those over the course of time.

Our depots are working at capacity today. Now they've got to extra shifts. They're working at capacity. In fact, we're subcontracting back out to industry because we don't have the capability to just refurbish the vehicles, so we're doing what's called a reset/recap. We're bringing the vehicles back to zero miles. We're bringing our existing old vehicles back to zero miles.

Our ability to ramp up and produce new--we can't do that today. Humvee, for example, we're at maximum production on the Humvee, up-armored Humvee, so what we're doing is the vehicles, as the units rotate out of Iraq, we're taking the old vehicles back and we put them through a recap/reset, bringing all vehicles back to zero miles.

So we end up at the end--

CHAIRMAN WORTZEL: That's given current capacity?

MR. GAEREMINCK: In the current capacity, what we end up with is a brand new old vehicle.

CHAIRMAN WORTZEL: Right.

MR. GAEREMINCK: No new technology.

CHAIRMAN WORTZEL: But are you saying that the United States as a nation is no longer capable of the sort of war effort and surge that we had to have in World War II?

MR. GAEREMINCK: I don't believe we have that capability.

CHAIRMAN WORTZEL: You do not?

MR. GAEREMINCK: No.

DR. RONIS: I don't believe it either.

CHAIRMAN WORTZEL: And could not reconstitute it?

MR. GAEREMINCK: Yes. Not at the magnitude we did in World War II. It may--

DR. RONIS: Oh, I think we could do it at the magnitude we did it in World War II today. But within five years, when the baby boomer generation retires, we will not. We do not have the next generation.

CHAIRMAN WORTZEL: And what's the effect of the baby boomer generation retiring on that?

DR. RONIS: All the knowledge in their heads will be gone because we didn't have enough of a sustainable industry to entice young people to come into it.

CHAIRMAN WORTZEL: Can you give us examples of countries that have this long-term strategic plan to build or increase this capacity?

DR. RONIS: I think probably there are many. I would be very cautious, though, other than perhaps Japan's to publicly say who they are. I tend to get my information through people, sometimes even in our intelligence community who find out about them. But you got to be very careful because they are amongst the most guarded secrets of those nations, and I don't know that I want them to know that I know.

CHAIRMAN WORTZEL: So these are secret strategies?

DR. RONIS: Oh, yes.

CHAIRMAN WORTZEL: And we don't have a secret strategy?

DR. RONIS: I don't think we have any strategy, sir.

HEARING COCHAIR BLUMENTHAL: Commissioner Houston.

COMMISSIONER HOUSTON: I'm going to go home and hide under the bed when I get back.

DR. RONIS: No, you’ve got to go back and fight. That's the idea.

COMMISSIONER HOUSTON: Absolutely. I cannot express enough our appreciation for the three of you being here today. This is a completely undiscussed issue in Washington, D.C., and certainly critically important. I don't want to go back over anything that you’ve discussed already because your information has just been startling and superb, but I do have just one easy technical question.

The buzzword, of course, is "jointness," and in your estimation, is there jointness in what you're doing? If there is a non-flying widget that the Army, the Navy, the Air Force all needed at the same time, is there jointness in the purchasing? Is there jointness in the decision to purchase or where you're going, all that kind of thing? And does that help you in any way as far as purchasing in mass quantity goes?

MR. GAEREMINCK: I'll start off saying it does. 25 years ago when

I started at TACOM, we managed a large portion of the components for the 3,000 plus vehicles. Over the course of time, we went joint. Most of our secondary items are resourced out to DLA. Defense Logistics Agency probably buys--I'm not sure what the numbers are--but more than 60, 70 percent of the second, third tier type supplies. So they go out and buy them, and they buy them joint for all the services. So we've absolutely gone joint in recent years.

When an issue becomes an DMSMS issue, Brian manages the Army DMSMS INFO system, but that feeds into the joint system, so when a manufacturer goes belly up on a particular widget circuit board, the project manager notifies us, we load it to the INFO system and it goes out to the GIDEP system, the government information system, looking for an alternative source, so one of the sister services may have that circuit card that we need. So we look to that process first.

MR. SUMA: Yes. The DMSMS community within the services is very joint. We are very tight group of individuals from each of the services that get together on a fairly regular basis, if not in person, over phones or VTCs or whatever, to discuss these issues.

We all have our individual systems because we all talk individual languages, shall we say, between the services, but they all connect into one central repository which we are in the process of expanding to try to get that information and to bring it more into bearing across the different programs because we do still find some instances of where things are kept to one group and another group is interested and if we had known, we could have made things better.

So we're trying to do that. And we're using that showing cost avoidance and cost savings type issues, which are always good to get the services to talk to each other on. So, whenever we can, we show some cost savings or cost avoidance.

COMMISSIONER HOUSTON: Can I just add on to that for one second?

HEARING COCHAIR BLUMENTHAL: Sure.

COMMISSIONER HOUSTON: I'm also curious as far as CFIUS goes. Are you called to testify? Do they look to you at all? Do they know you're there on these CFIUS-based issues? And as certainly CFIUS is going through a review, which will hopefully lead to a revamp, do you have any input on that as well?

MR. GAEREMINCK: I've never heard that term before.

DR. RONIS: It's Committee for Foreign Investment in the United States.

COMMISSIONER HOUSTON: That answers the question.

DR. RONIS: That's what CFIUS stands for.

MR. GAEREMINCK: No, haven't heard of it.

DR. RONIS: I'm afraid I'm the one who regularly interacts with the Department of Defense people who are on the CFIUS committee, but they have an uphill climb because something like a critical industry for the automobile that may or may not be directly used in a weapon system is just automatically not considered. It's like, well, that's not our problem because economic security is not perceived as national security. And that's a major deficiency.

MR. SUMA: Now some of our data does go to the industrial base people who take that information up, but directly we don't deal with them.

COMMISSIONER BROOKES: I have one more question. I know we're getting to the end of this. Mr. Suma, you're the right person—please walk us through a decision tree on terms of when you've identified a disappearing capacity, industrial capacity, that you need? So in other words, I guess you probably go to the other services, you started this sort of thing, and how do you go through that? Can you walk us through that quickly?

MR. SUMA: I'll try to walk through the general one. There's a variety of different ways you can go depending on where you're at in the life cycle and whatever. But the standard one or say the most reactive one, the one that really becomes the issue that somebody has to take care of today, is we'll get a notice that the manufacturer says he's not going to make it anymore, or we've had a turndown on the bid, and they state they're not going to bid. We also put out a bid and we got nobody responding. We put that into the system.

When we get that part, we try to identify where that part goes, all the systems that's affected by that item, and if that's a certain grouping of industry, then we try to go out and then we send out message traffic through GIDEP, which is the Government Industry Data Exchange Program, saying we have an urgent data request or a source of supply need, and we send that information out to them, and try to get from the industrial base that is defense orientated first if there's any response.

We also do checks through the different publications that are out there to try to identify any source that might be in the commercial site, and then we take that information, and once we get that information, we supply all that information to the weapon system or the item manager or the production person responsible for that area, and say, “here's what we’ve found out,” “you have a problem,” “here's what we know about it,” “here's who's available,” and “now it's up to you to decide how you're going to resolve that.”

COMMISSIONER BROOKES: And there's no differentiation in that decision tree between foreign providers or domestic providers?

MR. SUMA: None at all. It's just whatever the Army needs, from my perspective, whatever the Army needs. If it's not available, I need to let somebody know that that item isn't there, and it's not just, as we say, not just parts, but processes, materials, chemicals, whatever, whatever it is that's going to stop that warfighter from getting what he needs.

COMMISSIONER BROOKES: I assume there is some preference for domestic as opposed to foreign, if there's an option? Is that in law or is that a policy?

MR. SUMA: We try to go domestic if it's available, but the problem is that some of these items, there is no domestic sources.

COMMISSIONER BROOKES: But there is a preference? There is--

MR. SUMA: With the Berry Amendment, there is definitely. On these certain areas we have to. Before we can do anything, we have to try and get the domestic sources. And second of all, we are trying to get as many domestic sources as we can because, as I said in my remarks, the DPAS program gives us some leverage back to that manufacturer to say, when he says he's going to quit making it, say, well, you need to make it for us for another six months until we can find another source or we can redesign or we can replace or whatever we have to do, that issue.

So it gives us some time to get the problem fixed before it's gone. The problem we run into a lot of times is, is by the time we find out, it's all gone. And there's no source and then we're into redesign, reengineering, all kinds of issues, trying to solve that problem.

HEARING COCHAIR BLUMENTHAL: Thank you. I'm going to give the last word to Chairman Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you again. This has been very illuminating, and I think you've given us so much to think about. But it seems to me that one of the issues that we are facing now is not only the extent to which we have lost and continue to lose our manufacturing base and the speed with which it's happening, but when we sat across the table from our foes during the Cold War, they weren't the people who were taking our production capability.

We were not worried about the Soviet Union being able to manufacture components for our weapons that we would no longer be able to get, and while I am not sitting here saying that China is a foe, the potential of it becoming one raises a whole host of concerns that I think it behooves all of us to look at much more seriously.

Thank you very much.

HEARING COCHAIR BLUMENTHAL: Thank you very much. We're going to take a five minute break and then reconvene.

[Whereupon, a short break was taken.]

PANEL V: PERSPECTIVES OF PARTS MANUFACTURERS

HEARING COCHAIR BLUMENTHAL: We'd like to welcome our fifth panel to get perspectives of parts manufacturers and we have with us today Mr. Terrence Keating, the Chief Executive Officer of Accuride Corporation of Evansville, Indiana, as well as Mr. Larry Denton, President of DURA Automotive Systems or Rochester Hills, Michigan. These two are on the front lines of the global competition and we're very much looking forward to your testimony.

So if we can turn to Mr. Keating.

STATEMENT OF TERRENCE J. KEATING, CHIEF EXECUTIVE OFFICER, ACCURIDE CORPORATION, EVANSVILLE, INDIANA

MR. KEATING: Thank you very much. First, thanks to the Commission for allowing me to come and speak today. Briefly, I just wanted to mention what Accuride is. It's a $1.4 billion commercial component manufacturer for the commercial vehicle industry. It has 17 plant sites, 4,800 employees, and we operate totally within NAFTA, which is part of my concern because my issues deal with the Chinese exporting product into the NAFTA area and the implications of that.

In our business, I think it's fair to say we have known that we have to focus on efficiency to compete against low cost countries worldwide if we're going to be effective and our investment in that has allowed Accuride to have very low cost labor and as a result my issues with China are not labor based. I can compete with them, I believe, all day long on a labor cost basis.

Just an example of some of the things we've done--one of our plants in Kentucky, we've raised the output by 20 percent while we've reduced the employment by 50 percent, and we operate at world-class metrics on all our operating metrics. But that's not enough against the Chinese threat and let me explain some of the things that are un-leveling the playing field.

First, the currency valuation. I think that's a topic we're all very well aware of, estimated to be between 20 and 40 percent. Either of those numbers would solve my competitive threat issue.

The cost of steel in China for whatever reason--lots of folks have different opinions as to what causes it--but it's $200 cheaper than the cost of steel in the U.S. That's 33 percent lower in that marketplace. Our products--I'll get into that in a bit about how that affects our business.

The inability to import cheaper steel. I can't get my hands on that steel because we have penalty tariffs in place protecting the U.S. steel industry. While we have penalty tariffs in place on steel, we don't have any type of tariff structure on steel wheels that would prevent them to come in. I'll talk about that a little bit more as I get into it.

Chinese operate with export incentives that amount to 17 percent, which I think unlevels the playing field even more and I'm not sure that's legal within WTO.

And then I want to talk about intellectual property rights as they pertain to our product line. One of the issues I was asked to address was Chinese growth and its impact on our business and it's primarily in commodity prices. Steel has gone up 60 percent over the last two years, an $86 million impact on our corporation.

Aluminum has gone up 62 percent, a $36 million impact on our corporation. And scrap metals have gone up 115 percent, and that's a $56 million impact to our corporation.

When we think about these commodity prices or passing those through to U.S. OEM manufacturers, original equipment manufacturers, for commercial vehicles, we've done about $150 million worth of commodity cost pass-through over the past two years. What that has done has caused our OEM customers to look worldwide at whether better prices are available in other locales.

One of those certainly is China where they're finding cheaper prices, having to do with the currency valuation and the Chinese government is reluctant to let the currency float effectively, the fact that Chinese manufacturers can acquire steel at prices far below our prices and therefore offset and gain a competitive advantage. That same steel cost, as I talked about earlier, is not available to us because we cannot import that steel effectively.

When we talk about tariffs on steel wheels, I'm really not an advocate of tariff structures that would prevent imports into our country, but tariffs on steel wheels are 2.5 percent. 75 percent of the cost base of the steel wheel is steel. So in effect what they're doing is we're allow the Chinese government to use their policy of employing more people, do higher value add, and bring the steel in anyway, losing both the steel jobs and the manufacturing jobs as a result of that.

When I think about the other major truck manufacturers or commercial vehicle manufacturing areas in the world, certainly Brazil is about 100,000 vehicle market, Europe is about a 250,000 vehicle market. Both protect their industries on the steel side and steel- wheel side, by a 14 to 18 percent duty on that product, which is equivalent to their steel protection. So I think what they have is a balanced industrial approach to how they're going to deal with this issue from China or other countries.

I want to talk for a moment about intellectual property rights. Last January, I was at an HDMA convention in Las Vegas, and they had a Chinese supplier displaying product at a trade show and that Chinese supplier had a product out that was a brake drum that was exactly the same as the product made within one of my companies, Gunite Corporation, had the brand name Gunite, had that name cast into the product and had absolutely no authority from my company to do so.

So not only were they copying; they were directly copying both product and brand and bringing it into our marketplace. We frequently find those products in our warranty claims area of that company trying to sort those out as we do our best to try and figure out what the impact is of their penetration into our market.

These products are eroding U.S. market share and will effectively erode jobs as they continue to grow in penetration in the market. The warranty claim costs I mentioned, there's a fair amount of cost within our company to sort those products out, to differentiate them, to try and understand them, and try and deal with this issue within our business.

The other thing that's been talked about a couple times today already, the U.S. has very strict standards relating to products that are used on highway in the United States, especially when it deals with safety issues like wheels, brakes, brake pads, as you mentioned. We've tested these products and we would find them coming up far short to the NTSA standards as far as putting that product on U.S. highway.

Wheel products go through testing, as I mentioned, and there's a fair amount of cost behind that which my Chinese competitors who copy our brands don't have to deal with.

I think the combined impact of this is to make the U.S. highways unsafe, add to our warranty costs, create a fair amount of ill will when these products fail under our brand name with our customer base, and the lost jobs associated with lost market share.

Let me get back to the issues that are affecting my business, the steel costs, the tariffs, those type of things. As we look at that, I don't understand how those tariffs are going to go away any time soon. I don't see how we're going to get control of the Chinese government to bring their steel costs up to world levels. So my company is looking very seriously at investing in China, building manufacturing facilities for steel wheels and brake drums in the Chinese market.

That's part of my responsibility to my customers to offer them the lowest pricing available in the world, but also responsibility to shareholders to continue to keep the market share we have and continue to make a profit. I think it's important to note that I'm not talking about moving to China because of labor costs.

I'm moving to China because, I think, of a manipulated commodity cost, manipulated by a number of different sources as we go forward. But at the end of the day, the impact is no less significant.

I think in our own investigation of locating in China, we found that the Chinese government intends to maintain these lower steel costs for at least five years. That's a long enough period for us to put a plant in place, export to the United States for several years, and then start producing in China for China as we go forward from there. But there are some job losses associated with that as we think about that.

I think speaking on behalf of the other U.S. manufacturers, if I can, I think we can compete with the Chinese from a labor cost perspective. We can automate. We can get that cost down to where the transportation costs will more than offset that. But we have to deal with the trade law issues, the currency issues, and the intellectual rights issue.

My fear is that in taking action through government sources, that action will come later than we can possibly live with. The jobs will be lost and I doubt that the environment created by any laws we change would bring the jobs back. So I think the need to move and act is now on so many fronts.

As I said, I've talked about a number of different issues that our company faces, and collectively they create a very unlevel playing field, one in which we find very hard to compete with the folks coming into our marketplace. We are competing with them. We haven't lost significant share yet, but it's coming.

Thank you.

[The statement follows:]

Prepared Statement of Terrence J. Keating, Chief Executive Officer, Accuride Corporation, Evansville, Indiana

Company Overview

Accuride Corporation is a $1.4 billion component supplier to the commercial vehicle market primarily serving original equipment manufacturers and the aftermarket within the NAFTA region. We operate 17 manufacturing locations within North America employing over 4,800 associates. Our facilities are located in Indiana (2), Illinois (1), Wisconsin (1), Ohio (1), Pennsylvania (1), Virginia (1), Alabama (1), Tennessee (2), Texas (2), Kentucky (1), California (1), Washington (1), Mexico (1), and Canada (1). Accuride is headquartered in Evansville, Indiana, and incorporated in Delaware.

Our company operates metal processing businesses involved in basic industries utilizing forging, casting, metal forming, metal machining, and assembly operations to produce products for commercial vehicles. We find ourselves facing enormous changes to the competitive landscape, which are driven, in large part, by impacts from Chinese producers, the Chinese government, the US Government, and the extreme growth of the Chinese economy.

In an effort offset these changes to the competitive landscape and to remain competitive in the industry, which we operate, Accuride has consistently invested significant dollar amounts into automating our facilities to reduce our operating costs. The result of these investments has been our ability to lower direct labor expense to less than 6% of our total product cost in several of our plant operations. We are very proud of this achievement; however, it falls far short of creating an effective barrier to entry of Chinese competition.

The predominant issue we face, unlike most industries, is not labor cost based. Our issue relates to the significant under-valuation of Chinese currency, the widening gap between Chinese steel costs vs. the US market, the impact of China's rapid expansion, export incentives to Chinese manufacturers, Intellectual Property Rights Protection, and the current US tariff policies.

Before addressing the specifics of the business impact, I would like to expound upon the significance of our investment efforts and the positive results that have been achieved. First, I would like to highlight our steel wheel manufacturing plant in Henderson, Kentucky. Over the past 10 years, the facility has been implementing initiatives to improve its competitive position by reducing its labor cost per wheel manufactured while achieving and maintaining world-class performance metrics. Over this period of time the facility has made significant investment in automation, trained its employees heavily, and focused its management team very effectively. The results are that the facility has grown output by 20 percent while significantly increasing efficiency and decreasing cost per unit. The facility's on-time delivery to its customers is 100 percent, the quality rating is world class with below 50 parts per million (PPM), and the safety record is running near perfect and has for several years. Most would agree these are impressive numbers, as the performance result in the Henderson facility being deemed the most productive heavy wheel manufacturing plant in the world. However, it is ironic that the most productive facility is not the lowest cost facility. The reason-- steel price in the United States.

Labor cost advantages in the Chinese market are significant and would be an issue had it not been for our aggressive investment in automation and the transportation costs from China to the US. However, the protection offered by our investment in US automation is no longer providing an effective barrier to entry.

The issue now rests with steel cost and US tariff issues. Steel cost, which comprises roughly 75 percent of the product cost of a steel wheel produced in the US, was at parity in September 2005. Since that time, the price of hot rolled coil steel in China has reduced significantly while US steel prices have risen. The effect of these price movements is that Chinese steel is now 33 percent cheaper (FOB Port of Export) than steel sold in North America. If all factors were equal, we could simply import Chinese steel and offset a significant portion of this difference. The fact is, all things are not equal.

Existing US duties on Chinese steel equate to between 30 and 50 percent, making it impossible to economically import steel from China. This duty effectively creates a price support for the US steel industry which, when coupled with our extremely low steel wheel duty of 2.5 percent, results in the unintended consequence of creating an incentive for US commercial vehicle builders to purchase steel wheel products from China. As a result, displacement occurs in both steel jobs and wheel manufacturing jobs from the US economy. Unfortunately, this situation primarily has a negative impact on the US market alone, since our duties on steel wheels are the lowest of any major economy in the world and the only economy where such a disparity exists between steel and steel components.

It is important to point out that our steel purchasing power in the world market is significant in that we purchase 350,000 tons of steel per year to support our wheel making operations alone. However, if current business economics related to the Chinese market do not shift, that number is significantly at risk going forward. It is important that I underscore the fact that the number is at risk not because of steel coil imports but because of the import of products with significant steel content.

I think it can be argued that several years ago the US economy was facing a recession in industrial production and the demands for anti-dumping duties from the US steel industry for many people seemed appropriate. In today's healthy and growing US economy the effect of the current tariffs to, on the one hand, restrict competitive steel exports from China and on the other hand, encourage and support the import of Chinese steel products which take away US manufacturing jobs.

The under-valuation of China's currency creates the third significant issue regarding the competitive landscape with Chinese products. Until recently, China has had its currency pegged to the dollar but since allowing it to "float" we have seen very little movement. While I am not in a position to debate the current under-valuation of Chinese currency, a number of experts estimate the Chinese currency is under-valued by 30 to 40 percent. This under-valuation has allowed Chinese firms to compete with Accuride despite the significant barriers to entry formed by Accuride's improved plant efficiency and transportation costs from China.

In addition to these very significant competitive issues there are additional remaining issues. The first of these adds to the competitive disadvantage of US products when competing with Chinese products exported to the US. Products produced in China for export have the added advantage a value added tax rebate reducing costs related to export production in that country by roughly 17 percent.

The second is related to the very rapid growth of the Chinese market and the resulting increase in their imports of scrap metals to support both their steel making operations and their casting operations. Scrap exports to China have risen by approximately 350 percent in just the past 5 years. This of course occurs as the US economy is coming out of an industrial recession in 2001 and 2002. The scrap metal market in the US (Cast Scrap) has risen by approximately 115 percent from 2000 to 2005 to record price of $300/ton, a record high by more than $100/ton. In our foundry operations we use 350,000 tons of scrap materials annually. As you can quickly understand our operating costs have risen by $56 million since 2000. This cost must be passed through to our customers resulting in higher commercial vehicle prices and therefore import pressures in their markets also. These scrap prices have also had a negative impact on the world steel pricing since this material is also used in several steel making operations. In this same time frame, US steel prices for hot rolled coil steel have risen from $300/ton in 2000 to $540/ton in the first quarter of this year. These costs are expected to continue to rise to $600/ton by late 2006 based on current projections.

The third remaining area of concern is the protection of our intellectual property rights. This concern manifests itself in several areas of our business. First, there is the direct copying of our products and the theft of our brand name. I attended a conference held by the Heavy Duty Manufacturers Association in January of this year and found a Chinese company advertising a duplicate product of my company's' brake drum including the design, part number, and the use of our "Gunite" brand name. As US companies have shifted production to China, a number of them including Accuride are forced to compete against duplicate products due to China's ineffective protection of intellectual property rights. It is important to understand that the product may be a duplicate in style but the quality of some of the imported product falls far short of the standards required to protect the safety of the American motorist. The warranty claims, filed as a result of these knock-off products, are creating a negative economic and safety impact. This is in addition to the resources needed to identify and segregate the counterfeit product. It is very difficult to estimate the negative impact of these knock-off products in lost market share, damage of brand name and overall value, but it is fair to say it is very significant.

In summary, the impact of the aforementioned key issues to our US businesses is that our costs are rising rapidly due to raw material cost increases. As we pass these costs through, we put our customers into the position of searching for lower cost alternatives overseas. Because of the steel market price imbalance, the very low tariff on steel wheel products from China, the currency valuation issue, and export incentives we are now facing significant competitive pressure from Chinese suppliers who enjoy all these advantages. In addition to these pressures, we are significantly increasing our sourcing to low cost countries to favorably alter our manufacturing cost in an effort to remain competitive due to the scrap metal impact on our foundry businesses.

The situation for Accuride's wheel business is such that we are forced to look seriously at relocating part of our manufacturing base to China to retain and grow market share going forward. I want to make it clear that we are looking to make investment into China to manufacture products not because of labor costs, but instead because of commodity cost manipulation through duties, because of currency manipulation by the Chinese that has gone unrecognized by our government, and because of the incentives offered in the form of value-added tax rebates. Our evaluation of this investment will also look at the Chinese market for long-term growth opportunities for our company. The impact however could be to displace US manufacturing jobs to China. The impact will be to reduce steel making jobs, foundry jobs, machining jobs, manufacturing and assembly jobs. This will lead to the elimination of white-collar jobs as they too are displaced into China.

Let me make it clear that, as CEO of a large manufacturing company, I am not in favor of tariff trade barriers as a way to keep US manufacturing competitive. I believe that as manufacturing executives, it is our role to keep US manufacturing competitive through investment and aggressive management. In speaking on behalf of other US manufacturers, we can effectively compete with foreign competition on a level playing field. However, in return, it is expected that our government and the government of our employees initiate the proper action to ensure that a level playing field is created and maintained. Without a level playing field, US industry and ultimately the US workforce is at risk. We therefore request that action be taken to remove burdensome tariffs or in the alternative provide tariffs that are consistent and do not favor one industry over another.

HEARING COCHAIR BLUMENTHAL: Thank you very much, Mr. Keating. Mr. Denton.

STATEMENT OF LARRY DENTON, CHAIRMAN AND CEO DURA AUTOMOTIVE SYSTEMS, ROCHESTER HILLS, MICHIGAN

MR. DENTON: Chairman Wortzel, Vice Chairman Bartholomew, Commissioners Becker, Blumenthal, the entire Review Commission, I appreciate the opportunity to testify today on the impact of China's policy on the U.S. auto parts industry. I personally have worked in this industry for 34 years, both as an OEM for 24 and presiding over two leading automotive suppliers for the past ten.

I'm a product of Detroit. My parents worked in the auto industry and my grandparents worked in the auto industry. I actually was born in the city of Detroit.

The impact that China has on the U.S. auto parts business continues to grow at terrific rates each year. I believe that there is immediate need for action to ensure fair and competitive playing field that benefits U.S. and Chinese auto suppliers alike.

Today, I'd like to offer my view on the current uneven competitive landscape and how this is increasingly impacting the business of DURA automotive systems and the future jobs in the United States.

Let me first provide an overview of DURA Automotive Systems. DURA is a global automotive supplier based here in Michigan. Our revenue last year was $2.4 billion. We support both the automotive and the recreational vehicle markets. We employ nearly 16,000 workers worldwide and we have operations in 14 countries including China, Mexico, Brazil, the Czech Republic and Romania.

I'm going to reference a handful of charts today--I brought Sean with me to help flip them--to illustrate my main messages. The first point is on this chart here--the strategies for geographic positioning are based on a simple principle we call multi-geographic flexibility. In simple terms, we position our manufacturing footprint to have the flexibility to offer support near our customers around the world.

We support these manufacturing facilities with global technology and development centers which are centralized. We design the facilities to supply the domestic markets they serve. Based on logistics, equipment utilization and capital costs, we are positioned to manufacture product for export, but primarily we manufacture for the region that we're in.

As we expand with our customers in new regions, we strive to gain our competitive fair share of that particular market. Let me give you a quick easy example. If I have $50 a car in one region, then I expect my team to deliver $50 a car of product in another.

In the United States today, we have 27 factories and we employ 6,200 people including our manufacturing and research and development jobs. Our primary products are safety and performance based, and include driver and seating control systems, complex glass assemblies, chassis components, automotive cable systems, lightweight body and door structures.

Our products range from sophisticated electronic and software control systems to some as simple as a stamped jack assembly that we manufacture in the United States in Butler, Indiana. Many of our products are so compact that they can easily be shipped around the world.

We anticipate that China's impact on each of these businesses will continue to grow and it's of dire importance that we establish appropriate policies and enforcement mechanisms to ensure fair and balanced trade.

Now, two years ago, I spoke publicly at one of the largest and well-known auto manufacturing conferences held in Traverse City, Michigan, that probably earned me the privilege to speak today. My topics included government collaboration with industry to ensure fair trade and a sustainable position for U.S. manufacturing.

One area I focused on was the importance of establishing a floating Chinese currency and the role that that plays in fair trade. Let's take a look at this chart which I displayed in the Traverse City conference. It shows the change in exchange rates between the currencies around the world relative to the U.S. dollar.

The first chart was a period between 2002 and 2004. As you can see, the U.S. dollar weakened 27 percent against the Australian dollar and euro, 20 percent against the pound, 16 percent against the Canadian dollar, but the Chinese yuan was a big zero.

Let me show you the change since that period, now that another two years have gone by. The Australian dollar, the euro, the Canadian dollar continue to move and strengthen against the U.S. dollar. The pound now is actually 21 percent. Even the Russian ruble increased against the dollar 12 percent. Yet the Chinese yuan is up to a sterling three percent.

Today DURA is competing for business that will start production in three to five years. So the wins and losses of our new orders from today's competitive imbalance will impact our manufacturing employment levels not just today but probably stronger in 2009, 2010, 2011. Those are the vehicles we're supplying parts and designing for today.

With the Chinese government incentives for Chinese manufacturers to export goods, the artificial currency exchange rates between the yuan and the dollar, the U.S. manufacturers are at a significant disadvantage versus Chinese suppliers.

In the past two years, Chinese bids for auto parts orders have driven customer price targets to levels below our costs in some products. It's in the newspapers. It's called meet the Chinese price. Here's an example of an automotive cable part. We make a lot of cable for driver's controls. These go on parking brakes and shifters. But to illustrate, this example, you can see our selling price was $4.50 for a typical automotive cable of which we have a profit of 35 cents, something kind of unheard of today.

The Chinese landed selling price is $3.70, of which of the 3.70, 55 cents is for logistics. If we were to balance the currency at the appropriate level, maybe just pick the level of the Australian dollar or the pound or the euro, the 30 percent, guess what? The price is the same, 4.50 to 4.50.

The U.S. suppliers have two alternatives to react to these market conditions. First, relocate assembly jobs to lower cost regions. The second is to reduce pricing and profit levels by meeting the Chinese price and reducing profit levels is not a sustainable strategy because it takes away from our ability to invest in new capital and research and development.

So the first choice is our most likely event. We must be positioned to have fair and free trade. Advocating a fair floating currency for the Chinese yuan was my main message here today. But it's the essence of the capitalistic system.

But there are other factors where our policy appears to be designed to further disadvantage U.S. auto parts manufacturers. Terry mentioned one. The U.S. places tariffs on the import of foreign steel. It has created an unfair playing field driving domestic steel pricing to all time levels.

DURA buys $130 million worth of steel. Competing parts manufacturers in China can purchase the steel at lower pricing levels and import the finished product into the U.S. tariff-free. So we get the steel anyway. It just comes in a part and we get the hit of jobs. When you combine this disadvantage with the currency issue, you get what I call a double-whammy. In my view, if the U.S. wants to spread capitalism and free trade, we should start by demonstrating with removal of the tariffs.

Chairmen Becker and Blumenthal, I want to thank you and the entire Commission for providing me this opportunity. I look forward to your questions.

[The statement follows:][9] and [10]

Panel V: Discussion, Questions and Answers

HEARING COCHAIR BLUMENTHAL: Thank you very much to both of you. Mr. Keating, you mentioned some of the things that I think that the U.S. government could have policies that actually would help out with such as IPR and currency. Both of you mentioned currency. Tariffs on steel is another one. But I'm wondering if you can answer this?

The cheaper commodities in China, which you said, Mr. Keating, is one of the reasons you're needing to go over there, is that something we can do something about as a government or is it, how much of it is just the fact that the Chinese market for these commodities is so big? Is there something that the U.S. government can actually take--they're the ones I could understand the U.S. government could take action on, but maybe you can explain the cheaper commodities question a little bit more.

MR. KEATING: Currently, there is an 17 percent incentive for exports coming out of China, the U.S. government could, in fact, do something about. I think the other cost structure issue is behind steel. There's been a lot in the press in the last few days about whether China is controlling prices in that industry, whether they're forgiving debt, that type of thing. I really couldn't articulate on the issues within China that are controlling their steel costs to that level.

But I do know that if we go to a non-tariff structure, the price will level out worldwide.

HEARING COCHAIR BLUMENTHAL: Non-tariff structures here?

MR. KEATING: Tariff structures into the U.S. that will eliminate the $200 differential, whether China raises their costs or whether the effect of allowing Chinese steel into the U.S. that would lower U.S. steel costs, either way, it would level the playing field from my perspective.

HEARING COCHAIR BLUMENTHAL: Do you have a comment on that, Mr. Denton?

MR. DENTON: Personally, I'm against tariffs. I don't think that ever levels the playing field. I think capitalism works in a free market and

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[9] **Click here to read the prepared statement of Mr. Larry Denton**

[10] **Click here to view the slide presentation of Mr. Larry Denton**

a free market means that your currency has to move based on the productivity of the nation, and we've got a situation here where the currency is absolutely pegged and not moving regardless of the astronomical growth that they've had in that country.

HEARING COCHAIR BLUMENTHAL: Actually Chairman Wortzel had the first question.

CHAIRMAN WORTZEL: Thank you. We have sat through testimony by dozens of economists and financial market managers, and this is the clearest example and explanation of the effect of tariffs and yuan pricing that I've ever seen. I hope you can get it to Washington, D.C. and show it to Schumer and Graham. It will reinforce their argument.

MR. DENTON: Thanks.

CHAIRMAN WORTZEL: Some of what Mr. Suma said earlier resonated with me. He talked about the problem of quality control in bolts that were supposed to high quality steel. Let's assume they came from a large country with a big wall that's on the Pacific Rim. You talked about the problem of these brake shoes and other automotive parts that are coming in.

First of all, how did these counterfeit parts came in? Did they come in by sea? Were they container shipped? Did they come through U.S. ports? Did U.S. Customs help you at all to identify the fact that there were huge quantities of fake auto parts coming in with your name and brand and even numbers on them out of China?

As corporation or as an industry, in general, do you work with private security firms to check on fake stuff entering the supply chain out of China or other places in the world?

Does your industry have a quality control testing mechanism that you use to spot-check products you manufacture or buy from China? Do you routinely check to see the quality of the bolt, the steel, or the brake shoe?

Finally, if you decided to transfer manufacturing to China, how would you ensure that the product you're putting out there is using adequate materials?

I'm really asking a series of questions that talk about the whole supply chain out of China and how they affect safety and security here in the United States.

MR. KEATING: Let me try and take those in order. First of all, the product is coming in by cargo container. Initially U.S. Customs did not catch it because they were totally unaware as to whether or not we had a manufacturing location in China.

Once they were aware of it, they're helping us find that product as it comes in. We do use private investigator firms to go out and find out which distributors in North America are, in fact, handling this product. Of course, it's difficult to tell since it looks exactly the same as ours and carries the brand name. So we have some difficulty in getting to the bottom of that.

As far as going to China and spot-checking product quality, certainly, if we're buying any product from China, we would make sure the quality control standards are there before that product left China, but if we're making in China, one of the things they want very much is for us to bring our processes to China, which would allow them to make about a ten percent lighter-weight wheel, lower processing costs, higher quality levels.

And, of course, we have the same issue that everyone has with respect to intellectual property. If you take it over there, you're going to be competing against it very quickly, but I know that wheel technology isn't rocket science and it's certainly not something that is top secret, and if we don't take it there, someone will, so our issue is to get over and get involved, not only in the potential to export at current steel costs, but the idea also that the commercial vehicle market in China is going to double or triple over the next six or seven years as the automotive industry is, and we want to be part of that growth as we go forward also.

So there are several reasons to do it, but that product would be assured to be running to the process controls that we operate as a company because we're going to have our brand name on it. We would protect that very selfishly.

Okay.

HEARING COCHAIR BLUMENTHAL: Chairman Wessel.

HEARING COCHAIR WESSEL: Let me follow up if I could on Chairman Wortzel's question because I think it opens up an important area and I think Commissioner D'Amato raised earlier this morning the question of how does this product come into the country and what can we do about it? We've all talked about an IPR case and the question of taking it to the WTO. The fact is we can take unilateral action against pirated and counterfeit products. The law exists now that they can be confiscated at the border and that you can seek compensation without having to go to the WTO.

When your private investigators find this product, are you able to find out who the importer of record is? Is Customs assisting you in any of that work? Somebody here has to import it as record. The pier’s data base has a list of every bill of lading and where it's going to, what its destination?

It seems to me that if we put liability on those importers of record who are bringing the product in with clear knowledge that it's not a valid part, that we might be able to have a better enforcement mechanism than we currently do. Can you give us a little more information about how you find out how this is getting in, et cetera, et cetera?

MR. KEATING: We first find out who, in fact, is handling the product and selling it.

HEARING COCHAIR WESSEL: So the retail distributor.

MR. KEATING: Yes. And then we go into legal actions with that company. We usually find out the importer of record and work with U.S. Customs to stop that activity at the border and then we're back into China trying to stop the actual manufacturer of the product.

HEARING COCHAIR WESSEL: But what are you doing to the importer of record? Do they just get off scot-free? What do they say? Do they say we didn't know? How do they react?

MR. KEATING: Basically I didn't know. We have not taken any kind of prosecution action towards them at this point.

HEARING COCHAIR WESSEL: Do they have any ongoing duty to monitor the continuing sale? I assume that many of these importers are fairly large importers of record and probably are dealing with a lot of other pirated parts. Is the government assisting you in any way there?

MR. KEATING: Only through Customs. I have not asked for any other assistance. If there is other assistance available, I would appreciate knowing about it.

HEARING COCHAIR WESSEL: But when you say Customs, you mean for identifying just your product that may be coming in again?

MR. KEATING: That's correct.

HEARING COCHAIR WESSEL: Is the industry doing anything to say we're going to monitor this importer of record? I guess we share your frustration, what can we do about this? The law is pretty clear; if product is coming in, it can be confiscated at the border.

MR. KEATING: Right.

HEARING COCHAIR WESSEL: If somebody is ordering that product with knowledge, they should be liable as well.

MR. KEATING: I agree. Proving that knowledge is a difficult thing to do though.

HEARING COCHAIR WESSEL: Is the auto parts industry doing a lot more in that area?

MR. KEATING: The HDMA is working very focused--

HEARING COCHAIR WESSEL: I'm sorry. What's the?

MR. KEATING: Heavy Duty Manufacturers Association is working on this issue, counterfeiting overall. It's a big issue for all the member companies within that organization. We're all collectively trying to put pressure on importers of record and the U.S. government to get this whole process slowed or stopped.

HEARING COCHAIR WESSEL: And where do you think Customs places this in terms of priority? How has their responsiveness been to you?

MR. KEATING: Verbally it's been fine. I can't tell what action they're doing behind the scenes. They're not finding a lot of the product, but then they've got a massive job given all the product coming through ports today.

HEARING COCHAIR WESSEL: And from a business perspective, you have to do warranty service--

MR. KEATING: Exactly.

HEARING COCHAIR WESSEL: --because it's your name that's out there?

MR. KEATING: It also is one of my better investigative areas to find out where the product is coming from. If I can then trace it back to the customer who sent the product back, I can find out where they bought it possibly and get back to the distributor. So most of the investigation is internal to the company.

HEARING COCHAIR WESSEL: Thank you.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Mulloy.

COMMISSIONER MULLOY: Congressman Kildee submitted some testimony--he and Congressman Upton. This is a Democrat and Republican--chairing the House Automotive Caucus, and they mentioned the exchange rate issue. The other issue they say is China in 2003 accounted for 60 percent of all counterfeited products coming into the country. So this is a China issue as well.

Earlier in our hearing today, Mr. Belzowski testified that we need to make an example of companies that, quote, "knowingly purchase and distribute counterfeit components in this country."

Since I think this is both a public health and a public safety matter, these counterfeit goods coming in. Would you gentlemen think that the law should be strengthened, that we should put criminal penalties on people who are involved, knowingly bringing in these counterfeit goods into the country?

MR. KEATING: Yes, I would support that.

COMMISSIONER MULLOY: What about you, Mr. Denton?

MR. DENTON: Yes, I would support it personally. The order of progression from OEM, from a tier one perspective, most of our products are life of the product. What you normally see from China is they come in first with the replacement product because they know there's an ease of entry there.

It's very difficult to sell illegal product to the OEM. They have qualifying tests and so forth. So I don't personally see that in our business, and we make a shifter, when you buy a car, you expect to have the same shifter for the life of the car. So we don't see it there. What we see is that, you know, people manufacture shifters and ship them here at ridiculously low price or we hear you need to meet this Chinese price to continue your business. It's a different situation for us.

COMMISSIONER MULLOY: You both talked very much about the exchange rate issue, and I agree, I think it's a huge problem. I was reading about a recent meeting of the NAM, the National Association of Manufacturers, and the big split that took place in this meeting between the multinationals who don't feel the same concern about--

MR. DENTON: The OEMs, yes.

COMMISSIONER MULLOY: --and the smaller companies who say it's killing us, can you help me understand why the multinationals have a different perspective on this issue--

MR. DENTON: Yes.

COMMISSIONER MULLOY: --than the guys who are making things in the United States.

MR. DENTON: It's real simple. They're going to wait five years to the Chinese car comes and then you'll start to hear it.

COMMISSIONER MULLOY: Yes, but why? Why do the multinationals have different perspective?

MR. DENTON: Because there are no Chinese cars in the United States today, so they don't have direct competition. In fact, they're able to use this for leverage in lowering prices so it works to their advantage for now.

MR. KEATING: I think what I would add to that, the multinationals are looking to invest in China, so if you change the cost of investing in China, then they're against that at the present time, whereas we're seeing them more as a competitive threat, and the issue is working against the NAFTA market for products coming into this market. It's two different areas of interest.

COMMISSIONER MULLOY: You both think this exchange rate issue and the fact it's so unbalanced is kind of a really a national problem for the United States?

MR. KEATING: We've already seen an example of what it is. I mentioned that the steel is 30 percent cheaper in China.

COMMISSIONER MULLOY: Yes.

MR. KEATING: Fix that problem and it's not.

MR. DENTON: Let me give you another simple example. See these glasses here, they're made in China, I have to use them to read now. I buy them from street vendors in China. I like to negotiate. So you go there and, of course, if I'm in China, I'll try to buy ten at a time. But rather, you know, my negotiation techniques in the rest of the world has always been at the 11th--I don't want to give this away--but at the 11th hour, I'll say, okay, I'll pay you in U.S. dollars, and I'll demand another ten percent down.

When I tried this the last time I was in China, the street vendor looked at me and said I don't want the dollar. He even knows which is more valuable. But somehow we're missing it here.

COMMISSIONER MULLOY: So this gets into the issue of is there something operating in the multinationals and their focus on shareholder value makes them different from the national interest that you guys perceive? Just give me your comments on that.

MR. DENTON: Say that again, please.

COMMISSIONER MULLOY: Here's my view, and I just want to check it against you who are out there in the business world. The multinationals are so focused on share value and the CEO's compensation which is tied to shareholder value, that they tend to lose the focus on the national interest because they're so focused on the interest of the shareholder value, and that this then makes them lose sight of the national interest which you guys who still make stuff here are much more sensitive to.

Is that a realistic understanding of what is going on here?

MR. KEATING: I think it's a fair statement of what I see. First of all, multinationals because of the very term are going to have manufacturing locations around the world. They're not going to have a specific national interest of any magnitude because they've got to worry about keeping everything in balance between all the countries around the world.

I think shareholder value, I mentioned it in mine, I'm very focused on shareholder value, but my market is NAFTA, and the issue I have is China trying to move products with I think an unequal playing field into this marketplace. So I'm very nationally focused right now.

MR. DENTON: I don't know if I completely agree. We're a multinational global company so I could manufacture the product in China and ship it here. This is going to change quickly. This year it's projected the Detroit auto show will have 20 percent Chinese participation. If that starts to happen in a big way, just like the multinationals today complain about the value of the yen--I didn't put the yen up there--versus the dollar, they'll start to complain against the yuan.

But for today, they don't see those vehicles coming in, and what they do see is the ability to lower their costs. I don't know if it's shareholder value as much as survival now in the U.S. auto industry. Everybody has their back against the wall and we're looking at what to do to survive, and I'm not so certain people have taken a four or five year view. We're looking at what we need to survive for the next six months to a year.

So I think that mentality is there, and that China to them today helps the six to 12-month position, but I think it's going to be a real issue for everyone later on.

The other point I want to make because I'm not certain it was clear from my text, there are two effects that go on here. To stay in this business, the model life of a vehicle is five years, so very simple math, 20 percent of all your business goes away every year as an auto supplier. So you've got to go out there and get 20 percent of your business to break even four or five years from today. The orders I sell today we make for '010, '09, '011 type of time frame.

I don't believe U.S. auto parts manufacturers are getting that type of order book. So what we're seeing today is just the tip of the iceberg to what's going to happen in '09, '010, and '011, and those aren't published results. No one with a public company is going to stand up and say I'm going to be 20 percent smaller in '010 in the United States. It's just not a statement that's public.

COMMISSIONER MULLOY: Thank you very much for your testimony.

HEARING COCHAIR BLUMENTHAL: Thank you. We're going to move on to Commissioner Houston, but first we're going to assume that all those glasses you bought in China are not knockoffs.

MR. DENTON: I'll sell you some if you happen to have any yuan in your pocket.

COMMISSIONER HOUSTON: Mr. Keating, you brought up the point about warranty issues, and I've actually asked this question before of panelists, and the answer I think is no, but I'd like to hear it from your perspective.

On the liability issue, I go to Joe's Garage, and I get a new wheel, and as I drive home, it falls off my car, I crash into the wall, and I get hurt. It is proven somehow that this is your part, but not really. You know you can prove that it really came from China, that it's a pirated wheel, it's not really your wheel, but the trial lawyer chasing my ambulance down the street tells me I can come sue you anyway, even though you didn't produce the wheel.

Is that true? Is there any statutory liability protection for you as a manufacturer against any damage that might occur because of a knocked off or a pirated product that has your name on it?

MR. KEATING: I think it would be up to us to prove that we did not manufacture if it we were able to do so because if we can't, we do have liability.

COMMISSIONER HOUSTON: Assuming that you can't, let's say you can prove that this is not your part that came out of your plant, that it came out of somewhere in China or anywhere else in the world, do you have liability protection somehow?

MR. KEATING: I don't see that I would, but I can't answer that because I'm not a lawyer.

COMMISSIONER HOUSTON: Is that a fear that you have, that this at some point could happen?

MR. KEATING: My fear is that we would not be able to identify the product. They're getting very good at copying. If you put the products I mentioned side by side on the floor, there wouldn't be anybody in this room including myself that could tell you which one I made.

COMMISSIONER HOUSTON: And the quality is the same or different?

MR. KEATING: No, the quality of the material inside is different, very different, and they just look the same. We define the difference by metallurgical testing.

COMMISSIONER HOUSTON: Right. So then hypothetically you could prove that it was yours?

MR. KEATING: I count on the fact that we can tell that it's not our product.

COMMISSIONER HOUSTON: Yes.

HEARING COCHAIR BLUMENTHAL: Anyone else? Thank you very much for a very educational and insightful testimony.

We're going to take five minutes until we start with our last panel at 3:15. Thank you.

[Whereupon, a short break was taken.]

PANEL VI: PERSPECTIVES OF TOOL AND DIE MANUFACTURERS

HEARING COCHAIR WESSEL: Thank you to our last two witnesses. It has been a long day and we appreciate your being here and your perseverance. Both of you have been in the audience for some time.

For our last panel today, we have the owners of two family-held businesses from Michigan. As we will hear, the specialty tool and die making is one of highly skilled artisans who learned their craft over years of work. Their skills are critical in manufacturing many auto parts as well as in the aerospace and defense industries.

Laurie Moncrieff is President of Schmald Tool and Die in Flint, Michigan. Mark Schmidt is President of Atlas Tool, Incorporated, of Roseville, Michigan. We will proceed in the order introduced—you will be permitted seven minutes for your oral testimony. Your comments will be made part of the record, and we look forward to your testimony.

STATEMENT OF LAURIE SCHMALD MONCRIEFF, PRESIDENT SCHMALD TOOL AND DIE, INC., FLINT, MICHIGAN

MS. MONCRIEFF: Our company was actually founded in Burton, Michigan, which is right by Flint, in 1948.

Our initial operations were focused on General Motors' tooling needs in Flint, and I'd like to add on behalf of Mark and I that they always say that they save the best for last, and we hope we were worth the wait.

Every product that is manufactured is formed by a tool, die or mold. The self-sufficiency of U.S. manufacturing rests squarely on the shoulders of a strong domestic tooling industry. The majority are small family-owned businesses with approximately 27 employees. The auto industry accounts for more than half of U.S. tooling consumption.

Over 28 percent of the country's toolmakers have shut their doors in the past few years. Michigan has over 900 tool and die businesses, the largest concentration in the U.S. Companies are facing fierce foreign competition as the OEMs are purchasing parts, tools, dies and molds in China for as much as 35 percent less.

U.S. tool companies are paid on the average 55 to $65 per hour for an extremely capital-intensive business. Compare that to a computer tech with a screwdriver charging a hundred plus an hour. The squeeze is not just coming from the automotive manufacturers themselves, but is also being mimicked throughout the tiers. Many part suppliers expect the tool and die company to supply a tool that is built to stamp high volumes and needs little maintenance and expect to pay the same price they get from China.

The Chinese build tools that require more maintenance as labor is cheap in their country and in many instances do not use robust steels. They supply a cheaper tool that can be built for less, yet customers put their prices against ours.

Also, in many instances, payment terms are different. Chinese companies require that the tool be paid for many times in full prior to shipment from China. In contrast, the U.S. tool shops are forced to wait months or years to get paid. Besides all the other subsidies discussed today, I'd like to point out that the Chinese government pays for approximately two-thirds of their companies' equipment.

China's strategy has been to keep the currency low, boost its exports and hold down imports and peg their currency. Companies that relocate to China can benefit from currency manipulation and that subsidy with low labor costs, and Chinese products become irresistible. An investment in the country becomes extremely attractive.

The very policies and practices that benefit large manufacturers are destroying small companies like mine. The government and the multinational companies seem to view small companies and the labor force as an expendable commodity.

Patents are not prevalent in our industry, but we have experienced selling automotive instrument clusters to Southeast Asia. These customers buy just one. Once a big part of our business, we have lost that entire market to our overseas competitors. They are draining our knowledge to develop their own market.

The result of the 3-2-2 hearing before the ITC in October of '02 for our industry was that the government will help us export. They do not want our products. Their goal is to make their own. One of our customers also experienced the theft of their product when their Chinese tool source built a set of tools for the customer and one for themselves. The cost of intellectual property theft, as previously discussed, is astronomical and growing.

Since the early '90s, foreign automakers began to locate their production plants here in the U.S., predominantly in the South. Thankfully, our companies developed some contracts with the transplants, but the ITC reports that transplant vehicle manufacturers tend to import tools, dies and molds from their country. NAM noted that 36 percent of companies have jobs that go unfilled due to the lack of qualified applicants.

The problem will only get worse as baby boomers retire. The massive closure of die shops has been a deterrent to younger workers entering this field. Many of the companies that have closed could not afford to train their employees in the new skill sets, thus, many job applicants are not qualified.

Our industry needs employees with experience but also computer and advanced manufacturing skills. Training institutions cannot afford to purchase the equipment required to train and locating qualified instructors is difficult. Most tool and die shops stopped training years ago because the automotive companies would entice their employees to leave as soon as the apprentices were trained.

Frequent layoffs and high turnovers have also added more training costs. Fewer vocational schools and high schools train in machining, which leaves the new generation much less prepared in core skills than their predecessors. In 1997, China established Mold City to train in mold design manufacturing and other activities related to industrial molds.

China's industry is benefiting greatly from the state-run educational system. Technical schools in China train hundreds of students on advanced machinery and computers. Universities focus on tool and die research and other advanced training and design.

Many of our U.S. manufacturing hardware and software companies have donated equipment to the Chinese universities. If in fact our country is going to open the floodgates to trade, we need to be willing to assist U.S. companies in training our employees to be the best in the world.

We are the only industrialized country that does not have a manufacturing policy or plan on how to compete. I recently read a copy of India's manufacturing plan and it appears as though they have figured out everything that the U.S. has forgotten.

It's time to take steps to revitalize manufacturing. Congress and the administration must act against China's WTO violations and currency manipulation if we want manufacturing to survive. Our country is obviously viewing China as a big potential market, but it is deplorable to develop markets at the expense of the rest of the supply chain with virtually no plan on how to preserve jobs.

We are not asking for protectionist trade policies but a level playing field. We need to look at the effects that trade policies are having on our country, not just the effect it has on the stock market. Through my involvement in the United Tooling Coalition and a variety of local and national organizations, I am working with other shops on how we can survive.

It is my opinion that our government is the one that has been complacent, turning their blind eye to China. They need to catch up with the rest of us in the manufacturing that have been fighting for our lives and get their house in order.

Excuse me. I turned the page too fast. The decline of our industry does not just have adverse economic impacts, but also has grave national security implications. In the short-term, constituents need to urge their congressmen to support H.R. 1498 to bring trade cases against countries like China that manipulate currency, and we need to discourage support of the Oman, South Korea and Peru trade agreements until we are ready to enforce the existing ones.

We also need to insist that permanent most favored nation treatment not be granted to Vietnam, which is coming up for vote shortly. I appreciate the opportunity to testify before this committee, and I'm happy to answer any questions.

Thank you.

[The statement follows:]

Prepared Statement of Laurie Schmald Moncrieff, President Schmald Tool and Die, Inc., Flint, Michigan

Good afternoon. I am Laurie Moncrieff, third-generation owner of Schmald Tool & Die, Inc., located in Burton, Michigan. My grandfather established Schmald Tool & Die more than sixty years ago. Our initial operations were focused on General Motors (GM) tooling needs in Flint. Today, our employment is currently at 30, and our primary focus is the production of dies, molds and other precision tools utilized to produce parts, as well as machinery. We service the tooling and machining needs for such vital industries sectors as automotive, medical, electronics, and home products.

I serve on the boards of the Genesee Regional Chamber of Commerce, the Michigan Manufacturers Technology Center, the Michigan Chamber, the Mott Foundation, and the Mott Community College M-TEC Center, and am active in the National Tooling and Machining Association (NTMA).

As a supplier to the U.S. auto and auto transplant industry, I appreciate the opportunity to discuss China's impact on the U.S automakers and the devastating effect it has had on the tool and die industry across the country and especially in Michigan.

Overview of Tool & Die Industry

In the face of intense global competition and rising costs, I am very concerned about the state of manufacturing in this country and particularly for the tool and die industry. Every product that is manufactured is formed by a tool, die, or mold made by our industry. Manufacturing companies like mine contribute more to the economy than just employment and spending. The self-sufficiency of the U.S. manufacturing sector rests squarely on the shoulders of a strong domestic tooling industry.

Our $40 billion industry employs 200,000 workers in 11,000 companies across the nation (Bureau of Labor Statistics data - 2005). Tool and die makers are some of the best-paid workers in the country, making approximately $47,000 per year. The majority of our operations are small, family-owned businesses with an average of 27 workers. In fact, ninety percent of all tool and die shops employ less than 50 people.

According to the International Trade Commission (ITC) report on the competitive conditions of tools, dies, and industrial molds, the largest single user for tooling products is the motor vehicle industry, which accounts for more than one-half of all tooling consumed in the United States

We are facing challenges as never before. Nearly three million manufacturing jobs have been lost since 2000. Nationwide, the National Tooling & Machining Association estimates that 28 percent of the country's toolmakers have shut their doors since 1998. The estimate by Plane Moran is that by the end of the decade, China's expansion in tool and die could cause the loss of over 900,000 industrial jobs in the U.S.

Michigan Tool & Die Industry

Because of its close ties to the U.S. auto industry, Michigan is still the largest tool and die state in the country with approximately 900 operations. Sixty out of Michigan's 83 counties have some tooling presence, with the majority of shops are located within the Grand Rapids and Detroit metropolitan areas.

As of January 2005, there were only 39,000 tool-and-die workers in Michigan compared to 2000, when there were more than 57,000 workers. (Michigan Labor Market Information Office). At this rate, foreign competition and technological change could eventually kill half of all Michigan tool-and-die jobs just as the state has lost half of its manufacturing operations since 1998.

Why this huge loss of tool and die jobs? There is a direct correlation to the loss of auto-related jobs in Michigan and the loss of tool and die employment. Critical industries supplying the auto industry -- tool and die shops, forging shops, foundries, and machine shops -- are all facing tremendous foreign competition. The original equipment manufacturers (OEMs) are purchasing parts, tools, dies, and molds at cost savings of at least 35 percent (or more) compared to domestic suppliers. Customers are paying tool and die companies somewhere in the range of $55.00-$65.00/hour for their services. Compare that to an auto repair shop or a computer tech charging $100.00+/hour. Tool and die companies pay much higher wages and are very capital intensive. The squeeze is not just coming from the automotive manufacturers themselves, but is also being mimicked throughout the tiers creating a no-win situation for the entire supply chain.

Many parts suppliers expect the tool and die companies to supply a "Class A Tool" (a tool that is essentially built to enable them to stamp millions of parts and requires little maintenance), but demand to pay as much as 35% less, or the same price they would be charged for a tool from China. The problem is that with U.S. wages, administrative costs, the high investment in equipment and the exorbitant cost of doing business in the U.S., there is no margin for the U.S. supplier of the tool.

We have seen the tools that some of our customers are bringing in from overseas and we are certain that if we were allowed to build to the same standards, we could be competitive. However we are not given the opportunity. We have asked if we could change our standards to match that of our overseas competitors and were told "no way". The Chinese build tools that require more maintenance (as labor is not an issue in China), and in many instances do not utilize the robust steels that are used in U.S. tooling, thus they are selling a cheaper product, or a tool that could be built for significantly less.

Factor in the subsidization of the Chinese government paying for two-thirds of equipment used in their shops, no environmental standards, and low wages, it is clearly not a level playing field. Also in many instances, payment terms are different. Chinese companies require as much as 90%, if not 100% of the tool to be paid for before prior to shipment from China. In contrast, the U.S. tool shops are forced to wait months and in some instances years, if ever, to get paid on their tools. Bigger businesses are essentially forcing small businesses to carry their debt.

As component industries and design work follow assembly lines to China, key elements of the U.S. industrial base are beginning to erode. American plastic-molding and machine-tool industries have shrunk dramatically. When our industry companies go to make their sales calls, they find their traditional customers have gone out of business, moved to another country—most likely China—or are unwilling to make the new investment in sophisticated and productive equipment.

One small die shop in Portage, Michigan lost 30% of its business due to the recent outsourcing of the Big Three automakers to China. The owner estimates that labor costs in China are one-tenth as much as those in the United States.

This is a huge National Security risk as the tool and die industry is the same industry that provides the means to produce defense parts. The Department of Defense has been aware that there are production issues regarding obsolete components and subsystems. Only recently is there a growing realization that there is a problem with heavy manufacturing. The Defense Department is a relatively small buyer in the scheme of things and does not buy tools and dies every day, therefore it is only until they need to buy replacement parts do they realize they can no longer purchase critical components and tooling in the United States. The majority of metal castings needed in the U.S. come from China and other third world countries.

With the unrest we are seeing in the Middle East and problems with North Korea this does not lend for a good nights sleep in my opinion. As was pointed out in The commissions 2005 summary "The U.S. Treasury Department has identified a Chinese bank alleged to be involved in money laundering related to activities that could be financing North Korea's nuclear weapons program". In other words we are helping fund North Korea's nuclear weapons program by growing China's economy, and if we needed replacement parts for our tanks I'm sure China would be glad to oblige.

China and Impact on U.S. Auto Industry

Today, the largest investments made by the automotive industry have been by General Motors (GM). GM reports that it has approximately 13,000 employees in China and operates seven joint ventures and two wholly owned foreign enterprises. It has participated in investment of over $2 billion in China. Last year, GM announced that it "expects to increase its original equipment parts purchases from China… from $200 million in 2003 to $4 billion in 2009." By 2009, GM expects to spend around $10 billion on sourcing for its China production.

While China's economy continues to prosper with low cost exports and major foreign investment in its automotive sector, the U.S. assembly and auto parts industries have been hit hard. Earlier this year, GM and Ford announced that they would be eliminating 60,000 jobs and at least 28 plant shutdowns across the country. Flint, Michigan, once the epicenter of General Motors' manufacturing operations, is a mere shadow of the boomtown it used to be thirty years ago. In the early 1990s, over 50,000 Flint residents were employed in the manufacturing sector. Current government statistics peg the number of manufacturing jobs at 22,000 – a decrease of 50 percent in fifteen years.

China is now a major supplier of automotive parts in the United States. The majority of the nameplate automotive manufacturers and parts suppliers have set up operations in China, and parts from those operations are increasingly being exported to the U.S. for assembly plants or for suppliers that integrate standard parts and components into customized modules for final assembly.

It is obvious that China's economic strategy over the past decade has been to keep the value of its currency low, boosting its exports and holding down imports. It is indisputable that there is no free market for the yuan. Despite rapid economic growth, rising productivity, soaring exports, and huge foreign investment inflows – all factors that would normally cause a currency to appreciate – China has kept its currency pegged at approximately 8.25 yuan to the dollar since 1994. This is a critical factor in the huge U.S. trade deficit with China, $220.077 billion in 2005, and in the relocation of so many large domestic manufacturing enterprises overseas.

Companies relocating to China can benefit from the currency manipulation that is, in reality, a tremendous subsidy. When this subsidy is added to the very substantial differential in labor costs between our two nations, Chinese products become irresistible, and it makes investment in Chinese manufacturing extremely attractive. The very policies and practices that benefit large manufacturers are destroying small companies. It as if our government, and the multinational companies, view small companies as a rather expendable commodity.

It is interesting to note, by the way, that in India's "National Strategy for Manufacturing" published earlier this year, the Indian government speaks to the point that manufacturing is essential to growing their economy. The report states that by increasing manufacturing in India, it will also allow them to grow their service sector. In addition, the report highlights the fact that "the small and medium industries form the backbone of the Manufacturing Sector not only in their country but even developed countries, ensuring the competitiveness of the small scale sector is important as it would help in overall growth of the manufacturing sector and also the National Economy." Somehow our government has forgotten this important lesson that we learned during the boom times of our industrial revolution.

Although in the tool and die industry we have very few patented products, we have experienced Asian companies buying automotive instrument cluster molds from us, that were at one time a large portion of our business. In every instance these clients would purchase one mold. They would reverse engineer the mold and never buy another. We have lost all of that business today to overseas . Although this is not an example of truly stealing intellectual property from a legal stand point, they are no doubt draining our knowledge to develop their own market. The Commerce Department needs to stop trying to convince us that we will eventually export to these countries… they do not want to buy from us they want to make them in their country.

We also had a customer that decided to purchase tooling for a new product from China, and the Chinese tool source built a set of tools for their customer and set for them. When the new product was rolled out on the retail shelf there were two identical products side by side. One produced by the U.S. company that held the patent, and one by the Chinese tool source. I'll bet you can't guess which one was the cheapest! Both the USA Today study as well as the American Society for Industrial Security estimates that the cost of intellectual property and trade secret theft was in excess of $59 billion in 2001, and will exceed $250 billion by the end of the decade.

The domestic tool and die sector, as a subset of the auto industry, has felt the pain of China's manufacturing boom, low labor costs, and currency manipulation. In 2002, China machine tool sales passed the United States in the process of becoming the largest consumer of machine tools in the world China's machine tool consumption continues to be 60 percent above that of the United States. At my company, our sales to Delphi and GM have decreased from 95% of my business to 1%, in the last several years.

To combat the loss of work from the Big Three, many tool and die shops such as mine, have gotten a short-term boost by repairing work that was outsourced overseas. In many instances though, the cost to fix the problems went well beyond the original price the customer thought it would save. Many of us are traveling to Southern states to develop new clients to fill the void in automotive work, but this is extremely costly and time consuming. Companies that are still supplying the current U.S. Automotive Industry are being squeezed to the extent that there is virtually no margin. The new big business model in the U.S. is clearly pay Chinese wages and charge U.S. prices. That philosophy is destroying the supply chain. The multinationals are out to please Wall Street, while the silent majority is struggling to survive. This is very short term thinking.

Impact of Transplant Motor Vehicle Manufacturers

Since the early 1990's, we have seen a huge shift in the structure of the U.S. automotive industry. Foreign automakers, or "transplants," began to locate their production and assembly plants here in the United States. With the downsizing and closure of domestic assembly plants primarily in Michigan and Ohio, foreign plants are continuing to open in other locations, such as Kentucky, Tennessee, the Carolinas, and Alabama. Thankfully, our company has developed some contracts with the transplants and in fact, are now are doing work for Toyota, Honda, BMW, Hyundai and Mercedes. However, this has not been the case for many of my competitors. They point to the fact that many of the Japanese transplants receive tooling from Japanese based companies, so U.S. companies don't receive the parts business or machining business. In fact, the ITC report on the competitive conditions of tool, dies, and molds noted that transplant motor vehicle manufacturers tend to import tools, dies and molds from their home country, displacing work from North American companies.

Survival: Importance of Training and Investment

A study by the National Association of Manufacturers (NAM) noted that 36 percent of companies have jobs that go unfilled due to the lack of qualified applicants. The problem will only get worse as a seasoned workforce of baby boomers retire with relatively few workers in the pipeline to replace them. If the current trends continue, experts estimate that the U.S. will face a shortage of roughly 13 million qualified employees by 2020.

The massive closure of tool and die shops in the state of Michigan has been a real deterrent to younger workers entering this field. This shortage means that we are not able to train the next generation of the skilled workforce in order to compete and survive. Dave Martin of Accu-Mold Inc. in Portage, Michigan said the average age of his worker is now forty-five. Just five years ago, the average age was thirty. Many of the companies that have closed have not changed the way they do business, nor have they trained their employees in the new skill sets, thus the majority of employees we see apply for employment are not qualified.

We need employees who have years of experience in the industry, but also who possess a strong mechanical and mathematical aptitude, as well as computer skills to utilize simulation software, 3D design software, and are knowledgeable in CNC programming. It is a challenge. Unfortunately it is cost prohibitive for the majority of training institutions to have the types of equipment required in a high technologically advanced job shop and there are great challenges in finding those that possess the necessary skill sets to train. Unless you are working in the field and keeping up with the latest technology you are falling behind. We find a tremendous gap between what is being trained today and the skills that are required to survive.

Tool and Die companies years ago used to teach the trade in house but many companies found that as they trained apprentices large automotive companies would entice those employees to leave for better wages. It became too expensive for small shops to pay to train for their customers. Some estimates are that training costs in our trade have increased by as much as 30% from 1999-2001. Also, the highs and lows of the industry are unlike anything we've seen in the past. It has always been a feast and famine business. However, we are feeling peaks and valleys like never seen before, and coupled with the slim margins, companies are now forced to do more and frequent deep layoffs to survive.

When you add the current turnover experienced, and the costs of continually training and retraining new employees it has been devastating to many companies. Vocational schools and high schools that trained in machining in the past have dropped courses due to budgets cuts which leaves the new generation of employees much less prepared in core skills than their predecessors.

China has made a point of assisting in education and supporting the industry, according to the ITC report from 2002. In 1997 during the 9th Five-Year Plan, the Chinese Ministry of Light Industry and Yuyao Municipal People's Government, jointly established Mold City. Its purpose was to build a large industrial area for mold design, manufacturing, training and other activities related to industrial molds. The project began with a$115 million investment and an additional $48.9 million followed in 2000.

The Chinese tool and die industry benefits greatly from China's extensive state-run educational system. Many technical schools in China are well equipped with advanced machinery and computer systems. Universities focus on tool and die research and development and offer advanced training in design. The National Die and Mold CAD engineering research center at Shanghai Jiao Tong University is very well known.

The schools in China are training hundreds in the trade. China understands that it is imperative to grow and retain the industry that enables them to produce products. As a matter of fact due to the recent bid a U.S. firm made to purchase a large Chinese equipment manufacturer, which China is trying to block incidentally, a new policy document was published by the Chinese calling for special government protection and support for machinery and capital-equipment industries "that affect economic security and national defense".

If in fact our country is going to open the flood gates to trade we had better step up our game to compete and be willing to assist U.S. companies in training our employees to be the best in the world, just as China is doing. The United States, including our government has become complacent, and I have heard statements uttered from our government on how Americans are the best in the world, they'll find new jobs, invent new products. Americans are resilient and will survive this economic transition. I do not agree if policies continue to be stacked against us. When is our government going to acknowledge the loss of jobs and lowering of the wages that are occurring in our country? We are the only industrialized country that does not have a "Manufacturing Policy" or plan of how to compete.

Conclusion

It's time to take steps to revitalize manufacturing. Congress and the Administration must take action against China's WTO violations and currency manipulation if we want manufacturing to survive in this country. It is obvious that with lopsided trade policies, surging prices for raw materials and relentless competition from China and other low-cost markets, small manufacturers have been squeezed.

The Bureau of Labor Statistics found that out of a net loss of 27,000 manufacturers' establishments from 2001-2204, 90% were companies or individual plants employing fewer than 250. This whole issue boils down to the Chinese market that had 27 million cars on the road in 2004 and could reach 130 million in the next 15 years. But it is deplorable to develop markets at the expense of the rest of the supply chain and with virtually no plan how to preserve jobs in the United States. We are not asking for protectionist trade policies, but rather a level playing field and an honest look at the affects that trade policies are having on our country, not just the affect that it has on the stock market. Large manufacturers are benefiting from the very policies and practices that harm small companies. This phenomenon has divided U.S.-based manufacturers in an unprecedented way as is evidenced in the recent debate over China currency manipulation legislation at the National Association of Manufacturers.

Through my involvement in the United Tooling Coalition and a variety of local and national organizations, I am working with other tool and die shops on ways we can survive in this ever-changing global economy. Our industry is taking steps to revitalize manufacturing in this country, but we cannot succeed if the government turns a blind eye to China's unfair trade practices. Multinationals need to realize that someday if China shuts the doors on their products, they may have a tough time finding the skill sets that they need to manufacture in the U.S. Small and medium-sized manufacturers need help to compete. It is time to wake up in the U.S. and take a hard look at the realities of the impact that China is having on our country. The decline of our industry does not just have adverse economic impacts but also has grave National Security implications.

I appreciate the opportunity to testify before this Commission and am happy to answer any questions.

HEARING COCHAIR WESSEL: Mr. Schmidt.

STATEMENT OF MARK SCHMIDT, PRESIDENT ATLAS TOOL, INC., ROSEVILLE, MICHIGAN

MR. SCHMIDT: Thank you. Atlas Tool, Incorporated was founded in Roseville, Michigan in 1962 by my late father. We have 265 people and we are a leader in the manufacture of automotive stamping dies. We also provide prototype parts and contract machining.

Almost everyone here has ridden in a vehicle with parts made by dies from Atlas Tool. Over 95 percent of our employees are highly skilled. Our specialized ability to apply high technology has also led us to become a machining subcontractor for some notable government projects such as the F-22 Joint Strike Force Fighter and all of the major rotational parts of the space shuttle main engine. Sometimes tool and die is rocket science.

We are also a leader in the application of new technology to our industry. We are currently working on research projects with the Center for Automotive Research, NIST-ATP, the University of Michigan, the Auto-Steel Partnership and various software manufacturing companies.

I want to give you a little bit of an overview of the importance of the die industry before we talk about China. The modern tool and die industry is based on the application of high technology.

In the last 20 years, many manufacturing innovations and technologies have been introduced and incorporated by our industry such as computer aided manufacturing, design and engineering; electrical discharge machining; laser cutting of sheet-metal parts; computer aided solid model design of tools; computerized simulation of sheet-metal formability; and white light scanning, which takes three-dimensional pictures of solid objects.

The ability to produce advanced tooling is vitally important to the economy of the United States. Tools, dies and molds are used to produce virtually every manufactured product. The method and execution of tooling controls the cost, quality and efficiency of the production process.

A capable tool and die industry gives the United States an incredible advantage in the ability to efficiently manufacture a wide variety of products. When the Second World War started, we tooled up the Arsenal of Democracy with unbelievable speed. We were not able to do this because of an abundance of cheap labor. Our accomplishments were based on the wealth of knowledge to apply civilian tool and die manufacturing concepts to military hardware.

Recently, while on vacation, I toured a plant where old or damaged Bradley fighting vehicles are rebuilt. People in the tooling industry sometimes take odd vacations. But not surprisingly most of the management people I met had previously worked in the tool and die industry, and the jobs they were performing in that particular plant were ones we could also do in our plant. The tool and die industry also provides excellent employment opportunities. Proficiency in the tool and die trade takes over ten years to acquire.

Training begins with four to six years of on-the-job training and in our company over 90 credit hours of college classes. Tool and die employees sometimes continue their education and receive associates or bachelors degrees in engineering. In fact, many manufacturing engineers and managers have tool and die backgrounds. Because of their rigorous training and unique skills, die makers are usually well compensated. I personally believe their intense training and the rarity of their skills justifies their income.

The tool and die industry is faced with overcapacity resulting in severely depressed pricing. One of the main reasons for this overcapacity is increased foreign competition and our customers' desire for the lowest available price.

The highest levels of tool and die knowledge today are based in the United States, Canada, Western Europe and Japan. These countries are not a competitive threat since their costs are very similar to ours and local companies usually have an advantage because of better understanding their customer and shipping costs.

Many nations, especially in Asia, want to enter this relatively exclusive club because they realize it's important for their future and they have a long-term coordinated strategy.

Unfortunately, in our industry, low initial costs do not transfer into the low total costs. Our industry has had many cases of tools and dies made in Asia, which were built improperly which had to be fixed at an expense far greater than any money that would have been saved. However, still these low bids have eroded our pricing structure of the U.S. tool and die companies and make it nearly impossible for us to be profitable.

More specifically, the threat imposed by China. The Chinese government has targeted investment in its tool and die industry in recent years. The majority of China's major tool and die plants did not exist ten years ago. Many economists and industry experts claim that the Chinese government has subsidized this growth by providing capital equipment and plant facilities at little or no cost to these new companies.

I'm not an expert on this so I'll let others speak to that point. I do, however, know that these plants are equipped with modern tools and have a large number of employees who earn ridiculously low wages by American standards. They also do not enjoy the benefits that American employees enjoy.

At the present time, the skill and technology in China is far behind that of the United States and other major tool producing companies. A Chinese die shop would employ three to five times as many people to produce our annual volume of work. But this inefficiency can easily be hidden by their sub-dollar an hour wage rates.

In fact, I was told by a former official of the Chinese government that they want to promote excess employment in the tool and die industry so that they have more skilled jobs and more trained people for the future. The Chinese are working diligently to learn and I feel their main means of learning is to form partnerships with high tech companies.

Our company has been encouraged to do this by some of our customers. I fear, however, the Chinese companies will abandon their partners and replace them in the marketplace as soon as they have learned enough from them. For this reason, Atlas Tool has avoided seeking partnerships with low-wage countries.

Many economists also believe there is a currency manipulation problem. Again, I leave this to the experts. I think that in the future, Chinese wages will certainly increase quicker than wages in the rest of the world. This coupled with their labor inefficiency could some day make their tools more expensive than ours.

It is imperative for the United States to have a healthy tool and die industry. Our position as a high-tech manufacturing country depends on it. The loss of tool and die employment would also be detrimental and I believe the Chinese are currently working and planning to become a dominant force to take over this industry.

When that happens, we will be powerless to control our own tooling and production costs and we will be completely at their mercy. The tool and die industry is a technological leverage point for American manufacturing competitiveness.

I thank you for the opportunity to testify today. I welcome any questions you have and I appreciate your indulgence in letting me go a minute over. I'm sorry about that, but I tend to be long-winded.

HEARING COCHAIR WESSEL: Thank you.

MR. SCHMIDT: Please feel free to contact me should any questions come up at a later date.

[The statement follows:]

Prepared Statement of Mark Schmidt, President Atlas Tool, Inc., Roseville, Michigan

<u>Company History and Brief Overview</u>

Atlas Tool, Inc. was founded in Roseville, Michigan in 1962 by my late father. We have 265 people and we are a leader in the manufacture of automotive stamping dies. We also provide prototype parts and contract machining. Typically, it requires between three and six different dies to complete a part. Almost everyone has been in a vehicle with parts made by dies from Atlas Tool. We are considered a leader in the application of new technology. Over 95% of our employees are highly skilled in the specific disciplines used by our industry.

Our specialized ability to apply high-technology has also led us to become a machining subcontractor for some notable government projects. We machined large turbines for the "F-22" Joint Strike Force Fighter, and all of the major rotational parts of the Space Shuttle Main Engine.

We are currently working on research projects with the Center for Automotive Research, NIST- Advanced Technology Program, the University of Michigan, the Auto-Steel Partnership, an equipment manufacturer, and four software development companies. In every year since 2001, our industry has faced extreme overcapacity and severely depressed prices. Some of the reasons for overcapacity will be addressed later in this testimony.

<u>The Importance of the Domestic Tool and Die Industry</u>

The modern tool & die industry is based on the application of high technology. In the last 20 years, the tool and die industry was at the forefront of many widely-used new manufacturing technologies. Some of these technologies are: Computer Aided Design, Manufacturing, and Engineering (CAD/CAM/CAE); electrical discharge machining which cuts steel with an electric arc; laser cutting of sheet metal; computer aided solid-model design of tools; computerized simulation of sheet-metal formability; and "white-light" scanning technology which takes 3-dimensional pictures of solid objects.

The ability to produce advanced tooling is vitally important to the economy of the United States. Tools, dies and molds are used to produce virtually every manufactured product. The method and execution of the tooling controls the cost, quality and efficiency of the production process. The North American Tool & Die industry is especially adept at this type of process development.

A capable tool & die industry gives the United States an incredible advantage in the ability to efficiently manufacture a wide variety of products. When the Second World War started, we tooled up the "Arsenal of Democracy" with unbelievable speed. We were not able to do this because of an abundance of cheap labor. Our accomplishments were based on the wealth of our knowledge to apply civilian tool & die manufacturing concepts to military hardware.

Recently, while on vacation, I toured a plant where old or damaged Bradley Fighting Vehicles are rebuilt. They are made I found the plant had assimilated and organized the most appropriate technologies into their process. Not surprisingly, most of the management people I met had previously worked in the tool & die industry.

The tool & die industry is also provides excellent employment opportunities. Proficiency in the tool and die trade takes over 10 years to acquire. Training begins with four to six years of on-the-job training and over 90 credit hours of college classes. Tool and die employees sometimes continue their education and receive associates or bachelor's degrees in engineering. In fact, many manufacturing engineers and managers have tool & die backgrounds.

Because of their rigorous training and unique skills, diemakers are usually well compensated. Their earning potential is often greater than that of a bank executive. While a diemaker's earning potential may surprise many people, I personally feel that their intense training and the rarity of their skills justifies their income.

Tool and Die Industry Today

The tooling industry today is faced with overcapacity resulting in severely depressed pricing. One of the main reasons for this overcapacity is increased foreign competition, and our customer's desire for the lowest price.

The highest levels of tool & die knowledge and technology today are found in the United States, Canada, Western Europe, and Japan. Companies in these areas compete very closely since they all have similar cost structures, but local companies usually have an advantage because of the costs and delays due to long distance shipping. Also, tool makers in each region are more familiar with their local customers' specific needs. . The U.S. competes well tool & die companies in these advanced regions.

Many nations, especially some in Asia, want to enter the relatively exclusive club of tool & die excellence. They realize the importance of a world-class tooling industry to their economy, and they recognize that they will need a long-term, coordinated strategy. Although they possess lower technology and experience, this is more than compensated by their wages. Our company's customers have been impressed with their low bids, and are encouraging their tool & die suppliers to develop partnerships with companies in low-wage regions.

Unfortunately, in our low bids do not often translate into low total tooling costs. This is due to mistakes made by inexperienced companies. Many of the tools placed in low-wage countries have performed poorly. The US tool & die industry has worked to repair tools improperly made by so-called "low-cost" countries. The need for these repairs has often been much more costly that the amount which was saved by the low initial bid. There are also costs of delayed vehicle launches, increased tool maintenance and lower productivity.

Some of the companies that have suffered the most from these problems have made policies requiring their tools to be made in North America. A study currently in progress by the Center for Automotive Research in Ann Arbor, Michigan has estimated that placing work with low initial bids results in life-cycle costs which are actually 38-43% higher than work which is placed in a collaborative manner with high performing suppliers.

Most customers however remain enamored with the promise of low prices made by bidders from low-wage countries. Another facet of this problem is fragmentation in our customers' organizations. The Purchasing Department employees may receive large bonuses for the cheap initial placement of work. Costs due to poorly built tools are often suffered by Manufacturing, Engineering and Sales Departments.
These low bids have eroded the pricing structure of US tool & die companies, and make it nearly impossible for us to be profitable.

The Threat Imposed by China

The Chinese government has targeted investment in its tool & die industry in recent years. The majority of China's tool & die plants did not exist 10 years ago. Many economists and industry analysts claim that the Chinese Government has subsidized this growth by providing capital equipment and plant facilities at no cost to these new companies. I am not an expert on this, so I will let others speak to this point. I do know however that these plants are equipped with modern machine tools and have large numbers of employees. These employees earn wages that are ridiculously low by American standards. They also lack almost all of the benefits American employees enjoy.

At the present time the skill and technology in China is far behind that of the major tool producing countries. I spoke with a man who was formerly employed by the Chinese Ministry of Machinery and Tooling. After visiting our company, he said that a Chinese die shop would employ three to five times as many people to produce our annual volume of work. This inefficiency is easily hidden by the less than dollar-an-hour Chinese wages, there no motivation for them to improve labor utilization. In fact this former official told me that the Chinese government wants to promote excess tool & die employment to provide more skilled jobs.

The Chinese are working diligently to learn. Their main means of learning is to form partnerships with high-tech companies to learn their methods. I fear however that Chinese companies will abandon their partners as soon as they have learned enough from them. They will then use their new knowledge and low wages to replace their former partner in the marketplace. Again, I am not an expert in this area, but I am certain that many others can testify to this point. This is why Atlas Tool has avoided seeking partnerships with low-wage countries.

Many economists also believe that China is manipulating its currency to gain price advantages. Again, this is not my field of expertise, but if it could be stopped, our price-competitiveness would benefit.
In the future Chinese wages will certainly increase much quicker than in developed countries. This, coupled with their labor inefficiency, could make Chinese tools much more expensive than those currently produced in the US.

Conclusion

It is imperative for the United States to have a healthy tool & die industry. Our position as a high-tech manufacturing society depends on our ability to efficiently produce products of all types. The tool & die industry provides this expertise. Without a world-class tool & die industry, we will lose our manufacturing advantage. We would also suffer a great loss to our ability to produce the equipment necessary to defend our country.

The loss of tool & die employment is also detrimental to our economy. Tool & die employees are highly trained, skilled people who are compensated accordingly. Without a healthy tool & die industry, hundreds of thousands of people would be forced to seek lesser employment.

I believe that the Chinese are currently planning to become a dominant force in the world-wide tool & die industry. They can use their current low-wage advantages to drive companies in other countries out of business. When this happens they can dramatically increase their prices because they will have little effective competition.

In the future their wages will increase much faster than ours, and their tools will be more expensive than those currently produced here. Unfortunately the domestic industry may be gone in the time it takes for this to happen.

If China is allowed to dominate the tooling industry, the United States will be powerless to control our tooling and production costs. Also, China will use its new tool & die skills to benefit its own industries rather than ours.

The tool & die industry is a technological leverage point for manufacturing competitiveness. As representatives of our government and guardians of America's future, I ask you to take all appropriate steps to keep this essential industry alive.

I thank you for the opportunity to testify today, and I welcome any questions you may have. Please feel free to contact me in my office if you need any further information.

Panel VI: Discussion, Questions and Answers

HEARING COCHAIR WESSEL: We will do so and thank you. If you could give me somewhat of a picture of both of your companies? What's the average age of your workforce? Are new people coming in? You talked about the apprenticeship program and how, I guess, the Big Three had stolen some of those employees. With their downsizing, are they giving them back now and is there any work for them? As a family-owned business, you're not subject to the same market pressures, although clearly you have banks and other financial pressures.

How does that figure in? If you could talk a bit about your businesses and how you may be somewhat different than others?

MS. MONCRIEFF: Actually that's not a true statement that we don't have financial pressures.

HEARING COCHAIR WESSEL: No, I meant from stockholders. You may have family stockholders.

MS. MONCRIEFF: I purchased the company from my father for

$1.3 million six years ago. So I was not a gifted child.

HEARING COCHAIR WESSEL: Understand.

HEARING COCHAIR BLUMENTHAL: You seem very gifted actually.

HEARING COCHAIR WESSEL: I meant the--

MS. MONCRIEFF: So, no, actually I think we have more financial pressures because the larger the company the more they are able to withstand all the pressures that we're feeling now out there in the market. I mean bigger companies can absorb it more so than we can.

HEARING COCHAIR WESSEL: But in terms of how you do return on investment, understanding it's your investment, but are you able to look a little longer-term? Are you subject to capital constraints?

MS. MONCRIEFF: Oh, yes, all of us in our industry. It's everybody in the industry. I think a year ago the average profit was a half a percent in tool and die. It's that bad. People are either breaking even or losing money in the industry, and the problem, as I see it, and I've had four companies call me in the last four months, including someone's mother, who said her ex-husband and two sons had 160 employees, they're down to the three of them. And they can't afford to be in business. They have next to no business and they don't even know how to get out of business because they didn't plan for their futures.

What I've found, and it's been astounding to me, I didn't come from the tool and die industry--I have an engineering degree; I worked for Fortune 500 companies--what I found is that years and years ago, the tool and die industry was a very lucrative business, and I can look at my father. He was a second generation, and excuse me, Mark, if you're second gen, but he did not plan and make investments. Their thought in the back of their minds was that we have this trade, this invaluable trade, we have this equipment, you know, and our customers just love us. 95 percent of my business was GM direct when I bought the company. It's now one percent.

So they banked on the fact that that business would keep walking in the door, and when they got ready to retire, they would sell the company. The only thing they have now, tool and die owners, you have skilled employees, you have a building and equipment, and you have customers. The equipment is changing so fast that most of the equipment most those companies own is worthless.

They would get auction or gavel price. If they go out of business, their employees go find another job or--many of my employees actually as I went through a transition phase left and they go into insurance, they become truck drivers. They've been so disillusioned in this business that a lot of tradesmen get out of it.

But in other words, they've worked and built up this company that's pretty much worthless and they didn't plan for the future. There's a lot of destitute tool and die owners out there from what I've seen and have personally talked to.

HEARING COCHAIR WESSEL: If we had to ramp up production for whatever reason--let's talk about a conflict--would you be able to find the skilled people to bring in and do the work that needed to be done? Again, what age are we looking at? Are we at risk not only because of the financial pressures, but because of the downsizing of the industry, of losing capacity that we can't ramp up with a surge need?

MR. SCHMIDT: I'm going to go back to your last question. We are in quite a different position. Being a family-owned business, you are correct in your assumption. We are immune to the short-term pressures. I have an engineering degree and an MBA and I don't use the MBA so much, especially not the finance part.

But we are looking at the long term. We're not looking at quarterly profits. It's one of the reasons we're staying out of China is because we want to survive in the long term. Until 2001, from 1962 until 2001, nearly 40 years, our company had never had a losing year. We didn't have a lot of years where the return was very great, but we had consistent returns of usually the single digits and the percentage points on sales, almost always the single digits.

Since 2001, we haven't made any money. In 2001, we had 350 employees. Today we have 265. We have never in our history until even including today laid anyone off. We've kept people employed and done whatever we could to stay busy. So we have contracted and not replaced people that leave our industry because they want a different profession, they retire, for some other reason they don't work out. We have just organically contracted to this point.

But we consider the losses we've suffered since then to be an important investment in our people which are our most important resource. Our average age is increasing dramatically because we haven't hired any people, and unfortunately our costs are increasing too, because generally in our trade, newer people start with lower wages and learn from the other people.

we don't have that many newer people. So the other people's wages keep going up. Training is not a problem for us. We do our own training; we prefer to do our own training. We don't want people that are trained in other places because we have special methods to do things and we want people to learn our way.

HEARING COCHAIR WESSEL: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: thank you very much. I have two separate questions, one for each of you. One to Mr. Schmidt. I actually don't think it's so strange to visit a Bradley vehicle.

I would do that on my vacation.

MR. SCHMIDT: On your vacation?

HEARING COCHAIR BLUMENTHAL: Yes. That's I guess if you're in the policy field, you take strange vacations as well. You said earlier in your testimony that you machined large turbines for the F-22, you looked at the Bradleys and saw that a lot of them were tool and die industry.

The employees who had shifted, if I understood you correctly--I don't know if you heard the testimony earlier.

MR. SCHMIDT: Yes.

HEARING COCHAIR BLUMENTHAL: Okay. Do you share that assessment? The F-22 is obviously something we're building in the future. Is that something that we have the capacity to do continue at the stated aspirations of the Defense Department?

MR. SCHMIDT: That's difficult for me to speak to. We only made a few parts on the F-22, maybe about five or six of the major large turbine rotors. And we don't make them on production basis. A company with a different skills--

HEARING COCHAIR BLUMENTHAL: Right.

MR. SCHMIDT: --different priorities makes them on production. We made the pre-production samples for that that they based--and then they take our data, our information, and then give it to a production-oriented company that produces those, and I don't know what their capacity is to produce those parts.

We only can produce very few of them. We are not the company that could do production of the F-22.

HEARING COCHAIR BLUMENTHAL: Take the Bradleys; you say that basically the tool and die workers are really a dying breed, if what I--

MR. SCHMIDT: Yes.

HEARING COCHAIR BLUMENTHAL: --so is that something that say Bradleys are something we're going to need looking out.

MR. SCHMIDT: I don't know how you'd make them without a tool and die industry.

HEARING COCHAIR BLUMENTHAL: So this is a very immediate problem in the sense that you can't--

MR. SCHMIDT: I believe it is.

HEARING COCHAIR BLUMENTHAL: --you need to train tool and die makers today in order to keep making Bradleys in the future?

MR. SCHMIDT: I'm involved in a symposium that's hosted by the Center for Automotive Research in Traverse City, Michigan in August. That symposium has the title "Will There Be a Domestic Tool and Die Industry Ten Years From Now?"

HEARING COCHAIR BLUMENTHAL: And if there is no tool and die industry, there are no Bradleys?

MR. SCHMIDT: the consensus is probably not.

HEARING COCHAIR BLUMENTHAL: Thank you.

MS. MONCRIEFF: Yes. The tool and die industry, we make the tools so the stampers can make the parts.

HEARING COCHAIR BLUMENTHAL: Right.

MS. MONCRIEFF: So we're further down the tier yet, and the further down the tier, the bigger the squeeze.

HEARING COCHAIR BLUMENTHAL: I'm focusing on defense items--but do you think that without the tool and die people trained in these skills, how will we continue to make Bradleys?

MR. SCHMIDT: I don't know. If you look at the 1920s in the United States, the economy was booming. People were making lots of cars, all kinds of things. Nobody was making tanks. Nobody was making destroyers. Nobody was making fighter planes or bombers. No one was doing any of those things. The government didn't to pay for a dormant industry for products they didn't need.

A lot of people were involved in making cars. Then in the late 1930s and early 1940s, people started to need these things, and they took the same skills, the same people, they knew how to weld, they knew how to tool things, they knew how to put things together. Just moving something that's huge is a special skill. You cannot take an untrained person and move something that weighs 80,000 pounds, just moving it. You have to know what you're doing just to move something like that. And that's just an example of one of the skills that you need.

But being able to weld and machine and all of the different disciplines that that takes, we converted immediately to that production during the war as an industry and then immediately afterward away from it to civilian production, but again using the same skills.

HEARING COCHAIR BLUMENTHAL: And we're currently at war, but you've seen no attempt to think about how to ramp up in case we need to in terms of producing these particular vehicles; is that correct?

MR. SCHMIDT: I don't know that we need to ramp up production of military hardware at this time. That's not an issue for me. It doesn't seem to be needed. It's just a risk in case sometimes we do. I can't tell you if that's needed or not, but what I want to impress on you, it isn't just defense. If we lose the tool and die industry, we lose our expertise in being able to make things.

If we are not good at making things, that has serious consequences. That means we're going to be a second-rate manufacturing country. We can't compete on the basis of low wages. And if we can't compete because we can make things better--DURA can compete fairly well, as Mr. Denton pointed out, with the Chinese. They're fairly close to the Chinese in cost and he feels currency manipulation is the only difference.

The reason for that is DURA employees make a lot more in the United States than Chinese employees do, but the reason for that is that DURA employees in the United States know how to make things a lot better. And if the American tool and die industry disappears, we will have to go to China to get our tools and dies and be happy with whatever they give us at whatever price they charge us.

Keep in mind when they have a monopoly-- they might be cheap now--they won't be cheap then. Sorry.

HEARING COCHAIR BLUMENTHAL: Thank you. Commissioner Mulloy.

COMMISSIONER MULLOY: Thank you very much for being here, both of you. Ms. Moncrieff, you mentioned that you had worked for a Fortune 500. What you're telling us is enormously important to the national interest, it would seem to me.

Do you two sit there and wonder why policymakers in Washington don't pay more attention to this problem? Ms. Moncrieff, you tell us in your testimony on page five, it's as if our government and the multinational companies view small companies as a rather expendable commodity.

But what you're telling us, this may be expendable commodity, but it's an enormous importance and it's really not expendable in terms of our national interest.

You've been in a Fortune 500--why do you think that those guys are driving this policy of moving our industrial base across the Pacific Ocean into China? What is your take on what's going on here, both of you?

MS. MONCRIEFF: I don't think the tool and die industry has enough lobbyists, period. They listen to the squeaky wheel and those that contribute to their campaigns.

COMMISSIONER MULLOY: What was that?

MS. MONCRIEFF: The small businesses can't afford to affect congressmen. They can't contribute to their campaigns, and we don't have lobbyists.

MR. SCHMIDT: Because we are by nature small. I think there is a diversity of focus where larger multinational companies are extremely focused on short-term profits because that's how their shares are valued.

We are not focused on short-term profits because we are family-owned companies. We can tend to take the longer view. I think in the long term, this will be very detrimental, but a lot of our customers and our customers' customers are scrambling right now.

COMMISSIONER MULLOY: I think you guys are absolutely right, and I think what goes on is the multinational is focused on the short-term profit and their shareholders. They have the money to hire the lobbying firms, the law firms, the academics who publish all these papers about the benefits of free trade, and then we got an $800 billion current account deficit, moving toward a trillion.

The real story is hidden down where you're telling us what is going on here, but you can't get it up into the policymaker level to make them understand what is really going on here. I just urge you to get after your local congressman and senator because they will, I think, understand this stuff.

MS. MONCRIEFF: My congressman is Dale Kildee. He's the only one that's never voted for a free trade agreement in Congress.

COMMISSIONER MULLOY: He submitted testimony.

MS. MONCRIEFF: Yes.

COMMISSIONER MULLOY: And he noted Congressman Upton so it's a bipartisan issue. It's not just a one-party issue. It's a bipartisan issue to get after this type of problem.

MS. MONCRIEFF: Part of the problem, too--but I've been to Washington many, many times. I've testified many, many times. when I have brought a group to Washington, we actually had a guest speaker from the administration and U.S. Treasury Department, and he basically said that currency manipulation is not going on in China.

I also had someone from the Commerce Department, someone very high up in the Commerce Department who quit recently when Bush was reelected. But he was in the meeting, telling us all business is good, it's all good, he almost got railroaded out of the room, and then basically admitted to us after some of us chased him up the hall that business is really bad. We know it's bad.

COMMISSIONER MULLOY: That wouldn't be the Under Secretary for International Trade; would it?

MS. MONCRIEFF: I did not say that. Strike that.

COMMISSIONER MULLOY: Mr. Schmidt.

MR. SCHMIDT: I'd like to pose to you a rhetorical question. If the tool and die industry isn't that important because it's all small and mostly family-owned companies, why would the Chinese be interested in building a tremendous number of new manufacturing plants when there is not yet any demand for them?

In most economies, capacity follows demand. Here we see a clear case of where capacity not only of plants but of workers is preceding demand, where somebody who used to work in Chinese Ministry of Machinery and Tooling told me that they want to have many more employees than they need because they figure in the long run it's going to be good for their country.

They're seeing something we aren't, and I agree with the speakers who were saying before that we lack a longer-term--Dr. Ronis mentioned that in defense, we lack a longer-term focus. But in society, we lack a longer-term focus, not only our government but our consumers, our companies. Everyone wants a short-term focus.

COMMISSIONER MULLOY: Thank you very much.

HEARING COCHAIR WESSEL: Commissioner Brooks.

COMMISSIONER BROOKES: We're focusing on China and that makes sense obviously since we're the U.S.-China Commission--but, Ms. Moncrieff, you mentioned that you were--I don't know if it was a cavalier remark or off the cuff--that you opposed certain free trade agreements with certain countries. Is that because there's a threat to your industry or is it a principled thing? Is there a threat to the tool and die industry beyond China?

Are we talking about India? Are we talking about Vietnam? Where else are we talking about besides China?

MS. MONCRIEFF: I just think we need to send the message that we're not going to have any more free trade agreements until we can enforce the ones that we have in place, from that standpoint. If we could get and enforce the trade agreements, stop the currency manipulation, if the government recognized that we have problems with manipulation of currency and the other issues that have been brought up to them, then when we started addressing those problems and coming up with great solutions, I think the U.S. could be competitive. It's just it's so stacked against us.

COMMISSIONER BROOKES: Is there any other foreign competition to the industry besides China?

MS. MONCRIEFF: Brazil.

COMMISSIONER BROOKES: Brazil?

MS. MONCRIEFF: Yes, there are. Brazil, Japan, Europe. They bring in tooling--Germany. There are tools that come into the United States from there. You could read the ITC report, the 2002 3-2-2 hearing that outlines all the countries that we compete against. There's a number of them. But China right now is the biggest threat.

MR. SCHMIDT: China is the one that worries me the most. I'm convinced we can compete very effectively with Europe. We can compete very effectively with Japan. The only way that Japan has been able to compete with us lately is because they will source work to China and get most of the work done in China and touch it up and fix it up in Japan and send it here. That's the only way because things made in Japan versus the United States, their costs are similar to ours.

They pay their people similar to what we do, but the cost of coordinating tool building in Japan is expensive. And as Dr. Helper mentioned, there are advantages to being local. For example, we worked with Ford Motor Company on the development of parts for the F-150 truck. We worked very closely with the product designer. The initial concept for some of the parts were not manufacturable.

We helped him change it into something that worked and still was pleasing to him. This is a very common process. But difficult to do over the ocean. So if you're competing with people that have similar costs, the local companies have the advantage. The other companies just plain lack our expertise so they might be effective competing in niches that aren't as sensitive, that are lower technology niches of our industry, and that has happened.

Portugal for a time was very active in producing small inexpensive molds, but that's waned mostly now. Those are short-term in nature. And I think we can handle those threats. China worries me because I think we're being targeted and it's a concentrated effort to eliminate us from this industry.

COMMISSIONER BROOKES: Thank you.

HEARING COCHAIR WESSEL: Commissioner Houston.

COMMISSIONER HOUSTON: Yes, I think you're right. I'm sure we are being targeted in this area as well as many others from China, but I have a question. It follows up a little bit on what Commissioner Brookes was asking. There are a lot of pressures on your industry that are causing the 28 percent of the toolmakers closing the door since 1998, as Ms. Moncrieff mentioned.

I would guess that there are domestic and international pressures. Domestic, some of them--I'm just guessing--I don't know your industry--some industries deciding to in-source and do it in-house, and also I would guess the estate tax has taken a very heavy tool on your business as it has with so many businesses in the U.S.

if each of you were to make a pie of those pressures that have caused such a decline in your industry here, I don't need to know where all the other little pieces of the pie are, but how much of that would you say both from the domestic and the international pressures in total, how much of that is China? How much do you see of that pie being China? Is it five percent, ten percent, 90 percent?

MS. MONCRIEFF: it's hard to pinpoint. We're getting pricing pressures and to say that it's all coming from China--I think part of it, too, in our industry--I think China is a major factor--but there's a lot of businesses out there. The industry has shifted in its technology and some companies have not shifted with it--it's a race to the bottom. Everybody just keeps cutting their prices, cutting their prices, cutting their prices, just to stay in business.So we're kind of cutting each other at the same time, too. There is some of that going on. What percentage is what, I really can't speak to. All we know is we're getting tremendous pricing pressures. To be paid the hourly rate that we're getting paid with the investments that we have in our buildings and our equipment and the wage level that we pay, it's not sustainable, period. It's just not.

MR. SCHMIDT: I don't consider the estate tax to be a burden on our business. I feel that it is my job and it's incumbent on me to create more value in the business so that we can pay that estate tax. I do not consider that as a problem. The major problem in our industry, as Laurie pointed out, is the pricing, the erosion of pricing, and it's due to a couple of factors.

China is the driving force behind that, but a portion of the pricing erosion is the race to the bottom thing. There are companies in our industry that have not adapted the newest technologies, that in previous times every now and then our industry would go through a technological change. The companies that didn't keep up with that change would whither and die or they'd get on board. I'm sure Dr. Helper would say that that's a healthy thing for an economy and I agree with that.

But the fact that we have these two factors happening at the same time makes it worse, and the overemphasis on price, it's actually perverse now in that some of the lower-tech companies are bidding extremely low prices, and they're the first ones to partner with Chinese companies because they're no longer able to compete on their own. And that's happened in our industry. Some of our competitors have partnered with Chinese companies quite frankly because they're no longer viable in making tools on their own, but with the Chinese capital influx and with the Chinese cheap labor advantage, suddenly they can quote cheap prices, but they are lower in technology.

COMMISSIONER MULLOY: Are they making them here or there?

MR. SCHMIDT: They are making them there with some of our knowledge and being fixed and repaired here.

MS. MONCRIEFF: There are some companies bringing the details or the guts of the tool over from China and other countries, Korea, and then they are assembled in the U.S. also.

MR. SCHMIDT: But in a matter of four or five years, those companies will be gone. This is a very bad strategy because once the Chinese are established in the marketplace, they will make sure they take steps to become known with the customers, they develop the skills, they will abandon the empty shells of their partners, which really will be empty shells because they're not producing anything here anymore.

COMMISSION VICE CHAIR BARTHOLOMEW: But, Mr. Schmidt, do you think that your colleagues who have taken that strategy recognize that that's what's going to happen and they're just sort of--

MR. SCHMIDT: It doesn't matter; they're dying. This is the only way to prolong their life.

COMMISSION VICE CHAIR BARTHOLOMEW: This is the only thing that prolongs their life. And are they then meanwhile making other plans about what they're going to do with their--

MR. SCHMIDT: I assume they're making plans to invest their earnings in other industries.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you both very much. This is for us one of the benefits of getting out of Washington is to hear from those of you who are dealing with these challenges and trying to maintain your workforces here.

One of the things that we always find helpful is suggestions as to what we can do. Obviously, things like currency valuation, there are a number of people who are fighting on that front, so far not successfully. But if there are other things we can do to help particularly small and medium-sized businesses--we've been concerned that small and medium-sized businesses don't have access to some of the trade remedies that the big companies do because you don't have the kind of deep pockets, where you can enter into a long process, especially when you know that the ITC might rule one thing and nothing ends up happening.

What can the federal government do to help you? What is it that you would be encouraging in terms of steps that can be taken to help you survive for the health of our national economy?

MS. MONCRIEFF: Again, trade policies, we need to enforce them. We need to make sure that China plays by the rules and we have a level playing field. I think that's just huge, the currency manipulation thing, and I think training is a huge issue.

There's some grant programs out there. We actually got a grant in Genesee County, but too often communities like that focus on the stuff that's easy. They're training in retail and you know all these touchy-feely things that are easy to train in. It's difficult to put together training centers in an industry like ours. So a lot of people just shy away from that.

There are some good training centers in the U.S. We're actually working on trying to mimic some of those and trying to encourage the interest there in doing that.

COMMISSION VICE CHAIR BARTHOLOMEW: Mr. Schmidt, suggestions?

MR. SCHMIDT: If there is a currency manipulation, if you could stop that, that would be greatly appreciated.

COMMISSION VICE CHAIR BARTHOLOMEW: We've tried.

MR. SCHMIDT: That certainly would be helpful. I'm again not the expert on how that is occurring or how that mechanism works. International currency fluctuations is not my field of expertise. If we are competing against companies that are subsidized by foreign countries, if we are competing, to me that seems tremendously unfair. If we can stop that kind of competition, that also would be appreciated.

Just having you know our plight and what it could do to the rest of the country. I do want you to understand that tool and die is a leverage point for the rest of manufacturing. If you give away the part that shows you how to make things well, how can you justify making things at all after you can no longer make them well?

HEARING COCHAIR WESSEL: Commissioner Blumenthal.

HEARING COCHAIR BLUMENTHAL: Yes, I have a follow-up to that, which is let's say we did manage to have success on the trade policy front and we really were on a level playing field and we really had a free market in the sense that currency wasn't being manipulated and IPR violations were being enforced, and we made sure that other companies that didn't subsidize unfairly -- do you, both of you, believe that the tool and die industry in the United States would survive on free market forces alone or would we need also to engage in a subsidization or industrial policy in the United States?

MR. SCHMIDT: I'm against subsidization on principle. It's not a long-term policy that's viable for our country. We can't survive as beggars getting handouts. If we can't produce value for the American economy, if we're unable to do that, then we should shift our resources to something else, but I think that we can.

There's one more piece that Dr. Helper mentions that concerns me. I think we can compete very effectively. Normally, with an economy growing as rapidly as China's, you would expect wages to increase equally rapidly. When it happened in Brazil, they had 100 percent a year inflation. You would be expecting that level of inflation in China.

It's not happening. If it did happen and was allowed to happen naturally, and you removed all these other barriers such as subsidization, currency manipulation, things like that, I think we can compete extremely well because we can make a lot better tools that are lot more productive for our customers.

By the way, we are having some success in getting our customers to realize that. One of our customers recently sourced a large program with us even though it was a 20 percent cost disadvantage, but that was just the tipping point for them. If it had been 22 percent, we'd have lost it.

HEARING COCHAIR BLUMENTHAL: How about you, Ms. Moncrieff.

MS. MONCRIEFF: I agree. I think our industry could compete if it were a level playing field. The only thing that I think would be helpful, I know the government invested in these MTCs all over--well, the MTC paid for the building. And, you know, the building doesn't do any good in and of itself.

COMMISSION VICE CHAIR BARTHOLOMEW: MTC standing for?

MS. MONCRIEFF: The Manufacturers' Technology Centers. We have one with Dale Kildee's name on it, as a matter of fact, in Flint, and they put up a beautiful building, but they have no equipment. As a matter of fact, I donated some old equipment to the building, but it's old equipment.

HEARING COCHAIR BLUMENTHAL: So besides the level playing field, you would encourage government investment in training in these centers?

MS. MONCRIEFF: They assist in training programs in other areas. I think that that would be an area of focus that would be helpful because it's so cost prohibitive for voc eds and high schools and universities and colleges to pay for the equipment.

HEARING COCHAIR WESSEL: Commissioner Brookes.

COMMISSIONER BROOKES: One of the things that has always made the American economy competitive even today with higher fuel prices and things is innovation. How technology driven is your industry and how often, with the computer today, a PC, we're seeing changes about every six months. It's probably faster than that. What kind of changes are we seeing in your industry in terms of technology or is it rather static?

MS. MONCRIEFF: Can I answer that part of the question at least in relative terms in my company? I bought the company in '97. We had five computers. I've got 35 now and we've got predominantly all CNC machines, computer numerically controlled. We run simulation software. We buy CT Unigraphics, which are very costly by the way, and of course Unigraphics gives seats of Unigraphics to Chinese universities who pirate those seats. So that's the kinds of things. It's a huge technological advance in our industry. We're doing things very different, and I think the companies that aren't doing things very different are the ones that are already gone and are getting ready to leave here pretty shortly.

If you aren't into the technologically advanced equipment at this point, you're pretty much done.

MR. SCHMIDT: I think that's the key to survival among American companies and has certainly been the secret to our success. It's one of the reasons I mentioned all the research projects were involved with currently. Just some recent examples: the manufacture of styrofoam casting patterns, something we need to make castings. We make it out of styrofoam and you bury the styrofoam in sand. To make enough casting patterns to supply our company took two of our suppliers approximately 33 people. Through advances in technology and a completely different method to make it that's based on computer methods and solid modeling, we currently make all of our own casting patterns with eight people.

That's just one example. We are constantly applying various portions of technology to our industry. Right now we're focused on projects that allow us to process high-strength steel more effectively because that's in demand by our customers. Projects that allow us to simulate more accurately. We know what a tool will do before we build it now, whereas previously it was mostly guesswork and art. Now, we've taken that art and brought it into the realm of science.

We aren't done with that transition yet, but we're pretty close. We're not very close with high-strength steel yet. We have to close that gap. That's just an example.

I could give you several more examples, but the successful tool and die company now should be applying all of those things, and there are some that should disappear. They're using old technology. There's no way they can compete with us.

COMMISSIONER BROOKES: Thank you.

HEARING COCHAIR WESSEL: Commissioner Bartholomew.

COMMISSION VICE CHAIR BARTHOLOMEW: Thank you. And again thank you to both of you. it's impressive to hear also about your commitment to your workforce and your companies.

On the issue of training, I understand that training your current workforce helps make you more competitive, which is obviously one of the keys. but how do you bring young people into a trade or a profession to train them if they don't believe that there's going to be a future in that trade or profession in the first place?

So, Ms. Moncrieff, when you're talking about these training centers, who is it that would be trained in those training centers and how do you create an environment that--several people have said today a lot of the people with the skills and experience that we need are on the verge of retiring?

MS. MONCRIEFF: There's a great example of a training program in Meadville, Pennsylvania. It's called Precision Manufacturers Institute and actually they just got a grant from the federal government recently. That's an example. They actually have come up with some creative ideas to work with machinery manufacturers who showcase their machinery on their floor so they get the machines and then when people want to look at buying machines, they go into their training floor and look at the machines. The problem is those machines rotate often.

That center actually started with a model that I've had conversations with a local university about, and that is they were going to scrap their machining training program all together. They said, it's just slow, we can't afford the equipment, we don't want to tie up the space anymore. So we have been in discussions about them leasing the machinery I'm not running at night, which is how actually this PMI started. If you could get enough people to look at the model and start looking at using it--training costs have increased from 1991 to 2001 by 30 percent.

COMMISSION VICE CHAIR BARTHOLOMEW: And would you find that the people who you are aiming the training at are young people who are heading into their work life or older people who have lost their jobs because of other changes in the industry?

MS. MONCRIEFF: I actually resurrected our apprenticeship training program, and I tried to bring in a couple young kids every other year at least and always have a couple of apprentices all the time, and they go to Mott College at night and then work for me during the day. So we tried to foster that in-house training. We do the same thing. It's just very costly.

COMMISSION VICE CHAIR BARTHOLOMEW: But the issue is cost, not an inability to find people who want to be trained?

MS. MONCRIEFF: As long as you keep bringing kids in, and again it's costly, but I've made a commitment to always keep bringing these young kids in, and just keep training, training, training.

A lot of folks, though, have cut that out a long time ago because it's just so cost prohibitive. That's the only way we've been able to survive.

MR. SCHMIDT: We don't have enough work right now to justify adding other people, but we've suffered for it, because we've always had a diversity of skill levels. Because we don't have anybody at the beginning of that spectrum, we have too many people as an average that are too high on the skill level so our hourly cost goes up.

In terms of motivating people into this industry, in the past, it was easy because your earnings potential was a lot better than unskilled labor. Your employment potential was a lot better because people knew in this area you could apply your skills to other industry.

I used to work for a machine tool company. They loved to hire die makers because they know, oh, a die maker can do our stuff. He's not a machine builder, but we know that we can do our stuff, and there's cross-training. Even the carpentry industry, oh, get the die maker, he'll know how to use tools, he knows how to put things together, he'll be able to do something.

COMMISSION VICE CHAIR BARTHOLOMEW: So we're also, to go back to one of the earlier panelists, losing surge capacity too because we are losing people with technical skills who can do other technical things if necessary in a situation where we were confronted with needing to scale up?

MR. SCHMIDT: When business is slow, some of our employees go get engineering degrees. Some laid off employees in our industry--we don't have any at our company--but in our industry, it's not uncommon for them to go to school

COMMISSION VICE CHAIR BARTHOLOMEW: Right. Now some people, of course, would argue that they are moving themselves up the economic food chain by doing that, and that it is sort of the trickle up of our economy changing.

MR. SCHMIDT: That part is a good thing, but there are only so many of those opportunities. And if you're not making anything, how many engineers are you going to need?

COMMISSION VICE CHAIR BARTHOLOMEW: Yes, good point.

HEARING COCHAIR WESSEL: Thank you. We appreciate your participation. Hopefully you'll have a better day in Washington with some of your current representation out here as well as raising the national importance of this issue.

OPEN MICROPHONE SESSION

HEARING COCHAIR WESSEL: Mr. Stokes, if you're prepared, we'll move right into your ability to present some comments to us and we look forward to them.

MR. STOKES: I do have a special request. I think that I'm the only one from the public side this afternoon, and what I have to say I believe is of great importance to this Commission, and therefore I would ask six minutes instead of the three, if the Commission would indulge.

HEARING COCHAIR WESSEL: Yes.

MR. STOKES: I am publisher of eMotion!Reports.com. We are an automotive and aerospace industries' research and analysis site that targets professionals within the academic, media, corporate and government sectors. We've also created an environment wherein white papers and other scholarly works can be presented to a broadened, yet still defined, audience, papers like "Super Globalism: Strategies for Maintaining a Robust Industrial Base Through Technological, Policy and Process Improvement."

I'm here today to follow up on Dr. Ronis' comments about another chilling fact of our current existence, and this has to do with a set of circumstances that calls for the immediate implementation of actionable plans to mitigate U.S. industrial base global supply chain vulnerabilities as represented by the fact that no ocean-borne shipping is in U.S. hands, but with China and South Korea.

As of this moment, General Motors and Ford and other core components of the U.S. industrial base are at the mercy of Chinese and South Korean whim. That is to say they are capable of instantly disrupting and diverting the global supply chain in the event of Sino-American discord. Tonight, GM and Ford could have their supply chains disrupted.

So I wanted the Commission to know, and I think that you'll be pleased to know, that my colleagues in industry and government have been quite busy over the past five years bringing together the intellectual resources to craft architecture for infrastructure for a new American-controlled heavy-lift industry utilizing commercial versions of the Boeing C-17 Globemaster III Airlifter along with the development of strategies designed to mitigate U.S. industrial base global supply chain vulnerabilities as represented by the fact that there is no U.S. owned ocean-borne transportation.

And we plan to do this through permanent air augmentation of the U.S. industrial base global supply chain. Heavylift is the movement of the goods via air that are too large or outsized to fit in any door of any 747 or similar size freighter aircraft, items like oil derricks, DA class bulldozers, helicopters, satellites.

Boeing developed 14 years ago data that suggested the emergence of a new subset of the ad hoc opportunistic air cargo industry, heavy and outsized or the home heavy and outsized market.

Despite Boeing's encouraging existing air cargo operators to work with them to exploit this data utilizing proposed commercial versions of the superlative C-17, there were no takers. The Russians and the Ukrainians immediately seized the initiative through the massive AN-124.

They now control this industry so much so that the U.S. military makes up airlift shortfalls with the AN-124. This is unacceptable. Considering the constraints of today, the very short story is that within a 24-month period from today, we will not only control the U.S. heavylift industry but most of the world. In place at this moment is a 30-year business plan and 17 case studies conducted by the Air Force, Boeing, and private sector support--and with private sector support with the largest corporations in the world inclusive of ExxonMobil.

The combined value of these let projects around the world is in excess of 400 billion, and that's just the study subjects. The total value worldwide in identified and unidentified projects exceeds one trillion.

Most of these projects are in absolutely austere locations such as Sakhalin Island, Russia, and whose supply chain logistics' requirements can only be serviced by the commercial variant of the C-17, the BC-17, because of its extraordinary aero-athleticism, the ability to take off and land with 87 tons aboard and under 4,000 feet, the ability to take off and land with 22 tons aboard and under 1,310 feet.

In 90 days, we will name three global air operations epicenters in the U.S., Europe and Asia; two special support operations centers in two states; one global administration epicenter in the U.S.; and the lead investment bank to bring together a syndicate consortium for the up to $3.6 billion private placement in each geographic locale for a total of 10.8 billion.

We will utilize both used and new C-17s. Our business plan works for both. However, what is urgently needed is congressional language, originally presented in the April 29, 2005 version of H.R. 1815, that allows the Air Force to resell first generation C-17s, money which through the transformational recapitalization initiative mentioned by Dr. Ronis flows back.

In short, the Air Force budget is recapitalized through this resale creating new vistas and efficient use of funds.

Gentlemen and ladies of this august Commission, we submit that this represents no less than a new industry and one which accomplishes three things simultaneously: one, it perpetuates and revitalizes a steadily eroding U.S. industrial base; two, mitigates U.S. industrial base global supply chain vulnerabilities as represented by the fact that no ocean-borne shipping is in U.S. hands but in those of the Chinese and South Koreans; three, establishes a new American-controlled heavylift industry taking it from the Russians via commercial versions of the Boeing C-17 Globemaster, and of course keeping Long Beach open.

I believe we are on the cusp of a new industrial economic era that reasserts American dominance by investing in and capitalizing on our traditional strengths. We must not fail in this initiative, as it may well represent the ultimate means by which we can neutralize industrial-base erosion.

We would ask your assistance in obtaining the necessary congressional language authorizing C-17 resale, an initiative that I started with Senators Warner, Levin and Lieberman, who have been extraordinarily helpful in keeping the C-17 alive.

I thank you for your time.

HEARING COCHAIR BLUMENTHAL: Thank you.

HEARING COCHAIR WESSEL: Thank you for your comments. We will certainly be making them part of the record, and as we evaluate what we have heard today and prepare our annual report in the coming weeks, we will look carefully at what you've said. Thank you.

COMMISSIONER HOUSTON: I know your name is Mr. Stokes, but I missed your affiliation.

MR. STOKES: My name is Myron Stokes. I said eMotion!Reports.com is the site. That is an automotive and aerospace industries' research and analysis site and it has been one of the primary means by which we embarked on an educational process with an industry and government relative to the heavylift initiative and of course we had as a core mission the perpetuation and revitalization of the U.S. industrial base.

HEARING COCHAIR WESSEL: Thank you.

MR. STOKES: Thank you.

HEARING COCHAIR WESSEL: And thank everyone for their participation today and we are adjourned. Thank you.

[Whereupon, at 4:25 p.m., the hearing was adjourned.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Statement of Jennifer M. Granholm, Governor of Michigan[11]

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Statement of Dale E. Kildee, a U.S. Congressman from the State of Michigan

I am very pleased that the U.S.-China Economic & Security Review Commission is holding a hearing on the important topic of China's impact on the U.S. automotive and automotive parts industries. This issue is very important to our nation and particularly to Michigan where the struggles of our domestic automotive and automotive parts industries have been felt the hardest. I regret not being able to join you in person today, but appreciate the opportunity to submit this statement for the record.

It is very clear that our harmful and unbalanced trade policies have hurt our domestic automotive industries and workers. This could not be more obvious than with our relationship with China. The most clear example of this is China's currency manipulation which has been devastating to the U.S. automotive industry. As Co-Chairman of the Congressional House Automotive Caucus along with Representative Fred Upton, we have held briefings, written letters and taken other actions to

[11] **Click here to read a statement by Governor Jennifer M. Granholm**

press the Administration to address China's currency manipulation. Yet despite all the evidence to the contrary, the Bush Administration continues to tell us that China is not manipulating their currency.

Another major issue is intellectual property theft by Chinese companies that directly threaten U.S. automotive suppliers. Last year, the Federal Trade Commission estimated that the domestic automotive supplier industry loses approximately $12 billion in global sales annually due to intellectual property theft. This theft and the counterfeit and pirated automotive parts that it produces undermine U.S. and foreign safety standards and put customers at risk. In 2003, China accounted for 66% of all imported counterfeit products seized by U.S. Customs and Border Protection. Yet despite the lost dollars for U.S. manufacturers and the public safety risks, just as with the currency manipulation, our government has failed to address this issue in a meaningful manner.

Another issue, which is just beginning to make its way onto the radar screens of Congress, is the Chinese automotive manufacturing industry. Currently, two Chinese manufacturers have announced plans to begin selling cheap, Chinese-made cars in the U.S. in the very near future. However, China has a 25 percent tariff on American-made cars while the U.S. tariff on Chinese cars is 2.5 percent. For this reason, I joined Representative Walter Jones in introducing the Unfair Chinese Automotive Tariff Equalization Act that would prevent imports of passenger cars from China until the U.S. and Chinese tariffs on these items are equal. I believe this legislation is vital to ensuring that our domestic automotive manufacturers and workers have a fair playing field to compete on.

Lastly, it is very important to note that our trade policies and their effect on the U.S. automotive industry and its workers do not occur in a vacuum. While certainly our policies with China have played a harmful role, it is our overall trade policy that has hurt the U.S. automotive industry and workers the most. Our harmful and unbalanced trade policies have been devastating to our workers, small businesses, farmers, the environment and the economy. We are facing record trade deficits and an increasing pace of the outsourcing of American jobs. Our trade policies encourage the closing down of American factories and moving them overseas, usually to a country where wages are low and the standard of living is lower. Our trade policies are clearly flawed, yet Congress recently narrowly passed CAFTA and the Administration is currently negotiating more FTAs. We need to revisit American trade policy and stop entering into harmful and unbalanced Free Trade Agreements.

We need to call a 'timeout' on our headlong rush into free trade agreements and revisit our trade policies. For this reason, I introduced legislation, H.R. 4407, which would prohibit the U.S. from entering into any bilateral or regional trade agreement for a period of two years. H.R. 4407 would also immediately terminate any current negotiations. While I understand that in our current Congress it is unlikely this bill will be given consideration, this is a debate we must have if we are to end trade policies that further increase our race to the bottom.