U.S. China Economic and Security Review Commission
Hearing on China's Five-Year Plan, Indigenous Innovation and Technology Transfers, and Outsourcing
Panel IV: Technology Development and Transfers to China
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Remarks of Leo Hindery, Jr., Chairman of the US Economy/Smart Globalization Initiative at the New America Foundation and member of the Council on Foreign Relations

Right now, three fundamental premises underpin America's overall global economic and trade policy. All are faulty to one degree or another, especially as they relate to our overriding trade relationship with China and they all affect how the US pursues a largely misguided approach to economic relations with China.

1) <u>The first premise is that advancing the interests of America's multinational corporation always benefits American workers and in turn the American economy.</u>

   Ralph Gomory has today already addressed the often disconnect between big business interests and the best interests of the country which has largely removed employees and the nation from the responsibility mandate and left only shareholders and management. I concur wholeheartedly with Ralph and would only point out that in order to reconnect the two, we especially need to do away with the excessive corporate compensation which is driving U.S. business leadership into all kinds of selfish behaviors. For decades, CEO compensation as compared to average employee compensation was around 20 to 1 – now it is 400 to 1 with all the selfish behaviors which that has produced, most notably mindless outsourcing and a lack of acumen for looping together US R&D and innovation with production in the US.

2) <u>The second premise is that the rules-based, free trading system favored by the U.S., combined with the overall rule of country comparative advantage, will result in balanced globalization for all trading partners, especially to the advantage of American workers and the American economy.</u>

   This premise works well when all nations play by the same rules. However, we know that China especially continues to pursue mercantilist policies that are at best anti-competitive and often illegal.

   Much has been written about how China has gained unfair trade advantages through its abysmally low direct labor costs, lack of meaningful environmental and labor standards, and currency manipulation, all of which is valid. Less appreciated, however, are the other measures China uses to game the system, the two most extreme of which are China's "Indigenous Innovation Production Accreditation Program", about which you have heard much testimony, and its unceasing demands that U.S. and other developed countries seeking to do business in China make massive transfers to it of their intellectual property. These latter transfers, which is one of today's major topics, will, because of their significant ripple effects throughout our economy, ultimately be an even bigger 'drain' on our economy than the direct offshoring of millions of American jobs over the last 15 years.

A major example is the Boeing Company. Using an initiative benignly called "systems integration mode of production" which entails providing its foreign suppliers and overseas subsidiaries with massive amounts of business knowledge, management practices, training and other intangible exports, Boeing has gone from producing nearly 100% of its commercial aircraft and parts in America to today producing only a small fraction of that work here. The workhorse 727 airframe, launched in 1963, had just a 2% foreign content; the 777 airframe, launched in 1995, has about 30% foreign content; but the new 787 Dreamliner, officially launching this year, will have nearly 70% of its manufacturing content coming from foreign sources. In the year 2000, Boeing had 50,000 unionized workers in Seattle-Everett; 20,000 of those jobs have since moved to China.

3) <u>The third faulty premise is that the U.S. can make up for the millions of manufacturing jobs lost and still being lost overseas with, to quote Larry Summers in June 2009, exports of "software, movies, medicine, university degrees, management consulting and legal work" plus new employment by the "high technology" companies of Silicon Valley.</u>

This first conclusion is simply absurd on its face. And as for the high-tech companies and their plans and capabilities, the best example of what is *not happening* concerns the company Apple, which the Obama administration often uses to as the 'poster child' for the second conclusion.

Apple, despite its prominence, actually has only about 50,000 direct employees – 25,000 or so in the U.S. and 25,000 overseas. What the administration and others seem to purposely overlook are Apple's 250,000 *indirect* employees working at the company Foxconn, located outside of Shenzhen, China, dedicated to manufacturing Apple products sold in the U.S. (Foxconn's total employment in China is a staggering 1 million workers.) In other words, for every 1 of the 25,000 American workers now employed by Apple mostly in marketing, administration and R&D, there are 10 Foxconn workers in China who could, and many of believe should, be American workers.

By ignoring the fact that Silicon Valley is mostly a jobs-*exporting* juggernaut and not a jobs-*creating* one and the recent conclusion by its own BLS that U.S. employment in "information technology" will actually be *lower* in 2018 than it was as far back as 1998, the administration is playing into, and not addressing, the trend that now has half of the revenue of the Standard & Poor's 500 largest publicly traded U.S. companies coming from overseas and saw, from 2002 to 2008, overseas employment by U.S. multinationals increase 23% while their employment here at home increased by less than 5%, in each case heavily China-driven.

In the face of these three flawed policies in our own thinking and of China's policies and actions which are particularly counterproductive to our interests, we can either continue to try to resolve these issues through lengthy bilateral and international discussions over the next several years, though this seems a foolish course. Or, alternatively, we can adopt a realistic, hard-headed approach to leveling the playing field; straightening out our trade deficit; helping U.S. companies be more competitive; and creating American jobs, especially manufacturing jobs.

Going forward, it is imperative – for economic, employment, competitiveness and national security reasons – that the administration and Congress:

1. Formulate and implement a Manufacturing & Industrial Policy for the U.S. that balances the mercantilist policies of our major trading partners, especially China's, whose overall trade surplus in manufactured goods matches almost dollar for dollar America's trade deficit in such goods. Nineteen members of the G-20 have defined Manufacturing Policies – America alone does not, even though no economy as large and complex as ours can prosper with less than 20-25% of its workers being in manufacturing and without the sector contributing a like percentage of GDP. As it is, less than 9% of Americans now work in manufacturing, and as a percent of our GDP, it is just 11.2% of the total.

2. Demand that the U.S. government not enter into a bilateral investment treaty with China until China makes WTO-compliant the Indigenous Innovation Production Accreditation Program, and in the interim, demand that the United States Trade Representative bring a Section 301 case against the Program. Because China is still not a member of the WTO Government Procurement Code, a Section 301 action is the only remedy currently available.

3. Go after all of China's illegal subsidies, not just its currency manipulation. Many of China's practices provide its companies with a clear-cut "counteravailable subsidy" and they need to be treated as such, including China's abysmal environmental practices.

4. Put a halt to China's persistent theft of America's hard-gained, valuable intellectual property which zaps our economy almost as much as China's adverse currency manipulation. The U.S. International Trade Commission (ITC) estimated last month that "up to 2.1 million new direct private-sector jobs would be created in the U.S. in total if China raised its IP protection to U.S. levels." The best solution in the short-term to this theft would be to adopt Senator Slade Gorton's recommendation last month to this Commission that the U.S. impose tariffs which would generate revenues equivalent to 150% of the estimated annual IP losses suffered by American companies in China.

5. Establish buy-domestic and other domestic investment requirements for federal procurement and for grants to states and local governments to the fullest extent allowed under our various trade agreements and the WTO.

Following the US-China Strategic and Economic Dialogue meetings held in mid-May 2011, Commerce Deputy Assistant Secretary Craig Allen declared, and I quote: *"In all of these cases* –

indigenous innovation, intellectual property enforcement, transparency – we would have preferred much more explicit detail in terms of timeline, in terms of coverage, and in terms of implementation. But we are pleased at the same time that the Chinese did commit those previously verbal assurances in writing. That is progress."

This may be deemed *"progress"* by U.S. government officials but I, for one, am not satisfied that this is the kind of progress that we should be seeking or be satisfied with. We need to take a much more pro-active stance to get the Chinese leadership to modify their nationalistic economic policies and mercantilist practices.