China's Industrial Policies Hurting U.S. Industries and Workers

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WASHINGTON—A sense of dread filled the hearing room on Capitol Hill as China trade experts contemplated the reasons for America's increasing annual deficits with China, its loss of jobs and industries to China, and lack of any national strategy to put the country back on track.

Mr. Terence P. Stewart is Managing Partner of Stewart and Stewart. Mr. Stewart's practice focuses on international trade matters and customs law. (Gary Feuerberg/The Epoch Times)

On March 24, the U.S.-China Economic and Security Review Commission heard testimony from several experts from the private sphere and academia on "China's Industrial Policy and Its Impact on U.S. Companies, Workers and the American Economy." Some experts who testified said unless the U.S. somehow reverses the decline in domestic manufacturing, and stops the eroding of our industrial base, our economic recovery from the recession will not be robust.

The overall picture that emerged from the first half of this hearing is one where the U.S. government stands by, almost helpless, as China employs shrewd state planning and massive state subsidies to ensure success of its basic industries as well as the second tier industries, called "pillar" industries. China also makes it profitable for American companies or partly-owned companies to develop production facilities in China and bring in the most recent technology.

"The result is that U.S. companies are contributing to the development of China and simultaneously contributing to the loss of jobs and destruction of industries in the United States. Nevertheless, they are doing these things in the pursuit of the widely accepted corporate goal of maximizing profits," said Dr. Ralph E. Gomory, who until recently was head of the Alfred P. Sloan Foundation and currently is Research Professor at New York University.

Mr. Clyde Prestowitz is founder and President of the Economic Strategy Institute. His latest book is 'Three Billion New Capitalists: The Shift of Wealth and Power to the East.' (Gary Feuerberg/The Epoch Times)

The Commission heard from Terence P. Stewart, a lawyer who represents various industries in trade matters. He quoted from the American Chamber of Commerce in China:

"The Chinese [regime] employs direct and indirect subsidies such as grants, interest loan subsidies, debt forgiveness and tax concessions to prop up state-owned enterprises, introduce new technology and expand or build new capacity. Should these practices persists, American firms will remain at a distinct competitive disadvantage against Chinese enterprises when competing in the Chinese, U.S. and other international markets."

Stewart said that China failed to list numerous subsidies at the provincial and local level and that a number of the subsidies listed "appeared to be prohibited under WTO rules." The United States has identified several programs subsidized by the regime that China did not notify the WTO of, said Stewart.

China's Steel Production Dominates the Global Market

A good example of how direct and indirect subsidies really work spectacularly well and make it difficult for foreign producers to compete with China is in the steel industry. China is now the world’s largest stainless steel producer. Until 2004, China was a net importer of steel, but with the help of the regime, China began to run a surplus in steel for the first time in 2005. That surplus has increased each year, reaching nearly $67 billion in 2008, said Stewart.

Dr. George T. Haley is professor of Marketing at the University of New Haven (UMH). He is the author of "New Asian Emperors: The Overseas Chinese, their Strategies and Competitive Advantages." (Gary Feuerberg/The Epoch Times)

Chinese steel producers benefit from significant official subsidies, funding for research, restriction of foreign investment, tax rebates, and loans at low or zero interest, said Clyde V. Prestowitz, President, Economic Strategy Institute. "When currency manipulation is thrown in the mix, China has devised a policy to make its domestic steel industry almost impervious to outside market forces," Mr. Prestowitz.

China’s steel production far exceeds its own domestic needs, and the excess capacity forces global markets into severe price competition," said Professor George T. Haley at University of New Haven and director of the Center for International Industry Competitiveness. U.S. steel industry has been hurt as China dominates the production of steel. "Over twenty steel companies have closed down operations, creating over 50,000 lost jobs in the U.S. alone," said Dr. Haley.

"Many of China’s steel mills would have faced difficulties surviving without repeated bailouts and infusions of government financial support. Billions of dollars of steel enterprises’ debts have been written off to equity, taxes have been forgiven and new loans extended," said Alan William Wolff, a lawyer in the field of international trade and finance law.

Recent Shift in China’s Industrial Policy

The extensive use of subsidies is old news to the China Commission, from which Mr. Stewart even quoted previous Commission reports. And other Asian countries—Japan, South Korea, Taiwan, and Singapore—have also successfully instituted state planning in their economies.

Manufacturing & Technology Editor and Publisher Richard McCormack (right, foreground) testified before the U.S. China Economic and Security Review Commission. (Gary Feuerberg/The Epoch Times)

China, however, takes the direct intervention in its economy to a whole new level. The goal of China's new policies is to "promote certain state-owned enterprises into national and global 'champions,'" said Mr. Stewart. Selected companies that are to become leaders in the industry are guided and given preferential treatment, such as special access to the banking sector. "When it wants to stimulate a specific industry, such as autos, the [regime] instructs the banks to offer extremely low-cost loans," said Dr. Haley.

There has been a shift towards new policy tools that guide the company through its development, in addition to using old favorites like subsidies. At the same time, measures are in place to restrict foreign producer participation in certain domestic markets.

"China currently limits market access for some foreign goods and services, such as iron ore and auto parts, restricts [imports into China] through the use of quotas, license fees, and minimum ... prices, and implements unique national standards in high technology areas. The result of these policies is that China shores up its less competitive businesses, protecting them from any domestic or international competition, and promotes select industries that it wishes to make a pillar of its economy. ... As a result, manufacturers in the United States ... are effectively shut out of the world's largest market," said Clyde V. Prestowitz, president of the Economic Strategy Institute.

At the end of 2006, a state decree ordered that the state would maintain "absolute" control over SOEs that were deemed critical to national security and economic livelihood: defense, electric power and grid, petroleum and petrochemical, telecommunications, coal, civil aviation, and shipping.

In addition to these seven "strategic" industries that were named in the decree, the state would maintain "a strong position" for enterprises in the "pillar" industries, which include equipment manufacturing, auto, information technology (IT), construction, iron and steel, non-ferrous metals, chemical, and surveying and design.

"There is no single, permanent definition in China of a 'pillar' industry,'" said Mr. Wolff. In 2008, for example, Beijing authorities declared that tourism would be a pillar industry in the post-Olympics period. To some degree, being a "pillar industry" is synonymous with meriting the support of the central, provincial, or local regime policy, said Mr. Wolff.

If the Chinese regime wants to compete in a certain market dominated by the United States or other foreign countries, the state will designate that industry as "pillar," and then the state will provide subsidies and pay for R&D. The United States is presently highly competitive in pharmaceuticals, processed foods, electronics, and agricultural goods, according to Dr. Haley, but consumers have difficulty discerning quality in these industries. These are industries that China will likely want to compete in, Dr. Haley argues, because when the market cannot perceive, or does not value, differences in quality, "U.S. companies cannot compete on any basis with China's heavily subsidized industries." He indicates that these industries are likely candidates to become China's next designated "pillar" industries.

Forced Technology Transfer

A key feature of China's economic strategy is to attract foreign high-technology companies to set up production facilities in China in order to acquire a technology transfer.

"Access to the Chinese market in some sectors requires foreign companies to enter into joint ventures with domestic manufacturers. Approval to enter into a joint venture may rest solely on the ability of a company to provide technology, and future improvements to that technology," said Mr. Prestowitz.

Prestowitz said that foreign companies may end up in a joint venture with a competitor, who could have access to their "patents, production methods, and other intellectual property." In the case of consumer electronics, a company like Lenovo, which was once a production partner for IBM's ThinkPad computers, became a global success in its own right after the technology had been transferred. This method of luring foreign companies to China gives the Chinese immediate access to technology it would otherwise have to develop independently.

New Strategy Needed to Save U.S. Manufacturing

"The U.S. economy is in shambles not because we have been consuming too much, but because we have been producing too little," said Congressman Walter B. Jones in written testimony to the Commission. He pointed out that U.S. manufacturing employment is at its lowest point since 1941 and that U.S. manufacturing output dropped 3.5 percent during the eight years between January 2001 and January 2009.

The congressman as well as others at the hearing said that the United States has to do something to restore its industrial base. "America's international economic policies threaten our prosperity and national security," said Rep. Jones, who quoted from a statement made by 56 organizations concerned about manufacturing and trade.

Representative Jones's home state of North Carolina has been especially hit hard with losses in its textile industry. In 2001, textile and apparel products to the United States from China held 6.7 percent U.S. import market share. By 2008, China held 41 percent of the U.S. import market and exports had grown by eight-fold. Not surprisingly, U.S. textile mill output has fallen 48 percent since 2001; US. apparel output has fallen 50 percent.

The U.S. government has little comprehension of the effects of China's industrial policies on American industry and for American workers, according to Richard McCormack, editor and publisher of Manufacturing and Technology News. The Chinese regime's incursions into "strategic industries" are not systematically being followed. Little is being done to defend the U.S. companies that "must compete with entirely unfair Chinese trading," says McCormack. Finally, there is no strategy in place to counter China's "displacement of American industries."

The second half of the hearing dealt with the more technical aspects of China's industries: Telecommunications, Information Technology, Nanotechnology, and Optoelectronics, and are not covered in this report.

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