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WERE AMERICANS DUPED?

Rationale For Chinese Trade Deals Has Proven To Be Specious

The United States public has been told repeatedly that legislation allowing unfettered free trade with China would lead to a new era of Chinese political freedom. But no such thing has happened, and the specious argument made by multinational companies and politicians has led to the creation of policies based upon a "wrong paradigm," James Mann of the Johns Hopkins School of Advanced International Studies told a recent meeting of the U.S.-China Economic and Security Review Commission.

"American policy towards China requires public support — and the way to maintain public support for American policy, particularly its current relationship with China, is to claim that this will serve the purpose of changing China's political system," Mann said. "Since 1989, virtually every change in U.S. policy towards China has been justified to the American public on the basis that it would help to open up China's political system."

The argument was used by

President Clinton to convince Congress to pass trade liberalization with China and by President Bush to support China's entry into the WTO. Congressional leaders used it to justify their vote in favor of those initiatives.

"The paradigm of inevitable change offered multinational corporations the answers they needed [to convince policymakers] that not only was China destined to open up its political system, but trade would be the key that would unlock the door," Mann said. "Trade would lead to political liberalization — to democracy. The trouble is that the entire theory may be dead wrong."

Liberalization of trade has not changed the way China's Communist Party rules the country. There is no political opposition party in China. Censorship of the

press and the Internet endures. There are no free elections. "The argument that the Chinese system is changing seeks to divert attention to smaller realities and away from larger ones," said Mann. "This paradigm of a China that is destined for political change has deep roots in American policy over the past 35 years."

U.S. politicians from both parties and executives from multinational companies continue to argue that China's economic growth means it is inevitably destined for political change. President Clinton said that economic changes in China will "increase the spirit of liberty over time. I just think it's inevitable, just as inevitably the Berlin Wall fell."

"Why do we Americans believe that, with advancing prosperity, China will automatically come to

(Continued on page six)

ISO Prepares New Standards For Corporate Responsibility

The International Standards Organization says it has reached a "turning point" in creating a new set of standards for social responsibility. The 275 members of the ISO Working Group on Social Responsibility have culled through 5,176 comments received about corporate behavior with regards to the environment, human rights and labor practices, organizational governance, consumer issues and community involvement. The group is developing a working draft of the "26000" standard in preparation for a meeting in November 2007 in Vienna, Austria. "The need is to build consensus among individual experts...and build consensus among the national standards bodies and international organizations participating," says ISO. For information, go to www.iso.org/sr. To view the working documents, set your browser to www.iso.org/wgsr.

Average Worker Receives A Lousy Wage

The average American who is not a professional or a manager does not make very much money, as measured in 1982 dollars. In April, 2007, the average hourly earnings for a worker in the private sector were \$17.85, or \$590 per week. But counted in 1982 dollars, the amount was less than half that: \$8.32 per hour, or \$282.80 a week.

You don't want to work in the hospitality industry. Average hourly earnings of \$10.25 (\$263 a week) equal only \$4.91 per hour in 1982 dollars, or \$126.29 per week.

The highest paid category for nonsupervisory or production workers is the utility sector: \$27.88 per hour in April, or \$1,179.32 per week. But in 1982 dollars, that's only \$13.37 per hour or \$565.36 per week.

"Real average weekly earnings fell by 0.5 percent from March to April after seasonal adjustment," says the Bureau of Labor Statistics in its monthly release on earnings. "A 0.3 percent decline in average weekly hours and a 0.5 percent increase in the Consumer Price Index for urban wage earners and clerical workers were partially offset by a 0.2 percent rise in average hourly earnings."

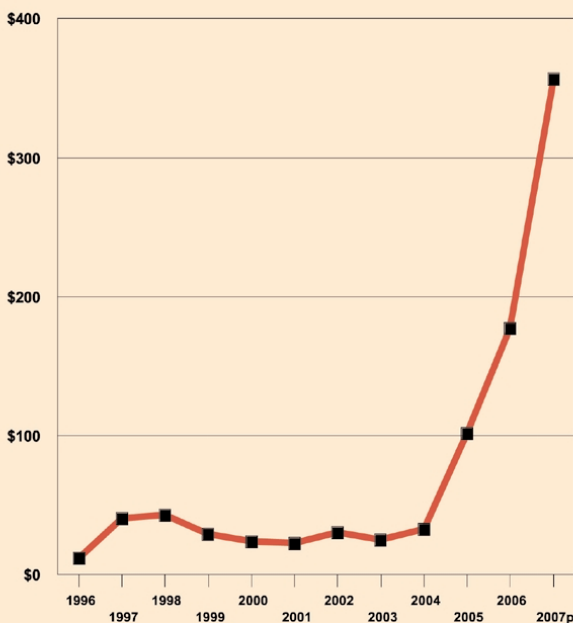
Average weekly earnings were 3.4 percent higher in April 2007 than in the same month of 2006, rising from \$566.81 to \$589.90. But after inflation was taken into account, earnings rose for the year by 0.9 percent. In constant 1982 dollars, average earnings rose \$2.47 per week, from \$277.99 in April 2006, to \$280.46 in 2007.

China's Current Account Surplus Is Soaring

Through the first quarter of 2007, China's global surplus in traded goods has increased by 101 percent over the same period last year, "and is almost three times the then-record surplus pace set two years ago," writes Charles McMillion, president and chief economist of MBG Information Services. China's global surplus for goods doubled its previous annual record in 2005 when it reached \$102.1 billion. In 2006, China's annual surplus soared to \$177.5 billion. "It is this pace that is now being doubled, suggesting that China's annual surplus could reach over \$300 billion in 2007," says McMillion. China's current account surplus could increase to more than \$400 billion in 2007, representing 14 to 16 percent of GDP. McMillion can be reached via e-mail at CWM@MBGInfoSvcs.com.

China's Global Balance in Goods Trade

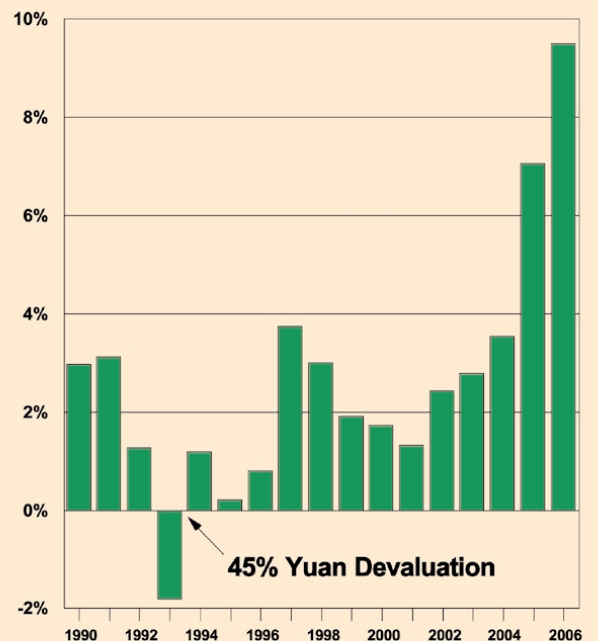
\$ Billion: Annual Global Balance



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China Census, Global Trade Information Services and MBG Information Services

China's Global Current Account Balance

%: China's Current Account Balance as Percent of GDP



International Monetary Fund and MBG Information Services © CW McMillion/MBG Information Services

NAM: U.S. Chemical Industry's Natural Gas Crisis Could Have Big Impact On U.S. Manufacturing

The U.S. manufacturing sector is facing a "hidden" crisis that could further impede its ability to compete internationally and result in a wholesale shift of production offshore, according to research sponsored by the National Association of Manufacturers. The U.S. chemical industry, described as being the "hidden backbone of U.S. manufacturing," is being hammered by skyrocketing costs of natural gas, the industry's primary feedstock. These costs are being passed on to U.S.-based manufacturing companies struggling to stay competitive. Forecasts for even higher gas prices could lead to a wholesale departure of U.S. manufacturing companies seeking lower input costs overseas, says the report written by Tony Friscia, president and CEO of AMR Research and Kevin O'Marah, vice president of research at AMR Research.

Based on a survey of 165 manufacturers, the analysis finds that companies plan to shift 25 percent of production abroad if "chemical issues of pricing and supply are not solved." This shift "could cause a ripple effect from large companies down to small companies as plants close or are downsized and as local suppliers lose their large company customers," says the report, underwritten by NAM's Manufacturing Institute. "While some of this movement offshore of capacity is an inevitable and understandable result of globalization, this report argues that allowing this trend to go too far can lead to economically and socially harmful results."

With 96 percent of manufacturers dependent on chemical industry inputs, U.S. companies "may be compromised by an over-reliance on chemical and other offshore supplies," says the report. "There will be a significantly negative effect on smaller manufacturers as they are both less able to relocate production offshore and likely to see reduced demand for their products as their big company customers close domestic plants. The main factor affecting the decision among chemical suppliers to stay in the United States is the growing price of natural gas compared to other parts of the world."

If U.S. energy policymakers don't wake up to this reality then the United States' dependence on offshore producers of chemicals will pose "security risks that are unacceptably high," says the report.

Chemical companies are already looking overseas to build new production capacity in areas where natural gas feedstock costs are substantially lower. "Plant locations in the Middle East, for instance, are increasingly attractive from a business perspective because of the dramatically lower costs of chemical feedstock and energy," says the study. "A number of leading manufacturers have already begun to change their long-term plans for domestic production as the shortcomings of

the U.S. chemical production infrastructure become clear."

The study found that 90 percent of the manufacturers surveyed see their chemical costs rising with 62 percent saying these increases are "substantial." Fifty-percent of companies said they "cannot replace" many of the chemicals they use with any substitutes; Seventy-three percent of manufacturing companies with 1,000 or more employees said that rising chemical costs will make them shift supply sources offshore.

"When asked about policy areas the government should fix, business leaders focused overwhelmingly on energy policy, which reflects how it is affecting costs in this hidden manufacturing backbone," says the study. Fifty-six percent of large companies and 42 percent of small companies said energy policies should be adopted to favor the further development of U.S. gas and oil supplies. Twenty-two percent of large companies and 39 percent of small companies said energy policies should be aimed at developing alternatives to oil and gas. Nine percent of large companies and 15 percent of small companies said environmental policies should favor U.S. production.

The domestic chemical infrastructure "is straining under heavy cost pressure and declining availability and it is difficult to replace," the study concludes. "The risk is that a wide range of downstream manufacturers who use chemicals will increasingly become less competitive and that production facilities, especially those of larger companies, will move offshore....Companies believe that there is not a realistic, focused strategy for dealing with this problem. The competitiveness and resilience of U.S. manufacturing depends on addressing this challenge."

EPA's Research Budget Is In A Free-Fall

Scientists with the Environmental Protection Agency say the Bush administration's plans to close a minimum of 20 percent of the agency's laboratory infrastructure over the next four years represents a "crippling disinvestment in EPA's scientific capacity" and would put the EPA's mission "in jeopardy." In a "mass petition" signed by the presidents of 22 unions representing more than 10,000 EPA scientists and technicians, the group said the agency "is refusing to consult its own experts about the effects its plans will have on the ability of the agency to protect the environment."

The planned reductions are the result of a "budget-driven agenda that does not take into account the effects on the quality and quantity of work produced at EPA's laboratories," says the May 23 petition sent to members of Congress in charge of EPA oversight. It asks that Congress convene hearings on the EPA's efforts "to achieve deep cuts in research and development" and

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Study: Countervailing Duties Are Good For U.S. Economy

Products being dumped into the U.S. market cost the economy orders of magnitude more in money, profits and jobs than the savings afforded to consumers, according to the first report of the recently created Alliance for American Manufacturing (AAM). Applying countervailing duties on illegally subsidized items that are being dumped does not harm the U.S. economy and their use should not be viewed negatively, says "Enforcing the Rules: Strong Trade Laws as the Foundation of a Sound American Trade Policy."

"The pure gains from unfair trade...are relatively small compared to the revenues lost by the domestic industry and are often not significantly higher than the financial costs associated with higher imports," says the analysis. "Given the potentially large direct and indirect economic losses due to dumping and subsidies that the conventional analysis assumes away, the relatively small pure consumer gains from dumping are hardly attractive. Under these circumstances, the economic case for weakening U.S. trade laws, whether unilaterally or in response to new international trade agreements, is not persuasive."

AAM, a Washington think tank, lobbying and educational group co-funded by the United Steelworkers union and management of the

major integrated steel companies, analyzed dumping cases in 10 U.S. industries, including garlic, lumber, crawfish, carbon steel, ball bearings, cement and bedroom furniture. In each case, lost revenue, lost indirect economic activity and the interest expense of being in debt due to the trade deficit in imports far surpassed the price gains offered to consumers from cheap imports

"When our trade laws are enforced, the contribution to the economy actually outweighs any of the so-called benefits of the dumped or subsidized imports by more than 50 times, in the form of American jobs, added productivity and a positive economic impact on the surrounding communities," says AAM executive director Scott Paul. Predatory trading practices have contributed to the loss of 3.2 million

manufacturing jobs and the closing of more than 40,000 facilities since 2000, says AAM.

In its case studies, the AAM researchers found that the U.S. shrimp industry lost \$210 million in revenue between 2000 and 2003 due to dumped and subsidized imports, along with \$175 million in lost indirect activity impacting suppliers. The interest expense on the debt associated with dumped imports was \$44 million. Yet the "pure consumption gains" were \$66 million.

The costs associated with dumped imports for the carbon steel industry were massive: \$5.9 billion; while the pure consumption gains were only \$1.3 million.

"For their part, anti-dumping laws are a rough parallel to some aspects of domestic anti-trust/competition laws, which are widely used by leading market economies around the world," says the study. "Further, in most industries where anti-dumping laws are employed, the pricing behavior that the laws aim to offset is a direct result of subsidies, closed markets or the operation of non-market economies. With all of the above in mind, one might suspect that anti-dumping, countervailing duty laws would be seen in a positive light by advocates of free markets and free trade. In the United States at least, this is not the case."

The report is located at www.americanmanufacturing.org.

Costs of Dumping and Subsidies Exceed the Pure Increase In Consumer Benefits: AAM

Product	Period	Lost revenue	Lost indirect activity	Interest expense	Pure consumption gains
		<i>Millions of current dollars</i>			
Shrimp	2000-2003	209.7	174.9	44.1	66.3
Crawfish	1994-1996	5.9	9.3	0.8	13.7
Garlic	1991-1994	12.3	9.2	0.6	0.8
Lumber	1999-2001	2,244.2	1,635.4	71.0	32.5
Honey	1998-2000	126.7	259.0	4.1	3.9
Raspberries	1999-2001	2.5	5.6	0.1	0.0
Cement and cement clinker	1986-1989	955.5	803.0	28.9	5.0
Bedroom furniture	2001-2003	332.9	409.8	11.8	4.0
Carbon steel	1996-1998	2,654.8	3,171.2	84.1	1.3
Ball bearings	1985-1987	877.1	793.8	28.6	8.0

The 'China Price' Should Be Considered Illegal Under International Trade Rules

A substantial percentage of the "China Price" for manufactured goods comes from illegal subsidies and mercantilist policies that should not be allowed under international trade rules, according to the "China Price Project" at the University of California-Irvine.

This advantage has led to the outright destruction of numerous U.S. manufacturing industries and has enabled China to establish dominant global market positions "in everything from furniture, refrigerators and washing machines to jeans and underwear," says Peter Navarro, professor at the UC Davis Paul Merage School of Business. China has used illegal practices to help capture more than 70 percent of the world's market for DVDs and toys and more than 50 percent of the world market for bikes, cameras, shoes and telephones. More than 300 biotech and pharmaceutical firms have offshored from the U.S. to China. Drawn by the lure of the "China Price," autos and aircraft are next.

Low wages, subsidies, counterfeiting, currency manipulation, the lack of health, safety and environmental regulations and the growth of foreign direct investment and industrial clustering are the biggest contributors to the "China Price" advantage.

The biggest contributor is cheap labor, but even that can be considered unfair because many of the country's workers are paid less than the country's minimum wage, are denied overtime pay and have no collective bargaining rights. "Most of the remaining economic drivers of the 'China Price' are clearly and overtly mercantilist," writes Navarro in a paper from the China Price Project.

Export subsidies account for 17 percent of the advantage; an undervalued currency adds 11 percent; and counterfeiting and piracy contribute 9 percent. Lax environmental and worker health and safety regulations add another 5 percent. "Together, these mercantilist drivers account for fully 41 percent of the China Price advantage," says Navarro.

The one area that does not seem to contribute to an unfair price advantage is industrial network clustering, which "presents one of the most efficient forms of supply chain management and production ever witnessed," says Navarro. But most of this clustering is fueled by foreign direct investment, "which, in turn, is being driven by distinctly mercantilist elements," says Navarro. "FDI is arriving in China for many reasons other than a legitimate attraction to cheap labor and a desire to gain a foothold in what may soon be the world's largest and most lucrative consumer market. One major mercantilist aspect of China's FDI magnet is the widespread 'round tripping' of domestic Chinese capital to avoid currency controls and gain preferential treatment regarding such elements as

taxes, subsidies and access to land. Other mercantilist aspects include the desire of foreign corporations to manufacture under far laxer environmental and health and safety regulatory regimes."

U.S. companies can take advantage of the Chinese policies by locating there, but that carries risks. However, companies that are committed to producing in the United States need to become politically active in an effort to force the United States government to start requiring China to play by rules. If the U.S. business sector does not get politically active, then it's likely it won't be able to compete with China's illegal mercantilist policies.

"Corporations may find it necessary to put themselves in what may be the uncomfortable and unfamiliar position of lobbying for more stringent environmental and health and safety standards as part of any international agreement on trade, whether bilateral, within organizations such as the World Trade Organization or through vehicles such as the General Agreement on Tariffs and Trade," says Navarro.

Then, too, it might already be too late. "Politically (Continued on next page)

The U.S. Manufacturing Cost Structure Dollar

Raw Materials	45.98%
Labor	21.00%
Advertising & Marketing	9.00%
R&D	8.50%
Interest Expenses	3.44%
Transportation	2.90%
Health & Safety	1.60%
Energy	1.53%
Environmental	1.48%
Land & Rent	1.46%
Utilities	1.16%
Software	0.80%

Relative Contributions Of The Eight China Price Drivers

Wages	39.41%
Subsidies	16.71%
Network Clustering	16.02%
Undervalued Currency	11.44%
Counterfeiting & Piracy	8.63%
FDI	3.09%
Health & Safety	2.44%
Environmental	2.26%
TOTAL	100%

(Source: the "China Price Project" at UC Davis)

Wrong Rationale...*(Continued from page one)*

have a political system like ours?" Mann asked. "Is it simply because the Chinese now eat at McDonald's and wear blue jeans? To make this assumption about China is to repeat the mistake others have made in the past — that is, to think wrongly that the Chinese are inevitably becoming like us... They were wrong."

U.S. trade policies with China have created considerable hardship for a significant number of Americans, Mann noted. "Across the United States, factories have closed and millions of Americans have been put out of work. There have been some benefits to those policies as well, especially to companies investing in manufacturing in China; yet if these policies had been judged exclusively in economic terms, they might not have won the public support and congressional approval that was necessary. As a result, the American people have been told repeatedly that the reasons for our policy were not merely economic but political. Unrestricted free trade with China was going to open the way for China to become a pluralistic country. These political arguments were the ones that made the difference. Without the claim that trade would open up the Chinese political system, trade legislation probably would not have been enacted. It is difficult if not impossible to find an American president or congressional leader who said 'China has a repressive political system and it's not going to change, but let's pass this legislation anyway.'"

Phillip Saunders, senior research fellow at the Institute for National Strategic Studies at the National Defense University, who spoke on the same panel before the USCC, wasn't so sure about Mann's argument. China is a very different place than it was 25 years ago, he said. It might still be a repressed state, but it is not threatening anybody militarily. China is becoming integrated into the world economy and its interests are changing.

"The costs of conflict are going to go up and, therefore, you might not get democratization or it might be a

century-long process, but what you will get is a change in behavior because its interest will change and the costs of military action are going to go a lot higher," he said. "I think that's actually a plausible explanation for what we've seen over the last decade, which is a China that is not militarily aggressive. It's building its capabilities and that's something we have to watch very carefully, but it hasn't been using them. You need to remember that side of things and that's a consequence of how China is

growing. The pattern that I see in Chinese foreign policy and international behavior is they're very cautious about doing things that might have a negative effect on the economy."

There is also going to be a generational change taking place in China. Younger people educated in the United States and the West will soon move into positions of power. They will want some aspects of a democratic system adopted in China. "Nobody believes in communism anymore," Saunders said. "It's 'I'm out for me. I'm going to do the best I can for me and for my family within the system.'"

EPA's Research Budget...*(From page three)*

for a GAO study "of the advantages and disadvantages of future EPA decisions that impact laboratory capabilities and operations."

The EPA's research budget is slated to decline to less than \$540 million next year, down from \$595 million in 2006, \$621 million in 2005 and \$647 million in 2004. "Unfortunately, EPA's research program is in a chronically unhealthy state," says Bruce Coull, Dean Emeritus of the School of the Environment at the University of South Carolina and President of the U.S. Council of Environmental Deans and Directors with the National Council for Science and the Environment. The council recommends Congress appropriate a minimum of \$700 million for EPA's Office of Research and Development. "The call for decisions to be made on the basis of science is almost a mantra used across the political spectrum," Coull told a recent hearing of the House Science Committee. "Yet, behind the rhetoric, a simple truth remains: without investment in science and its scientists, there can be no science-based decision making."

The need for environmental research is growing in areas such as endocrine disruptors, mercury poisoning, water quality, land restoration, sustainability, global warming's impact on human health, pollution prevention, economics associated with regulation and graduate fellowship programs.

The Bush administration request for EPA's overall 2008 budget is \$400 million less than in 2007: \$7.2 billion, a decline of 5.5 percent.

The petition is located at the Public Employees for Environmental Responsibility Web site: http://www.peer.org/news/news_id.php?row_id=861.

The China Price...*(Continued from page five)*

what's happening is as corporations outsource and offshore to China, we lose the political will to lobby against unfair trading practices," Navarro told a recent meeting of the United States-China Economic and Security Review Commission. "It used to be hand-in-glove five years ago: business sat right beside labor. It's not like that anymore because it's now in the interests of a lot of American corporations to stay over there. If we lose our white-collar base to China as well as our blue-collar base, that will be a very, very difficult story for us."

Moreover, with China now funding a large share of the U.S. federal budget deficit, the U.S. Treasury Department "is cowed by the prospect of China dumping greenbacks on international markets," says Navarro. "This is a dangerous trend which only gets worse as foreign currency reserves accumulate in China because of their mercantilist policies. We are losing our economic, financial and political independence."

Mass Protest In Canada Over Loss Of Mfg.

The rapid and substantial loss of manufacturing jobs is creating a popular uprising in Canada. On Sunday, May 27, an estimated 38,000 people demonstrated the loss of jobs at the Ford Test Track in Windsor, Ontario, Canada. The event, organized by the Canadian Auto Workers union, was in response to the 250,000 manufacturing jobs lost in Canada in the past four years, or about 150 jobs per day.

"This can't go on," declared the union. "Members of our communities must get involved in pressuring the federal government to change their trade policies and save Canadian manufacturing jobs."

The protest, called "Our Jobs, Our Community, Our Future," was one of the largest ever in Windsor.

The loss of so many high-paying jobs to foreign imports flooding the Canadian market represents an economic "crisis," says Canadian Auto Workers (CAW) union president Buzz Hargrove. "Almost every week another Canadian plant shuts its doors, files for bankruptcy or announces its intention to move its operations out of the country and the [Prime Minister Stephen] Harper government has done nothing to stop this hemorrhaging. In fact, it is exasperating the situation with a high Canadian dollar and support for unfair trade deals. The clear message to Canadian workers is that the government simply does not care."

Ken Lewenza, president of CAW Local 444, "led the charge, jumping up and down and pumping his fist into the air to motivate the crowd, which filled the air with an upbeat and electric mood," according to an account in the May 28 Canadian National Post. "Every Windsor politician participated, as did many from the county, including all city councillors and Mayor Eddie Francis. Liberal MPPs Sandra Pupatello and Dwight Duncan, both cabinet ministers, showed up to lead separate groups in the march."

Members of Canada's United Steelworkers union protested in 10 Ontario cities during the week of May 21. Its members "are frustrated [and] are getting angry," said Wayne Fraser, director of the union. "The province this summer is going to be in chaos."

New Alliance In Britain Mad About Loss Of Mfg.

Manufacturing is hemorrhaging out of the UK "at an alarming rate," according to the newly created Engineering and Machinery Alliance (EAMA). "It is in a downward spiral which needs arresting and turning round with new and dramatic government initiatives. The question is: does the government have the will to act in a radical way?"

The new lobbying alliance of eight trade associations involved in manufacturing and engineering represents the interests of 4,000 companies that generate sales of \$40 billion and have 400,000 employees. It met for the first time in May and issued a statement that the UK government has shown "a total disinterest in the future of manufacturing in the UK."

The Chancellor's recent optimistic forecast for the growth of the UK economy "shows complacency about the underlying consequences of a two-tier economy, which is driven by consumer expenditure," EAMA added. The forecast "lacks any recognition that it is through manufacturing that you gain true wealth creation."

The manufacturing sector in Britain has been in recession for almost a year and has experienced weak growth for the past decade. "Years of under-investment have left it ill-equipped to cope with the current global recession," said the alliance. "As a consequence, our productivity is far below the U.S. and our European counterparts, and we cannot compete on equal terms."

The UK government needs "to make a long-term investment in supporting manufacturing at this critical time," added EAMA chairman Mike Legg. "We are not looking for subsidies for lame-duck industries. We need the government to recognize the importance of manufacturing to the economy and to do something substantial to boost confidence and encourage investment. That is the only way to improve productivity and competitiveness."

Dip In Multifactor Productivity

Multifactor productivity last year in the private sector grew at the slowest annual rate since 2001, according to the Bureau of Labor Statistics. Multifactor productivity rose by only 1.1 percent in 2006, reflecting a 3.8 percent increase in output and a 2.7 percent increase in the combined inputs of capital and labor. "Capital services grew 3.0 percent," says the BLS. "Labor input posted an increase of 2.6 percent as both hours worked and labor composition rose. The capital-labor ratio (capital services per hour of all persons) increased by 0.9 percent."

BLS says that over the last 19 years, "capital services have grown more rapidly than hours in the private business sector, and the skills of workers — as measured by their education and work experience — also have risen over this period. "These shifts toward more capital intensive production and toward workers with more human capital have supplemented labor productivity growth, usually allowing output per hour to grow at a faster rate than multifactor productivity."

The six-page report "Preliminary Multifactor Productivity Trends 2006" is located at <http://www.bls.gov/news.release/pdf/prod3.pdf>.

U.S. Rep. Says China Is Like 'Jaws'

The United States government has no plan to assess the emerging military and economic rise of China, says Rep. Randy Forbes, (R-Va.). Yet China's actions continue to surprise many people in the U.S. government.

It has demonstrated an ability to shoot down satellites. It successfully stalked the USS Kitty Hawk aircraft carrier battle group with a submarine that surfaced undetected last November. Agents of the Chinese government were seen at an air show in Russia scouting planes that can be used on a newly designed aircraft carrier. China expects to field 17 new diesel-powered and three nuclear-powered subs by the end of the decade. The U.S. Attorney General told Frank that China is the number one espionage threat against the United States. Agents in China shut down the Commerce Department's Bureau of Industry and Security's Web site. The country is deploying sophisticated modeling and computer simulation software systems. "I was amazed when I discovered and had presented to me a very sophisticated modeling program in Chinese on a Web site with literally thousands of registered gamers where the gaming was against U.S. assets, U.S. carriers and U.S. planes," said Forbes, who chairs Congress's Modeling and Stimulation Caucus.

"As I traveled around the world, it seemed as I talked to various world leaders that it was as if the world was going along like the little sheriff in the Hollywood movie 'Jaws,' throwing bait back in the water," Forbes recently told the United States-China Economic and Security Review Commission. "All of a sudden, this huge giant appears on the scene and everybody looks around and says, 'Where did it come from and how did it get here?' We were awed, to say the least, and yet unlike the sheriff in Jaws, it seemed sometimes we continued to throw bait off the rear of our ship of state even though we have now seen the magnitude of this giant entity and we're somehow content to hope he will befriend us and not use his growing power to hurt us. I pray that we are not wrong. You would think by now that we would be shocked into some different courses of action, but I see little evidence that we have been. The only thing that continues to surprise us — that continues to surprise me — is that our government continues to be surprised over and over again by what we find and what we see in the development of China."

China's growing economic and military strength has put the U.S. government in a position of having to "pretend that these situations don't exist," Forbes told the Commission. "I understand the enormous pressure not to embarrass another government, especially the Chinese government at the negotiating table. I understand the vast interests that prevent us from publicly addressing China's true intention for fear of economic retaliation. I hear it over and over again. If we say something, they're going to hurt us economically; our companies won't be able to deal there, even though

many of our companies aren't able to deal there today."

The federal government needs to create a "national strategic interagency staff to harness the collective energy and opportunities of our nation to prepare for the long-term impacts of China's rising power and influence around the world," Forbes recommended. But agencies are not sharing information. They are not working together to develop long-term plans and assess facts, he claimed.

Forbes said that he and Rep. Ike Skelton (D-Mo.) have gone to "agency after agency" asking if they are talking with each other about China's growing global influence. "Without exception, we would always be told, 'No, we need to, but we're not,'" said Forbes. When asked if there is any comprehensive plan on how to deal with China, the answer is the same: No. "Every once in a while, we're told we have one, and maybe there's one that exists in some closet somewhere that I've just never seen, but I've never met the person who has seen it. Unless we have that comprehensive plan, I think we're going to continue to be surprised, and we can't afford to be surprised. We don't live in a world anymore where we have the resources that we can afford those tolerance levels."

Further complicating the situation is the fact that the

(Continued on page nine)

Environmental Degradation Ratings	
Sulfur Dioxide	
<i>(mcg per cubic meter)</i>	
1. Guiyang, China	424
2. Chongqing, China	340
3. Taiyuan, China	211
4. Tehran, Iran	209
5. Zibo, China	198
6. Qingdao, China	190
7. Jihan, China	132
8. Rio de Janeiro, Brazil	129
9. Istanbul, Turkey	120
10. Anshow, China	115
Emissions of Organic Water Pollutants	
<i>(kg per day, million units)</i>	
1. China	6.09
2. US	1.90
3. Russia	1.52
4. India	1.52
5. Japan	1.28
6. Germany	1.02
7. Indonesia	0.72
8. Brazil	0.63
9. UK	0.61
10. Italy	0.50

(Source: The World Bank)

China Is Like Jaws...*(Continued from page*

United States is no longer dealing with China from a position of strength. "I ask everybody that I meet, 'Where are we winning? Tell me where we're winning? You pick the point wherever it is. Is it trade, which is financing a lot of their military build-up?'"

Richard Lawless, Deputy Under Secretary of Defense for Asian and Pacific Security Affairs, said that China is engaged in an "impressive full-court press in all areas" associated with research and development and economic, industrial and military development. "What we see today is essentially the fruition of some programs that have been underway for five, eight, 10, 15 years," said Lawless. "I cannot think of a situation in which we are more challenged in more dimensions than we have been in the past over the near, middle and long term given the dynamics of this economy to deal with and manage the process. It is indeed a new situation and it will continue to evolve in challenge."

Lawless said the Department of Defense found China's ASAT test that successfully shot down a satellite to be alarming. When asked if there was truth to the claim by People's Liberation Army officer Huanqiu Shibau that China had notified the Department of Defense before the test, Lawless replied: "The answer is no."

DOD has tried to engage with the Chinese agency in charge of the test "in a spirit of cooperation," but has failed to make a connection, said Lawless. "China does have a robust multidimensional program to develop counter-space activities" and the ASAT test "was essentially just one component of that," he said. The test demonstrated a "destabilizing capability" for U.S. military operations.

Former Defense Secretary Donald Rumsfeld offered in October 2005 to open a dialogue with China's Second Artillery's Strategic Rocket Forces Headquarters, but General Cisheng, who leads the agency, has delayed an invitation from STRATCOM to visit the United States.

"We are anxiously awaiting that return visit, but it takes two to tango in this case and we really need to get this dialogue and get it going seriously," said Lawless. "The fact that the ASAT test took place in the absence of a strong dialogue is all the more concerning because we just simply are not being allowed to develop the quality of discussion that we need to have with them in these critical areas, especially areas where miscalculation is possible that is characterized not only by the ASAT test, but also by the Kitty Hawk incident. Probably in the near future, as Chinese capabilities continue to increase and they project themselves further out into the environment, the opportunity for additional miscalculations and misunderstandings will present themselves."

In response to the charge by Rep. Forbes that the federal government has no interagency coordination on issues related to China, Lawless said that is not the case. Discussions between the Office of the Secretary of Defense, Joint Staff, the National Security Council, State Department and the Office of the Vice President have been "exceptional." David Pumphrey, deputy assistant secretary of the Energy Department's Office of Policy and International Affairs, said there is a "very extensive interagency collaboration" on issues related to nuclear nonproliferation and nuclear energy. The Energy Department and its National Nuclear Security Agency "are quite directly involved with State, Defense and the NSC on those issues," he said. "I don't think the communication has proven to be a problem."

Unintended Consequences Of NIH Budget

The doubling of the federal research budget for the National Institutes of Health has had a "profound" impact on the U.S. biomedical research community, according to White House Science Advisor John Marburger. The surge in spending that resulted in a doubling of the agency's budget in 2003 has led to a "mismatch between research capacity and the federal resources to sustain it," Marburger told the American Association for the Advancement of Science's annual forum on science and technology policy.

The spending binge, which he described as being an "experiment," has led to the creation of too many biomedical researchers who are now chasing too few federal dollars. "We have moved into a new operating regime where the limits of the 'market' for research university services are being tested," said Marburger. "The most obvious lesson from this rapid growth is that it could not be sustained."

The new generation of researchers is now populating expanded R&D facilities throughout the country. They are writing research proposals that are "in competition with the previous still-productive generation of their faculty advisors," said Marburger. "And they are training yet another generation of new researchers who hope to follow the same pattern. I cannot see how such an expansion can be sustained by the same business model that led to its creation. The new researchers will either find new ways to fund their work, or they will leave the field and seek jobs in other sectors of the economy. This sub-economy is unregulated, and we can expect it to experience booms and busts typical of unregulated markets."

The health sciences enterprise's new business model will be dictated by private-sector research expenditures. "Federal science policy should encourage this change," said Marburger. "Not only will it enable an expanded research enterprise, it will also promote development of capacity in areas likely to produce economically relevant outcomes. Moreover, economists have documented a positive correlation between industrial research investment and national economic productivity, and to the extent this correlation indicates a causal relationship, increased industrial research will be good for the economy."

California Needs To Re-Think Workforce Strategy

The state of California is suffering a brain drain, according to the Public Policy Institute of California. "Between 2000 and 2005, 612,000 college-educated migrants came to California from other states, but 658,000 college-educated California residents moved out — a net loss of 46,000 college graduates, according to the institute's new report "Can California Import Enough College Graduates to Meet Workforce Needs."

By 2025, 41 percent of California's jobs will require workers with college degrees, up from 33 percent in 2005. But only 32 percent of the state's working-age adults are expected to hold a college degree, up a single percentage point

from 2005. "If education levels in the state don't catch up, the economy will adjust in one way or another," says Deborah Reed, PPIC's director of research. State income will not be as high "as current projections imply," she says.

The arrival of skilled immigrants will have to double to meet projected demand, an "unprecedented magnitude," says PPIC demographer Hans Johnson. "That seems implausible, if not impossible."

The report says the realities working against increased migration to California include difficulty in changing federal immigration laws, fast-growing competition for skilled workers from other states and

countries, and California's exceptionally high housing prices.

The state needs to "redouble" its efforts to raise college entrance and graduate rates among its own residents. "Public policy has a critical role to play because the vast majority of California's college students are attending public institutions," says Johnson. "The state has significant latitude to implement policies that could directly address participation and completion rates — and if there was ever a time to do that, it's now."

The report, underwritten by the William and Flora Hewlett Foundation, is located at <http://www.ppic.org/main/publication.asp?i=750>.

MAPI: U.S. Pays Europe's Health Care Costs

U.S. companies selling products into Europe are helping pay for government health care and retirement costs for Europeans, according to a report from the Manufacturers Alliance/MAPI. "U.S. exporters (who must pay a VAT to the country buying their products) pay twice for worker benefits: once for their own workers and once more for the workers employed by their foreign rivals," says the MAPI report. "Higher VAT rates thus discourage imports from the United States by raising the price of its products."

Border adjusted value-added taxes "place U.S. companies at a competitive disadvantage" and make the U.S. corporate income tax "ever less competitive," according to the report entitled "U.S. Exporters Beware: European Countries Pressured to Raise Value Added Taxes."

Border adjustment "enables governments to collect more tax revenue, and U.S. firms — relative to their foreign rivals — end up bearing a larger share of the heavier tax burden," writes MAPI economist Garrett

Vaughn.

Higher value-added taxes in Europe enable those countries to reduce their corporate income taxes, making it even harder for U.S. companies to compete. When Germany raised its VAT from 16 percent to 19 percent on January 1, 2007, it also reduced its corporate income tax from 38 percent to 29 percent. In contrast, the U.S. federal government has changed its corporate tax rate one time since 1986, increasing it from 34 percent to 35 percent in 1993.

"As a consequence, U.S. companies face higher taxes and thus more expensive investment capital than their foreign rivals," says the report. "The higher capital price, in turn, reduces the amount of new job-creating plant and equipment that economically locate in this country....Until the Congress makes this country's corporate income tax more competitive, U.S. exporters and their workers face an ever-tighter squeeze between what could soon be the world's highest corporate income tax and a steady diet of higher VATs."

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