

Prepared Testimony of Michael Wessel before the
Senate Committee on Commerce, Science & Transportation Subcommittee on Manufacturing,
Trade and Consumer Protection
“Examining the American Manufacturing Industry’s Response to the COVID-19 Pandemic”
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Chairman Moran, Ranking Member Blumenthal, Members of the Subcommittee. I want to thank you for the invitation to appear before you today to examine the American manufacturing industry’s response to the COVID-19 pandemic. Clearly, the COVID-19 pandemic has put stress on supply chains and our manufacturing base, and has spurred a debate about our preparation, the availability of public resources, and public policy responses. Your Subcommittee’s jurisdiction covers many of the key issues that demand attention and forward-leaning approaches to better prepare America for the future. Our citizens want to know that our ability to respond to the ongoing pandemic, and to contain a future pandemic, should it occur, is being addressed.

My name is Michael Wessel and I am appearing before you today as a Commissioner on the U.S.-China Economic and Security Review Commission (Commission), where I have served since its creation 20 years ago. But, as a disclaimer, I am speaking for myself, although my comments are informed by my service on the Commission and other work I have been involved in for many years.

The Commission was created by Congress in 2000 in conjunction with the debate about the grant of Permanent Normal Trade Relations (PNTR) to China, paving the way for its accession to the World Trade Organization (WTO). The Commission was tasked with monitoring, investigating and submitting to Congress an annual report on the national security implications of the bilateral trade and economic relationship between the United States and the People’s Republic of China, and to provide recommendations, where appropriate, to Congress for legislative and administrative action.

The grant of PNTR ended the annual debate about whether to extend most favored nation status to China. But as it passed PNTR, Congress created the Commission because it did not want to forego the annual review of our relationship with China. Since the creation of the Commission, our mandate has been extended and altered as the U.S.-China relationship evolved.

The Commission is a somewhat unique body: We report to and support Congress. Each of the four Congressional leaders appoint three members to the Commission for two-year terms. The Commission is scheduled to release this year’s report in a couple of weeks, with unanimous support. In eight of the last ten years, we have issued unanimous reports. In the two years where it was not unanimous, there was only one dissenting vote. In many ways, the evolving challenges and opportunities posed by the relationship with China have united us in our analysis. All of our hearings, testimony, annual reports and research are available at our website www.uscc.gov.

Our nation owes a huge debt of gratitude to our manufacturers and their workforce who have come to the aid of our country to meet the critical needs of our sick, our healthcare workers, first responders and our entire population in this time of crisis. Many worked tirelessly to retool and revamp operations to produce personal protective equipment (PPE), ventilators and other needed products and equipment.

Indeed, early on in the pandemic, I was contacted by companies and their representatives wanting to contribute in confronting the crisis. A group of textile firms in the Northeast wanted to know what specifications they should use in producing masks, gowns and other equipment. A firm in Mississippi similarly wanted to know what they could do. The Federal government was overwhelmed, and it became easier to match some of these firms up directly with states and hospital systems to meet their needs.

Today, as we all know, while supplies are more available, there are still shortages. Healthcare workers, and others, are having to reuse equipment, stressing safety protocols. And, as experts suggest a surge in cases will continue in the coming months, manufacturers will continue to face rising demand and limited capacity.

Mr. Chairman, I want to focus my comments on questions relating to U.S.-China policy and its impact on meeting the crisis and future challenges. Other panelists can add to the Subcommittee's examination of the critical issues you have identified for this hearing.

The debate about the impact of China's policies and practices on the U.S. continues to be divisive. There are some who view China's willingness to subsidize and dump products into the U.S. makes our people better off because it lowers consumer costs. While fewer and fewer people subscribe to this view, some still cling to it.

I couldn't disagree more and believe that the wealth of opinion has concluded that China's predatory and protectionist trade and economic policies undermine U.S. economic, health and national security interests. The cost of products cannot be the only measure of economic benefit. The public understands that while the flat screen television in their living room may be cheaper, the manufacturing jobs to support that product are not here in the U.S. They know, all too well, that globalization has increased the downward pressure on wages and our standard of living. It has contributed to rising income inequality. And, if we lose all these jobs, few will have the income to even purchase the subsidized and dumped products.

As predatory pricing drives outsourcing of jobs and offshoring of production, it can lead to a severe loss of domestic productive capacity. Industry after industry has faced this problem. Steel, aluminum, solar cells, rare earths have gotten the bulk of the attention. But China's industrial policies, as well as our own short-sightedness, have also created an unacceptable and dangerous reliance on China for our pharmaceuticals, active pharmaceutical ingredients (APIs), medical devices, and equipment, including PPE. In the early days, as we all know, the offshoring

of manufacturing limited our capacity to surge production of ventilators and other critical equipment.

China's economic policies, driven by the Chinese Communist Party (CCP), have contributed to the hallowing out of the U.S. industrial base. After years of these policies, the reality of our dependence, as well as the impact on our own capabilities, has been all-too-evident in the response to the current pandemic.

While the virulence and impact of the coronavirus was unexpected and, to some degree, our unpreparedness is a function of underestimating how broad a health crisis could be, our increasing dependency on China is not news.

In putting the spotlight on supply chains for medical equipment, the COVID-19 crisis taught the American public not only about our loss of productive capacity, but also China's policies that contributed to that problem and its ability to control supplies and use them as foreign policy leverage. The Chinese government's failure to conduct adequate inspections of manufacturing facilities and lack of quality control all became nightly news stories. Masks sold as meeting the N95 standard were often found to be almost ineffective—possibly less effective than simply using a bandana as a face mask.

We also saw that the CCP was willing to engage in “mask diplomacy” using shipments of PPE to garner political support and foster diplomatic gains.¹ For many, it raised significant questions about the CCP's actions. We have seen prior examples of the CCP's willingness to “weaponize” supply chains, most notably with regard to rare earth exports to Japan in 2010. We cannot allow the health and safety of our people to be held hostage during a diplomatic, economic or military confrontation.

While the COVID-19 crisis brought all of this to the front pages and to the nightly news, the threats to our economic health and security have been building for years. In 2014, the Commission held a hearing entitled “China's Healthcare Sector, Drug Safety, and the U.S.-China Trade in Medical Products.” In July 2019, former Senator Jim Talent and I co-chaired a hearing on “Exploring the Growing U.S. Reliance on China's Biotech and Pharmaceutical Products.” Our work, and the witness testimony we heard, along with staff research, identified broad and deep dependence on China for our medical needs and deep vulnerabilities.

We no longer have the fermentation capacity in the U.S. to make penicillin and are completely dependent on foreign sources. Eighty percent of the APIs we use come from abroad,² with a substantial portion coming from China. Of the ten active ingredients in Remdisivir, one of the therapeutics for treating COVID-19, eight come from China.³ For many other products, we are partially, or entirely, dependent on China. As Christopher Priest, the Acting Deputy Assistant Director of the Defense Health Agency told our Commission, “the national security risks of increased Chinese dominance of the global API market cannot be overstated.”⁴

Today, the focus is on medical supplies, but our dependence on China for many products—some of them critical products—is broad and deep. In certain areas, this dependence reduces our potential resilience. Last year, despite rising trade tensions and the imposition of Section 301 tariffs, the U.S. ran a trade deficit in advanced technology products with China of more than \$100 billion and an overall goods deficit of \$345 billion. As has been seen with 5G, the predatory actions of China’s Huawei have undermined the ability of market-oriented firms to develop the technology to ensure safe sources of supplies. Our dependence on China for telecom products has created dangerous vulnerabilities that our nation—and an increasing number of our allies—is only now really grappling with.

Mr. Chairman, this Subcommittee’s jurisdiction over consumer protection issues is also important in this area. There were numerous reports of masks and other supplies that were imported from China, but which did not meet appropriate regulations and safety standards. We saw this in the past with imports of tainted heparin that killed numerous citizens. We learned about blood pressure medications that were tainted with traces of rocket fuel, as both the APIs in the medication and rocket fuel were produced in the same facilities. The quality, efficacy, and safety of many Chinese-produced medical products must be addressed.

Congress should carefully evaluate supply chain risks to determine what the potential impact is on our national, health and economic security.

U.S. Business Activity in China and Its National Security Implications:

At the beginning of July, the Commission issued a staff paper entitled “Trends in U.S. Multinational Enterprise Activity in China, 2000-2017.”⁵ Since China’s accession to the WTO in 2001, U.S. business operations in China have expanded dramatically. The staff report found that “as U.S. MNE [multinational enterprise] activity in China increasingly focuses on the production of high-end technologies, the risk that U.S. firms are unwittingly enabling China to achieve its industrial policy and military development objectives rises.”⁶

Several of the report’s findings are relevant to today’s hearing:

- **China’s vast consumer market and the Chinese government’s coercive policies have incentivized many U.S. MNEs to move their manufacturing operations to China.** U.S. Department of Commerce Bureau of Economic Activity (BEA) data explored in this report indicates the major destination for goods and services supplied by U.S. MNEs in China is the Chinese market itself. In 2017, U.S. MNE foreign affiliates in China sold 82 percent of the goods and services produced in China directly to Chinese customers. At the same time, trade barriers, including localization requirements and export restrictions on key raw materials, have further induced production within China. Sales to Chinese

consumers may also constitute sales of intermediate goods and services which might be used in final goods for export to the United States.

- **China is the fourth-largest destination for U.S. MNE research and development (R&D) expenditure and increasingly competes with advanced economies in serving as a key research hub for U.S. MNEs.** The growth of U.S. MNE R&D expenditure in China is also comparatively accelerated, averaging 13.6 percent year-on-year since 2003 compared with 7.1 percent for all U.S. MNE foreign affiliates in the same period. This expenditure is highest in manufacturing, particularly in the production of computers and electronic products, but has diversified over time. For example, R&D expenditure on the improved manufacture of chemicals, including pharmaceuticals, surged nearly 30-fold from a low base of \$13 million in 2000 to \$392 million in 2017.
- **China has grown from the 20th-highest source of U.S. MNE affiliate value added in 2000 (\$5.5 billion) to the fifth highest in 2017 (\$71.5 billion), driven primarily by the manufacture of computers and electronic products as well as chemicals.** The surge is especially notable in semiconductors and other electronic components, which accounted for \$5.6 billion of total manufacturing value added in 2017, up 250 percent from \$1.6 billion in 2009. Separately, pharmaceutical manufacturing serves as the largest chemical sector in terms of value added, accounting for \$2.6 billion in 2017.

The impact of the CCP's industrial policies is broad and deep. China's government uses an "all of the above" approach to advancing its interests. For example, work by private sector forensic accounting experts⁷ uncovered acts of espionage to undermine the market value of firms which were later acquisition targets for Chinese firms. In other words, they undermined a company's value to put it into a "distress" situation, to reduce its attractiveness to other companies and to make it cheaper for them to acquire.

Chinese state-directed and -controlled entities have engaged in massive cyber intrusions in the U.S. The first major indictment on this was brought forward by David Hickton, U.S. Attorney for the Western District of Pennsylvania, who alleged in 2014 that between 2006 and 2012 five People's Liberation Army hackers had accessed the computer networks of the United Steelworkers union and five major U.S. firms to obtain trade secrets and other information.⁸ The next year, President Obama reached an agreement with General Secretary Xi whereby China agreed that they would not engage in hacking for economic gain. The premise of the agreement was faulty from the start as China treats economic and national security as inextricably intertwined. In short, all hacking undertaken by entities directed or controlled by the Chinese government was for national security reasons and, therefore, not covered by the agreement.

Massive hacking continued with incalculable harm. Indeed, press reports indicate that China, as well as Russia, has been trying to hack into our major medical firms to obtain vaccine information. As former FBI Director James Comey said, "There are two kinds of big companies in the United States. There are those who've been hacked by the Chinese, and those who don't know they've been hacked by the Chinese."⁹ The current FBI Director, Christopher Wray, recently said "The greatest long-term threat to our nation's information and intellectual property

and our economic vitality is the counterintelligence and economic espionage threats from China... It's a threat to our economic security and, by extension, to our national security.”¹⁰

In the area of medicine, multiple hacks attributed to actors in China, have obtained the longitudinal health data of U.S. citizens. While today's medicines are largely composed of APIs and other chemical compounds, tomorrow's medicines are likely to be biosynthetics. With the massive amount of data that Chinese entities collect—legally and illegally—they have the opportunity to develop new drugs and biosynthetics at a faster pace because of “big data.” Industries that fall under the umbrella of biotechnology are worth hundreds of billions of dollars annually, and their development will have a profound impact on U.S. economy and national security. There is also the potential to enable personalized medicine, to produce vaccines faster and more effectively and develop other products which have enormous national security implications. Earlier this year, the Theodore Roosevelt aircraft carrier was sidelined because of COVID-19. The implications are endless.

The Chinese government is aggressively working to obtain America's secrets. The Chinese government maintains many talent recruitment programs, with the Thousand Talents Program being the most prominent example, that are aimed at attracting high-quality researchers, often with expertise in emerging technologies or areas with potential military applications.¹¹ These programs offer a variety of incentives, including salaries, recruitment bonuses, and living allowances of up to \$150,000.¹² Chinese government guidance funds—more than 1,800¹³ of them according to some estimates—seek to invest in, and obtain, technology and trade secrets to support the CCP's industrial policies.

In many other areas the Chinese government and the CCP are aggressively pursuing opportunities to advance their interests, often at the cost to our own national, health and economic security.

Conclusion

The policies of the CCP and the actions of their government have already triggered a reaction by the U.S. While the honeymoon period after China's entry into the WTO lasted too long, and the period of engagement and dialogue yielded too few results, policy makers have identified many actions that will make a difference.

But the challenges posed by China's policies and practices are broad and deep and countering their negative impact on our interests will require concerted and long-term action. Action is needed not only in the economic policy realm, but on the diplomatic, human rights, health policy, military and other fronts.

Mr. Chairman, Ranking Member Blumenthal, Members of the Subcommittee, thank you for the opportunity to testify today. Your work on these critical issues will help lay a base for making sure that we never face these challenges again. The Commission members and our staff and at your, and your staff's, disposal.

¹ Brian Wong, “China’s Mask Diplomacy,” *The Diplomat*, March 25, 2020.

² U.S. Food and Drug Administration, *FDA at a Glance: FDA-Regulated Products and Facilities*, April 2017.

³ Mary Denigan-Macauley, written testimony for U.S. House of Representatives Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, *Hearing on Securing the U.S. Drug Supply Chain: Oversight of FDA’s Foreign Inspections Program*, December 10, 2019, 1.

⁴ Christopher Priest, testimony for U.S.-China Economic and Security Review Commission, *Hearing on Exploring the Growing U.S. Reliance on China’s Biotech and Pharmaceutical Products*, July 31, 2019. <https://www.uscc.gov/sites/default/files/Priest%20US-China%20Commission%20Statement.pdf>.

⁵ Kaj Malden and Ann Listerud, “Trends in U.S. Multinational Enterprise Activity in China, 2000-2017,” U.S. China Economic and Security Review Commission, July 1, 2020. https://www.uscc.gov/sites/default/files/2020-06/US_Multinational_Enterprise_Activity_in_China.pdf.

⁶ *Ibid.*, at 3.

⁷ Jeffrey Z. Johnson, testimony for the U.S.-China Economic and Security Review Commission, *Hearing on Chinese Investment in the United States: Impacts and Issues for Policy Makers*, January 26, 2017.

⁸ U.S. Department of Justice, “U.S. Charges Five Chinese Military Hackers for Cyber Espionage Against U.S. Corporations and a Labor Organization for Commercial Advantage,” May 19, 2014. <https://www.justice.gov/opa/pr/us-charges-five-chinese-military-hackers-cyber-espionage-against-us-corporations-and-labor>.

⁹ Maria Tadeo, “FBI’s James Comey accuses China of hacking into every major American company,” *The Independent*, October 6, 2014.

¹⁰ Christopher Wray, Director, Federal Bureau of Investigation, “The Threat Posed by the Chinese Government and the Chinese Communist Party to the Economic and National Security of the United States,” remarks as delivered, Hudson Institute, July 7, 2020.

¹¹ Anastasya Lloyd-Damnjanovic and Alexander Bowe, “Overseas Chinese Students and Scholars in China’s Drive for Innovation,” *U.S.-China Economic and Security Review Commission*, October 7, 2020. https://www.uscc.gov/sites/default/files/2020-10/Overseas_Chinese_Students_and_Scholars_in_Chinas_Drive_for_Innovation.pdf.

¹² In the indictment of former Harvard professor Charles Lieber, the Justice Department alleged that under the terms of Lieber’s three-year Thousand Talents contract, Wuhan University of Technology (WUT) paid Lieber a salary of up to \$50,000 per month, living expenses of up to \$150,000 and awarded him more than \$1.5 million to establish a research lab at WUT. It is alleged that in 2018 and 2019, Lieber lied to federal authorities about his involvement in the Thousand Talents Plan and his affiliation with WUT. U.S. Department of Justice, “Harvard University Professor Charged with Tax Offenses,” July 28, 2020. <https://www.justice.gov/opa/pr/harvard-university-professor-charged-tax-offenses>.

¹³ Karen Sutter, “‘Made in China 2025’ Industrial Policies: Issues for Congress,” *Congressional Research Service*, August 11, 2020. <https://fas.org/sfp/crs/row/IF10964.pdf>.