



REVITALIZING AMERICAN MANUFACTURING

AFL-CIO Industrial Union Council

The Crisis in Manufacturing



American manufacturing is in a deep crisis. As of December 2002, manufacturing has lost jobs for 29 consecutive months, the longest such stretch of monthly job losses since the Great Depression. After rising during the economic expansion of the 1990s, real manufacturing output dropped suddenly and sharply (by 6 percent) in 2001, at the start of the current recession. The result has been a dramatic decline in manufacturing employment, which has plummeted to its lowest level in 40 years—and it continues to fall. Since April 1998, the United States has lost 2.4 million manufacturing jobs, nearly 13 percent of the total manufacturing workforce. Over one-half million—592,000—manufacturing jobs were shed in 2002.

These data suggest that manufacturing is suffering from more than a recessionary decline. The United States is losing a large share of its capacity to produce material goods. For example, capacity utilization in U.S. manufacturing, a measure of production activity, dropped to 74 percent in November 2002, the lowest it has been since 1983. Meanwhile, the trade deficit in manufactured goods continues to grow, reaching unprecedented heights over the past three years, to more than \$450 billion in 2002, or \$1.2 billion each day.

The crisis is undermining the livelihoods of America's working families, and if it persists, it could have serious consequences for the nation's economy as a whole. Manufacturing historically has been a major generator of good, high-skilled, well-paid jobs, including in nonmanufacturing sectors, and remains a mainstay of local and state economies throughout the nation. Manufacturing's decline, however, not only is undermining the quality of manufacturing jobs, but also is contributing to the stagnation in all workers' wages. Moreover, the massive scale of manufacturing plant closings and job layoffs is contributing directly to the serious fiscal crises afflicting virtually every state in the nation.

Manufacturing has been the primary driver of U.S. productivity gains, technological innovation and economic growth. As such, a robust domestic manufacturing base is vital for maintaining a strong defense and homeland security. The loss of manufacturing capacity could weaken America's leadership in critical technological areas and limit its long-term productivity growth. In addition, greater reliance on foreign sources for strategically critical products and components could threaten the nation's defense, making it more vulnerable to international crises and terrorist attacks.

Finally, expanding manufacturing exports is essential for reversing the dangerously large trade deficit and returning it to a positive balance. If this turnaround is not achieved soon, the resulting massive foreign debt—nearly one-quarter of U.S. Gross Domestic Product (GDP)—could provoke a financial crisis and prolong, if not deepen, the economic recession.

America's manufacturing workers are the most productive in the world. But they operate under enormous competitive disadvantages resulting from several factors, such as unfair trade and tax policies, an overvalued dollar, inadequate investment incentives, health care costs not borne by overseas producers and foreign government subsidies. Unless these problems are addressed soon, American manufacturing capacity and jobs may end up permanently lagging, even after the economy recovers from the current recession.

The extent to which we successfully revive our manufacturing base may determine the depth of the nation's economic recovery and shape its future economic prosperity. It is therefore vital that Congress begins to acknowledge the severity of this crisis and take the necessary steps to reform the policies that are at its root.

American Manufacturing is in Crisis

U.S. manufacturing is losing production capacity and good jobs at an alarming rate. The U.S. trade deficit tied to manufacturing's decline is reaching dangerous heights, threatening the nation's economic well-being. The health care crisis is hitting manufacturers and their workers especially hard.

- Manufacturing employment fell to 16.5 million in December 2002, its lowest level in 41 years. It accounts for more than 90 percent of total U.S. jobs lost since March 2001. Capacity utilization in manufacturing dropped to 74 percent in 2002, its lowest level since 1983.
- Real average hourly earnings in manufacturing have fallen 9 percent since 1978.
- Unionized manufacturing jobs have been hit especially hard, falling from 28 percent of all manufacturing jobs in 1984 to only 15 percent in 2001.
- The U.S. goods trade deficit is 16 times larger than it was 20 years ago. The trade deficit in goods grew to an estimated record \$458 billion in 2002, or \$1.2 billion a day. From 1994–2000, the trade deficit cost 3 million job opportunities, mostly in manufacturing. It accounts for at least 40 percent of the decline in real wages since the 1970s.
- Health care costs are growing by 10 percent to 13 percent yearly. To cut costs, manufacturers are trying to shift the burden of health care and retiree benefits to their employees.

Why Manufacturing Matters

Manufacturing is vital for fostering a strong economy, generating good jobs and guaranteeing a high standard of living for America's working families. It is a mainstay of state and local economies, providing both jobs and tax revenues for essential public services. It is the major driver

of U.S. productivity growth and technological innovation. A strong manufacturing base is critical for restoring the nation's trade balance and ensuring economic and financial stability. It also is essential for maintaining a strong national defense and homeland security.

- Manufacturing workers' earnings exceed those of workers in services and other sectors. Average hourly compensation for manufacturing workers was \$24.30 in 2001, compared with \$19.74 in service-producing sectors.
- Union manufacturing jobs have higher wages and greater benefits. Manufacturing jobs create as many as four other jobs, providing a boost to local economies.
- Yearly labor productivity growth in manufacturing averaged 2.57 percent in the 1980s and 3.51 percent in the 1990s, compared with 0.57 percent and 0.71 percent respectively, in nonmanufacturing sectors.
- As the U.S. trade deficit rises, U.S. foreign debt also grows to record and unsustainable proportions—it was 23 percent of GDP in 2001.

Roots of the Crisis

The roots of the crisis include flawed trade policies, unfair trade practices, an overvalued dollar and tax policies that put U.S. manufacturers at a competitive disadvantage, drive up the trade deficit and encourage American firms to move factories and jobs offshore.

- The Economic Policy Institute estimates that the growth in U.S. trade deficits with our NAFTA partners has resulted in a net loss of more than 750,000 American jobs.
- The dollar appreciated 33 percent in international value from January 1995 to January 2003. The overly strong dollar reduced manufacturing investment by \$37 billion in 2001.

SUMMARY

Agenda for a Strong Manufacturing Base

Congress must take immediate steps to address the crisis in manufacturing.

Trade and industrial revitalization. We need measures that rectify the trade, dollar and tax policies that put American manufacturing workers at a competitive disadvantage in the global economy. We also need to return American manufacturing capacity to its former levels. This requires “high-road” industrial development policies—increased access to capital investment, technical assistance and workforce training incentives—that modernize and expand the nation’s manufacturing industries, while preserving and creating *good* manufacturing jobs. Key measures include:

- Fair trade policies that reduce the U.S. trade deficit, protect U.S. trade laws and require inclusion of enforceable workers’ rights and environmental standards in trade agreements.
- Revised tax laws that eliminate incentives for corporations to move production overseas and punish those that do; opposition to reform of the Foreign Sales Corporation (FSC) tax that would encourage shifting manufacturing jobs overseas; replacing FSC with tax incentives that help American manufacturers create U.S. jobs and help workers cope with retiree health care and pension costs.
- Legislation that penalizes companies that incorporate overseas to avoid taxes and denies government contracts to these companies.
- Strengthening the manufacturing base for national defense and homeland security through procurement reform, enhanced “Buy American” requirements, an updated assessment of critical defense manufacturing

capabilities and limits to “offsets” that drain critical technology and good jobs.

Health care reform. Solving the health care crisis, for manufacturing in particular, will require infusions of new public dollars as well as effective cost-containment policies. We need to bring new public money into the system, ease cost and competitive pressures and preserve employer-sponsored health care plans. Key measures include:

- A Medicare prescription drug benefit that provides continuous, comprehensive coverage for all seniors, including those previously covered by employers; opposition to proposals that discriminate against retirees with existing coverage.
- Guarantees that existing adequately covered retirees will not lose their benefits.
- Subsidies to encourage employers to continue these benefits.

Labor law reform. Reforming and enforcing the nation’s labor laws are essential to addressing the manufacturing crisis, as well as for promoting good jobs for all American workers. We need:

- Stronger labor laws to prevent employer interference and suppression of workers’ rights to organize and bargain collectively.
- A quicker and fairer process for determining union representation (including card-check recognition and employer neutrality).
- Opposition to proposals that weaken worker protections, such as “comp time,” which undermines the 40-hour workweek, or that prohibit workers from organizing through voluntary card-check recognition.
- Guarantees of meaningful collective bargaining rights and legal protections extended to all workers.

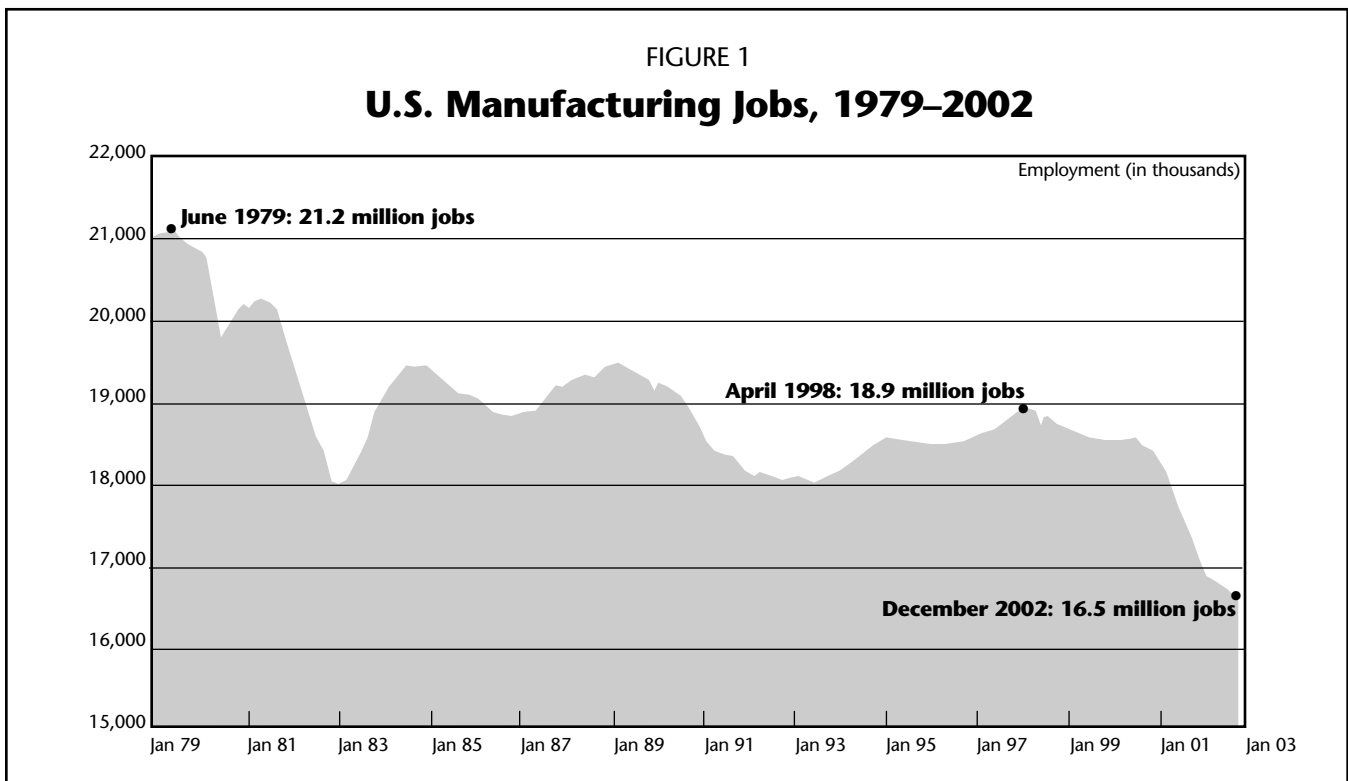
Dimensions of the Crisis

The scope of the crisis transcends the current recession. The United States is losing both manufacturing capacity and good jobs, a problem exacerbated by rising health care costs that impact manufacturers and their workers and retirees especially hard. The U.S. trade deficit, which derives directly from this loss of capacity, is reaching dangerous heights, threatening the economic health of the nation.

America is losing manufacturing capacity and jobs at an alarming rate. Total manufacturing employment fell to 16.5 million in December 2002, its lowest level since 1961 (Figure 1). Every industry sector in manufacturing has suffered a loss, some as great as one-quarter to one-third of their total workforces (Table 1). Since the recession began in March 2001, employment in manufacturing has taken a disproportionately larger hit compared with that in other sectors. In 2001,

mass layoffs (50 or more separations) and extended mass layoffs (50 or more separations for more than 31 days) at manufacturing plants rose dramatically, by more than 60 percent and nearly 80 percent, respectively. Although manufacturing is only 15.1 percent of the private nonfarm labor force, it accounts for more than 90 percent of total jobs lost in the economy.

Manufacturing's share of private nonfarm employment has declined steadily in the post-World War II period, from 40 percent in 1950, to 28 percent by the late 1970s, down to its current low level. This did not necessarily translate into loss of jobs, as manufacturing employment grew steadily in the first three post-war decades, reaching its historic peak of 21 million jobs in 1979. The dramatic decline in jobs coupled with the decline in employment share, however, suggests that the United States is losing manufacturing capacity,



Source: U.S. Bureau of Labor Statistics

especially compared with its major international trading partners. Manufacturing output as a share of U.S. GDP, which has fallen steadily for more than 50 years, suffered its largest decline (1.4 percent) in a single year, to 14.1 percent, in 2001. By contrast, in Germany manufacturing accounts for 21 percent of that nation's GDP; in

Italy, it equals 19 percent; and in Japan and Korea, the shares are 22 percent and 31 percent, respectively, placing the United States at the end of the list of advanced industrial nations.

The crisis also is being felt at the state level (Figure 2). All but three states in the nation have lost

TABLE 1
The Manufacturing Recession Since April 1998

(Numbers in Thousands—seasonally adjusted figures)

2.4 Million Lost Jobs in Almost Five Years—13% Drop in Employment

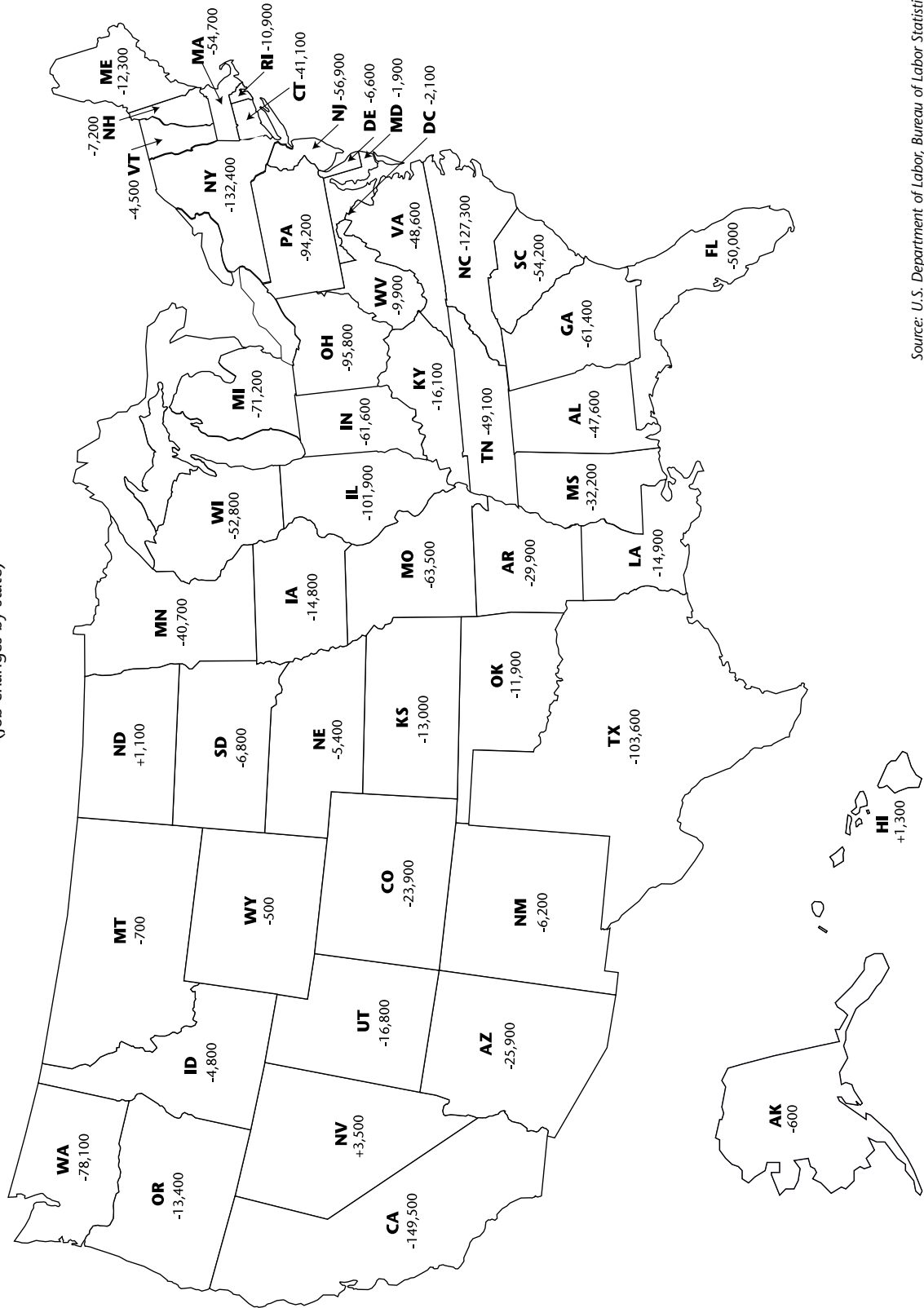
	Apr '98	Dec '02	Net Change Apr '98 to Dec '02	% Change Apr '98 to Dec '02
MANUFACTURING	18,890	16,470	-2,420	-13%
DURABLE GOODS MFG	11,254	9,710	-1,544	-14%
Lumber and wood	812	759	-53	-7%
Furniture and fixtures	531	481	-50	-9%
Stone, clay, glass	561	553	-8	-1%
Primary metal industries	719	581	-138	-19%
Fabricated metal prods	1,511	1,394	-117	-8%
Industrial mach/equipment	2,220	1,784	-436	-20%
<i>Computer, office equipment</i>	384	292	-92	-24%
Electronic, electrical equip	1,723	1,363	-360	-21%
<i>Electronic components</i>	671	531	-140	-21%
Transportation equip	1,902	1,634	-268	-14%
<i>Motor vehicles, equipment</i>	1,007	900	-107	-11%
<i>Aircraft and parts</i>	526	387	-139	-26%
Instruments, related	878	790	-88	-10%
Misc. manufacturing	397	371	-26	-7%
NONDURABLE GOODS MFG	7,636	6,760	-876	-11%
Food and kindred	1,684	1,685	1	0%
Tobacco products	42	35	-7	-17%
Textile mill prods	606	425	-181	-30%
Apparel, other textile prods	781	508	-273	-35%
Paper and allied	680	609	-71	-10%
Printing and publishing	1,566	1,395	-171	-11%
Chemicals and allied prods	1,042	1,007	-35	-3%
Petroleum and coal prods	141	125	-16	-11%
Rubber and plastics	1,009	917	-92	-9%
Leather and leather prods	85	54	-31	-36%

Source: U.S. Department of Labor, Bureau of Labor Statistics

The Crisis in Manufacturing: Lost Jobs, August 1998–November 2002

FIGURE 2

(job changes by state)



Source: U.S. Department of Labor, Bureau of Labor Statistics

manufacturing jobs since August 1998, according to U.S. Bureau of Labor Statistics data. Of these, 27 experienced double-digit percentage declines in manufacturing employment and five saw losses of 15 percent or more of their manufacturing workforces. California, New York, North Carolina, Texas and Illinois head the list with 100,000 or more lost jobs.

The quality of manufacturing jobs also has deteriorated. Manufacturing's ability to generate good-paying, skilled jobs that provide a high standard of living for millions of middle-class working families has been eroding. In efforts to trim costs and increase their ability to compete in global markets, numerous American manufacturers moved plants and increasingly outsourced operations throughout the 1980s and 1990s, to both offshore and domestic locations that usually offered access to lower-wage labor pools. Manufacturing jobs shifted to other locations or to suppliers within the United States usually paid less and provided fewer or no benefits—and usually were not unionized—compared with the original positions that were lost.

The result has been a decline in manufacturing workers' real earnings. After steadily rising through 1978, real manufacturing earnings dropped after the double dip recession in the early 1980s and the deindustrialization that followed. After a small recovery shortly after, manufacturing earnings fell further until the mid-1990s. Despite new growth during the economic expansion of the 1990s, the purchasing power of an average hour's pay in manufacturing was still 9 percent less than it was in 1978. The degradation of job quality in manufacturing also is reflected in the number of manufacturing workers living below the poverty line. Between 1979 and 1999, the share of manufacturing workers earning poverty wages rose from 14.9 percent to 18.3 percent.

Unionized manufacturing workers have been hit especially hard. The deterioration in good manufacturing jobs is tied to the loss of unionized jobs. Unionized manufacturing workers

have suffered relatively higher job losses, in numbers and share of total employment, as American employers have built much of their new capacity in "right to work" states and aggressively implemented sophisticated anti-union "human resource" programs. In 1984, there were 5.2 million unionized jobs making up about 28 percent of all manufacturing jobs. By 2001, unionized manufacturing employment fell by almost half, to 2.7 million workers, or only 15 percent of all manufacturing jobs. At the same time, nonunion jobs in manufacturing grew by 1.5 million, to more than 15 million jobs.

Because union jobs tend to be higher paid with greater benefits and protections than nonunion jobs, this trend drives down the standard of living for working families. Manufacturing industries usually offer higher wages and nonwage compensation, such as health care coverage, pensions and vacations, than nonmanufacturing industries, owing in large part to greater union density. According to an Economic Policy Institute (EPI) study, unionized employees are 28 percent more likely to be covered by employer-provided health insurance, are 28 percent more likely to be covered by a pension plan and receive 14 percent more paid time off. This "union premium" often has spilled over to benefit nonunion manufacturing workers, as employers provide similar compensation to discourage union organizing initiatives. Diminished unionization therefore is associated with depressed compensation for manufacturing workers as a whole.

The manufacturing trade deficit has grown dramatically, contributing to the decline in manufacturing jobs and wages. The U.S. economy started showing significant trade deficits in the 1980s, the result of foreign competitors' growing penetration into traditional manufacturing and high-tech markets once dominated by U.S. industries (Figure 3). Despite the economic boom of the 1990s, the U.S. goods trade deficit soared in the last half of the last decade, reaching historic heights; it is now more than 16 times larger than 20 years ago. Manufacturing imports have grown

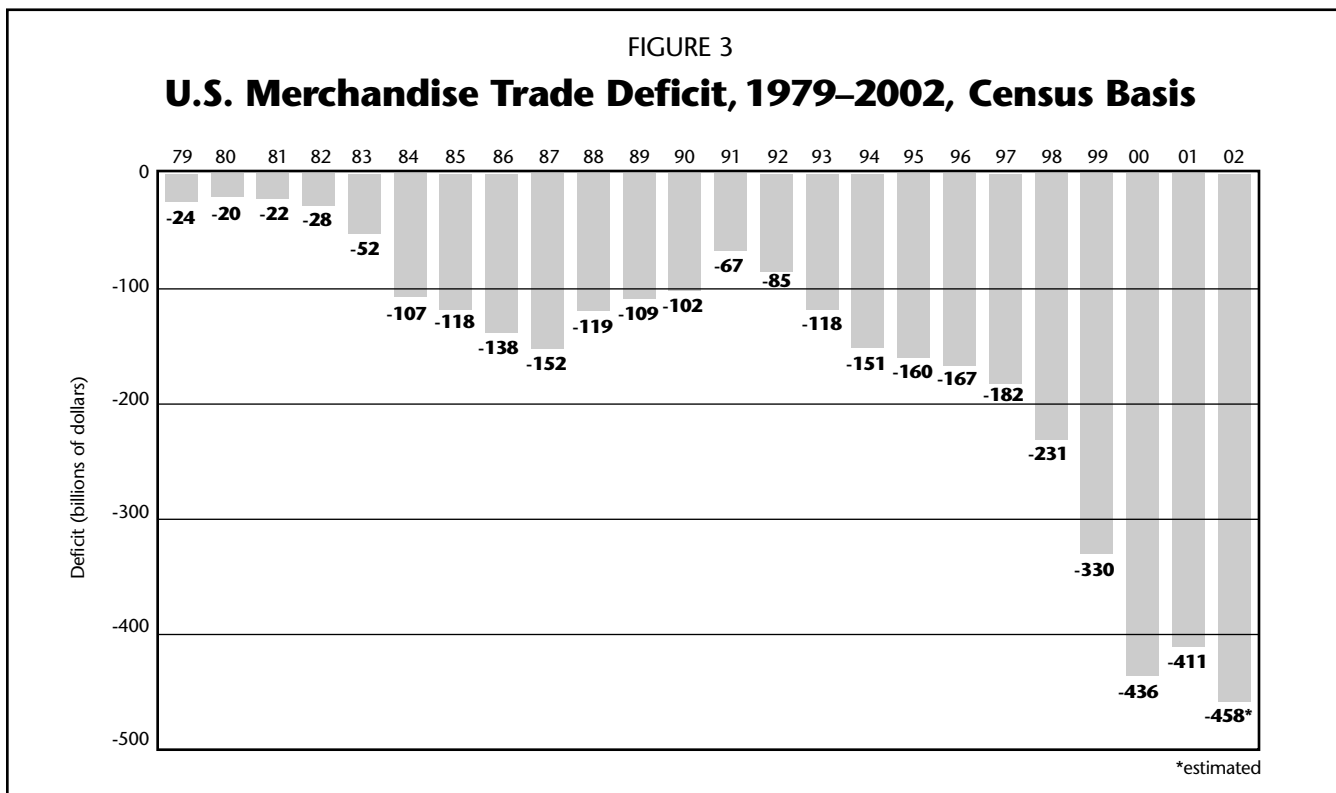
from 4.4 percent of GDP in 1981 to more than 10 percent in 2001, more than twice as fast as manufacturing exports. The goods trade deficits of \$436.1 billion in 2000 and \$411.4 billion in 2001 were the two highest in U.S. history. The 2002 goods deficit likely will exceed the previous two years' record deficits, reaching an estimated \$458 billion, equal to more than 4 percent of U.S. GDP (Figure 4).

Almost every industrial sector has been affected by the deterioration in the U.S. goods trade balance. Twelve industry sectors accounted for almost 90 percent of the trade deficit in 2000; of these, 10 were in manufacturing. Other major losers from U.S. foreign trade include the so-called "new economy" sectors of semiconductors, computers and communications equipment and audio and video equipment. A U.S. Department of Energy study similarly reports that reliance of energy-intensive industries on imported final products jumped dramatically between 1997 and 1999. Import dependence in glass and glass products manufacturing rose by more than 350 percent. The U.S. chemical industry ran trade deficits in

51 of 101 traded commodities, and the U.S. steel industry saw imports in its subsectors grow by 52 percent.

Although real U.S. GDP grew by \$2.4 trillion from 1992 to 2000, adding 23 million jobs to the economy, the rapidly growing trade deficit over that period cost 3.8 million job opportunities, primarily in manufacturing. An EPI study estimates that the rising U.S. trade deficit cost nearly 2 million actual and potential manufacturing jobs since 1994. If the U.S. trade deficit had remained constant, there would be 1.4 million more manufacturing jobs today. The stagnation in manufacturing workers' earnings since the mid-1970s also coincides with the U.S. trade balance in goods falling into chronic deficit (Figure 4). The trade deficit accounts for an estimated 40 percent of the decline in real wages over this period.

The manufacturing sector is being especially hurt by the national health care crisis and exploding health care costs. Health care costs are rising by 10 percent to 13 percent yearly, and accelerating. Absorbing these costs is hurting



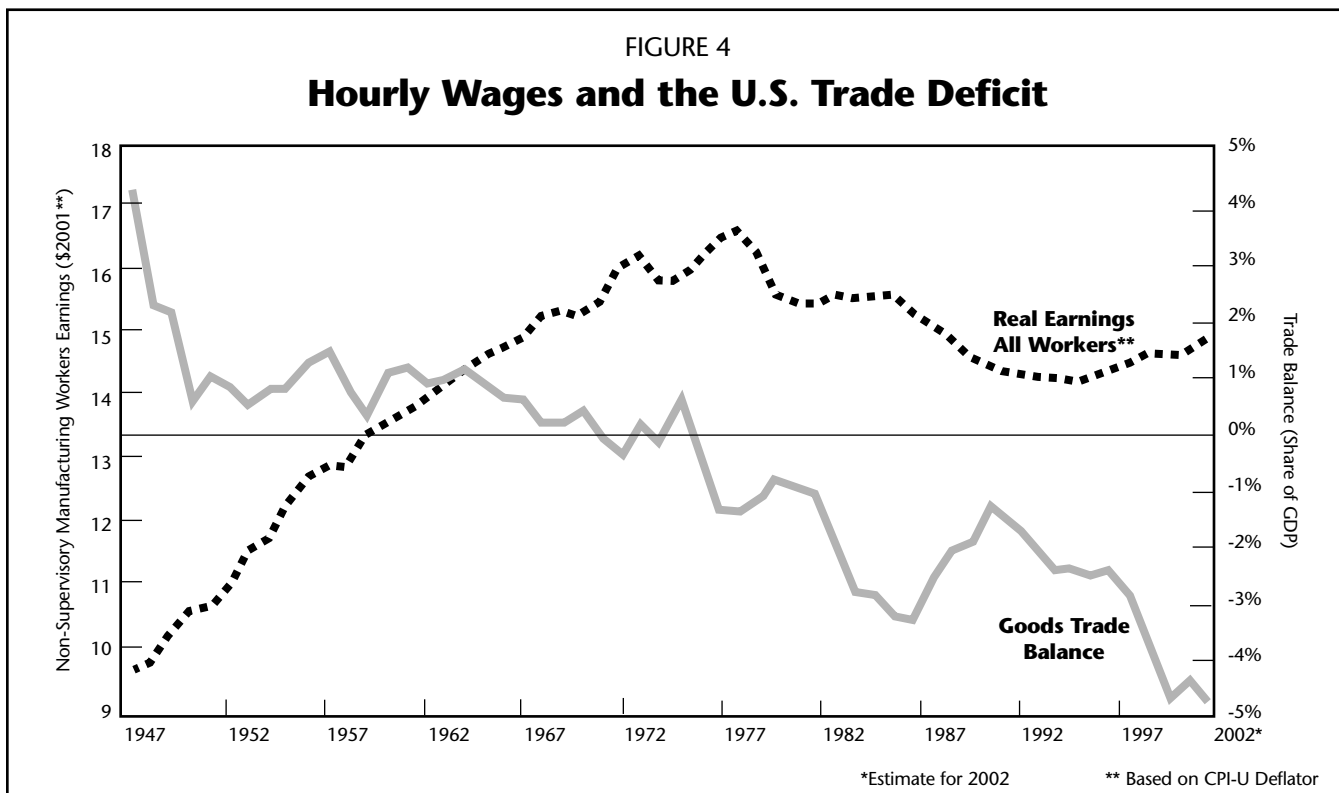
Source: U.S. Census Bureau

companies' ability to compete with U.S. companies that don't provide health care benefits and with overseas producers. Health care is the No. 1 issue in contract negotiations today. Many companies are trying to shift the burden of health care costs to their employees. Rising health care costs take a special toll on manufacturers for two reasons. First, unionized manufacturers bear health care costs that nonunion firms and manufacturers operating abroad do not bear. For example, between \$650 and \$830 of the cost of each car produced by the Big Three automakers goes toward health care costs. This is a major factor in undermining the competitiveness of unionized manufacturers, which are more likely than nonunion producers to provide health care benefits to their employees.

The second reason is the large retiree population in manufacturing. The share of large employers (with 200 or more employees) offering retiree coverage has dropped substantially over the past decade. This trend only will get worse with rising health care costs. The fastest-growing share of overall health costs hikes is prescription drugs.

Prescription drug costs constitute 40 percent to 60 percent of employers' retiree health care costs, and steep prices are prompting employers to eliminate drug benefits, cap their contributions or drop retiree coverage altogether.

Manufacturing firms have disproportionately more retirees whose costs are shared with a shrinking active workforce. Steel and auto in particular have enormous legacy costs that also undercut their competitiveness and create pressures for employers to eliminate retiree benefits. For example, one automaker has two and a half retirees for every active worker; a steel company struggling to stay in business has eight retirees per active worker. Active workers in manufacturing also tend to be older, with the average age in the late 40s and early 50s. An older workforce and more retirees mean a greater likelihood of chronic illness and greater use of medical care and prescription drugs. Rapidly rising health costs, led by unsustainable prescription drug costs, are wiping out retiree health benefits in many companies. Without employer-provided coverage, retirees have very few affordable options for health care coverage.



Sources: U.S. Bureau of Labor Statistics, Bureau of Economic Analysis, Economic Policy Institute

Why Manufacturing Matters

Manufacturing continues to be vital for fostering a strong economy, generating good jobs and guaranteeing a high standard of living for America's working families. It remains the major driver of technical innovation, productivity and economic growth. Revitalizing America's manufacturing base is especially critical for restoring the nation's trade balance and ensuring economic and financial stability. It also is essential for maintaining a strong national defense and homeland security.

Manufacturing is America's engine for generating good jobs and building a middle class.

Historically, manufacturing has been a major source of good jobs, and the traditional ladder to the middle class, for the three-quarters of American workers without a college education. Increasingly, many college-educated workers also provide high-skilled labor in cutting-edge manufacturing firms. Despite the deterioration of manufacturing jobs over the past two decades, manufacturing workers' earnings still exceed those of services and other nonmanufacturing sectors. In 2001, according to EPI, average hourly compensation for workers in manufacturing was \$24.30, or 23 percent higher than average hourly compensation of \$19.74 in service-producing sectors. Unionized manufacturing jobs in particular have higher wages and greater benefits than nonunionized, nonmanufacturing jobs.

Both because of the relatively higher wages paid in manufacturing and its linkages to other goods and services, manufacturing has a greater "job multiplier" effect than nonmanufacturing jobs. Each manufacturing job supports as many as four other jobs, providing a boost to local economies. For example, every 100 steel and every 100 auto jobs create between 400 and 500 new jobs in the rest of the economy. This contrasts with the retail

sector, where every 100 jobs only generate 94 new jobs elsewhere, and the personal and service sector, where 100 jobs create 147 new jobs. Aside from the direct jobs it creates, manufacturing also stimulates the creation of numerous jobs in high-end services (such as professional and engineering services and software) and tertiary services (including restaurants and health services) in local economies. This multiplier effect reflects manufacturing's linkages running deep into the economy, providing the means that translates improvements in manufacturing productivity to the economy as a whole.

Because manufacturing employment pays higher wages it also fosters a more equal income distribution. The disappearance of job opportunities in manufacturing for low-income workers has contributed to growing economic disparity. For example, Los Angeles's loss of 200,000 well-paid manufacturing jobs from defense downsizing in the early 1990s, combined with huge inflows of poorly educated, low-skilled immigrants, severely eroded the size and status of the city's middle class. As a result, in the midst of one of the world's richest and most glamorous entertainment communities, almost 15 percent of families in Los Angeles County live below the poverty line. Nationally, between 1980 and 1997 the decline in manufacturing share of private employment accounted for 40 percent of the increase in family inequality.

Manufacturing drives productivity, technology innovation and economic growth.

The manufacturing sector historically has led the economy in productivity growth, which is fundamental to future economic growth and continually increasing living standards. Growth in wages and employment is sustainable only through productivity growth. When manufacturing jobs are replaced with service-sector jobs, overall

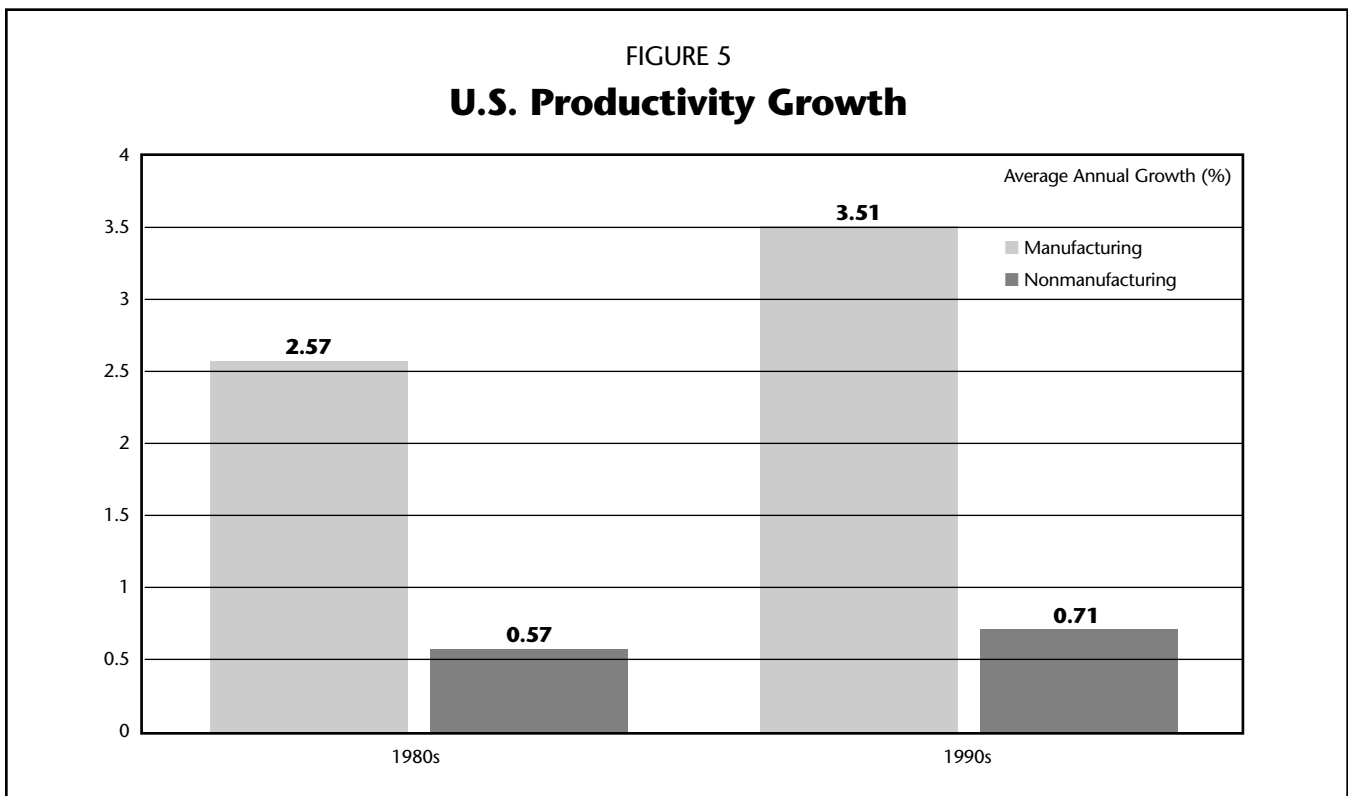
productivity growth tends to slow, which in turn slows economy-wide growth and wage gains.

In the 1980s, manufacturing labor productivity grew an average of 2.57 percent per year, compared with 0.57 percent in the nonmanufacturing sector. In the 1990s, manufacturing labor productivity increased by 3.51 percent per year, compared with 0.71 percent in nonmanufacturing sectors (Figure 5). From 1995 to 2001, manufacturing multifactor productivity (MFP), a proxy for technological improvements, grew by an average of 2 percent per year, compared with only 0.5 percent in the nonmanufacturing, private nonfarm sector.

Manufacturing's productivity gains reflect its role as the principal driver of technological innovation in the economy. As Federal Reserve Board Chairman Alan Greenspan has observed, future wealth creation hinges on the incorporation of advanced technologies into capital equipment. Major improvements in manufacturing processes are required to produce the next generation of goods, faster, cheaper and cleaner. Industrial research and development is critical in the genera-

tion of products and process innovations that drive productivity growth. Three-quarters of all industrial R&D is performed by the manufacturing sector. Although high-technology manufacturing (semiconductors, computers and telecommunications equipment) has led in industrial R&D, leading performers also include such traditional manufacturing sectors as transportation equipment, chemicals and allied products, electrical equipment, machinery, petroleum refining and extraction.

Manufacturing is a mainstay of state and local economies. Manufacturing plants are located in metropolitan areas, as well as in small towns and rural areas, providing both jobs and tax revenues to many communities. As a share of Gross State Product (GSP), manufacturing is one of the three largest sectors (out of nine) in all but eight states. It is the largest sector in 13 states and in the Midwest region as a whole. It is the second largest in nine states and the third largest in 20 others. These numbers mask the fact that some larger states showing a relatively smaller manufacturing share of GSP, such as California, Massachusetts and Illinois, have some of the nation's largest



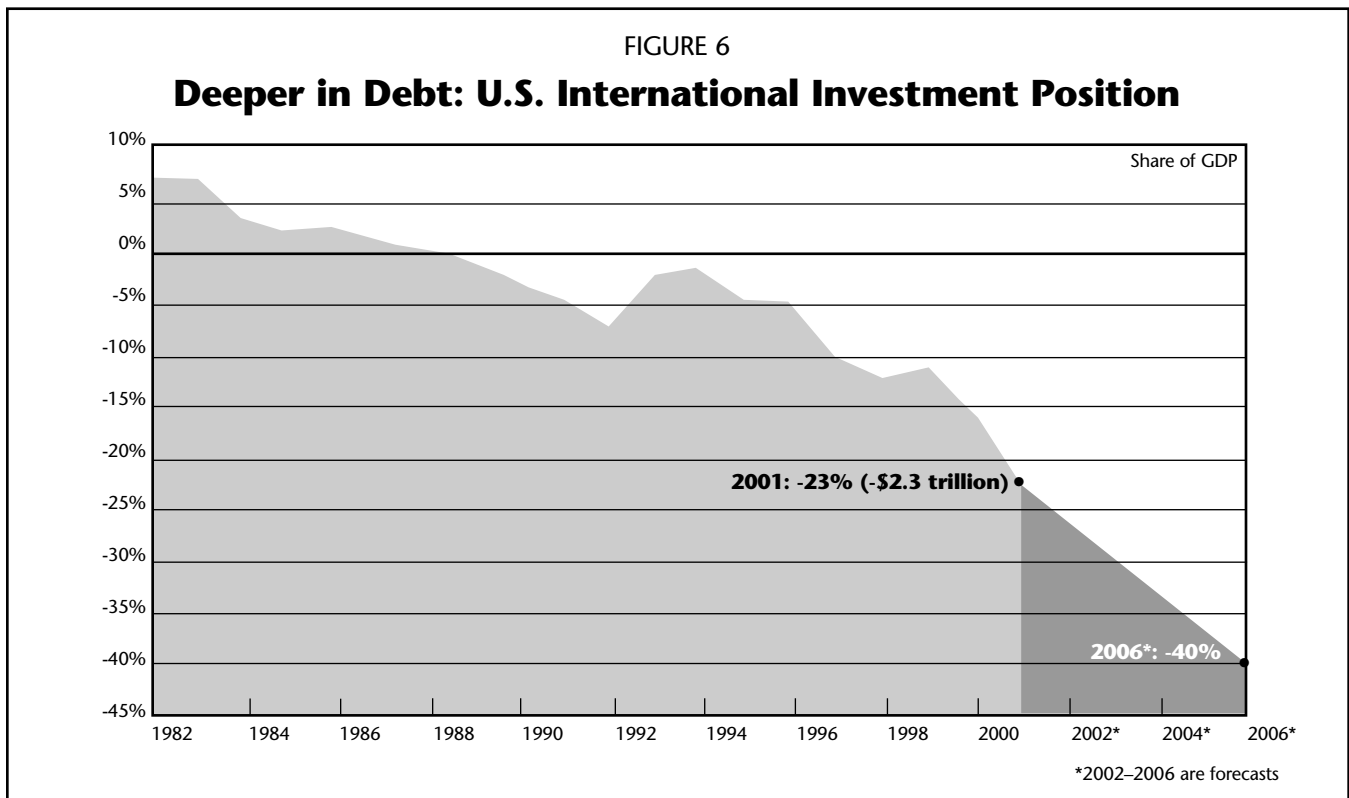
Source: U.S. Bureau of Labor Statistics

manufacturing clusters. For example, Los Angeles’s manufacturing sector, which underpins the economy of this most populous part of California, still had 606,000 total jobs in 2001. This is almost equal to that of the nation’s largest sector, in Chicago, even after massive defense-sector cutbacks in the early 1990s.

The loss of tax revenues associated with lost manufacturing capacity and jobs is contributing to the fiscal crises afflicting virtually every state in the union. To close their budget gaps, states are raising taxes and cutting important public services, placing additional burdens on working families. Smaller communities especially suffer hardships when manufacturing plants shut down, whether due to unfair trade practices or the recent recession. Aside from the lost jobs and all the costs associated with sudden large-scale unemployment, industrial plant closures undermine local tax bases—which can seriously undermine funding for important public services, such as education, causing even more jobs to disappear. For example, because of National Steel Corp.’s bankruptcy in

Granite City, Ill., the company ceased paying property taxes to the city and surrounding districts, leaving municipal treasuries short by \$3 million and forcing an elementary school to close, among other impacts. Steelmaker LTV Corp.’s bankruptcy cost East Chicago, Ind., \$16 million in lost tax payments, and Porter County, Ind., lost out by \$31 million in property tax revenues after Bethlehem Steel declared Chapter 11.

Manufacturing is critical for achieving a positive trade balance. Every day, the United States runs a goods trade deficit of more than \$1 billion. That is, every day it imports more than \$1 billion more in goods than it exports to the rest of the world. While it runs a surplus in services, that is not nearly enough to offset the enormous goods trade deficit (and the services surplus is shrinking rather than growing). As the U.S. current account deficit climbs to record heights, U.S. net foreign debt also grows to record and unsustainable proportions—to \$2.3 trillion, or 23 percent of GDP in 2001, and it could grow to 40 percent by 2006 (Figure 6).



Sources: U.S. Department of Commerce, Bureau of Economic Analysis; Goldman Sachs; Economic Policy Institute

To finance the difference between what it spends on imports and what it earns from exports, the United States has had to sell foreigners more assets such as stocks, bonds and other properties. This means each year the United States must devote more of its income to pay the interest on the debt and to cover the transfer of profits to investors in other countries. Debt at this level makes our economy vulnerable to destabilizing shifts in speculative capital, which could prolong or deepen the current recession. Eventually, the interest burden on U.S. foreign debt will grow to a level that sparks a financial crisis, causing the U.S. dollar to fall on international markets and interest rates to spike upward. Ultimately, the United States will have to run a trade surplus or face a Depression-level shrinkage in the economy. To run a surplus, however, the United States will need a strong—and much larger—manufacturing base.

A strong U.S. manufacturing base is essential for maintaining a strong national defense and homeland security. America's defense capabilities long have relied on a strong industrial base. It has been several years since an

assessment of manufacturing capabilities critical to national security has been made. But the emergence of globalized production networks in key manufacturing industries, and the loss of critical domestic production and technological capacity, has made the American industrial base more vulnerable to disruptions from international crises—including terrorism—than ever before. A 1999 National Research Council study warns that “greater reliance on foreign sources could threaten the security of product information and, in times of conflict, product sources.” The National Coalition for Advanced Manufacturing similarly notes the vulnerabilities in the existing supply chains for the American industrial base illustrated by the Sept. 11, 2001, attacks. Immediately after, ground, sea and air transportation systems nearly ground to a halt, leaving many companies' just-in-time supply chain management systems dangerously low on critical input. Major manufacturing firms came close to shutting down—and Ford, DaimlerChrysler and Toyota North America did shut down—production facilities. The automobile and industrial machinery industries especially are sensitive to border delays and susceptible to major economic disruption.

Roots of the Crisis

The 1970s saw the emergence of international competitors that eroded American manufacturers' once dominant position in domestic and global markets, in sector after sector. American firms have responded to the global challenge by restructuring, downsizing and heavily investing in automation. But it would be wrong to blame U.S. manufacturing's decline solely on normal market forces and productivity growth. The roots of the crisis also lie with government policies and corporate "low-road" strategies that promote further deindustrialization of America's manufacturing base.

Flawed trade policies and unfair trade practices have put America's manufacturers and their employees at a competitive disadvantage. First, domestic producers have been losing markets to foreign competitors because of liberalizing trade agreements, such as the General Agreement on Tariffs and Trade (GATT) and the North American Free Trade Agreement (NAFTA), and policies such as Fast Track. Multiple administrations have made deregulation of trade a priority, based on the *laissez-faire* belief that free trade will open up vast new markets, such as China, for U.S. producers. In actuality, these trade agreements reflect the interests of multinational rather than domestic manufacturers and their workers and families.

A second important concern is the limiting impacts of foreign protectionism on U.S. exports. For most products, U.S. trade barriers are far lower, its markets much more open than the domestic markets of trading partners, such as the European Union and Japan, whose economies are laced with formal and informal nontariff barriers to American goods—making the U.S. economy the "market of last resort" for the entire world.

Finally, the lack of international labor and environmental standards in trade agreements encourages multinational corporations to shift their production plants to locations where such standards either do not exist or are not enforced. The enormous differential between U.S. and developing nation wages, and the broad access to the U.S. market facilitated by such free trade agreements as NAFTA, strengthen the logic of globalizing production by industrial firms. Many manufacturers have moved plants or outsourced operations to low-wage, Third World countries, rather than modernize their existing U.S. plants and upgrade the skills of their workforces. A troubling trend is that of multinationals setting up state-of-the-art plants in low-wage developing countries to produce goods, especially sophisticated products like automobiles, for sale back in their home country. Because of the absence of effective labor and environmental standards, workers and other citizens in the low-wage countries are not able to obtain their fair share of gains from increased jobs and productivity.

American manufacturers' trade disadvantages have accelerated outsourcing to low-wage suppliers around the world. The U.S. content of manufacturing production has not kept pace with manufacturing production growth since 1979. The amount of imported intermediate inputs for all manufacturing industries between 1975 and 1995 has doubled. The share of imports of total intermediate goods used in manufacturing grew from 6.5 percent in 1972 to 11.6 percent in 1990. For example, the foreign content of both U.S. commercial and military aircraft is accelerating. Imported engines and parts content, which accounted for 8 percent of total U.S. aircraft sales in 1981, was more than 20 percent in 2001.

Our flawed trade policies have been costing American manufacturing jobs. The Department of Labor has certified more than 450,000 workers who have lost their jobs due to NAFTA. In a 1999 study, the U.S. General Accounting Office found that 47 percent of the workers qualifying for NAFTA trade adjustment assistance were Latino and 66 percent were women. The Labor Department numbers represent just a portion of the total workers who have lost their jobs because of NAFTA. The Economic Policy Institute estimates that the growth in U.S. trade deficits with our NAFTA partners has resulted in a net loss of more than 750,000 American jobs.

The overvalued dollar also has been a key factor diminishing U.S. manufacturing competitiveness and driving up the trade deficit. From January 1995 to January 2003, the dollar appreciated by 33 percent in international value. The chronically overvalued dollar has played a major role in the growth of the trade deficit. Between 1995 and the beginning of 2002, the international value of the dollar rose approximately 30 percent. By the end of 2001, the dollar reached its highest point since January 1986. The value of the dollar affects manufacturers' competitiveness in markets for internationally traded goods. A rise in the dollar increases the price of U.S. produced goods relative to foreign goods. Hence, U.S. manufactured goods become less attractive than foreign goods in domestic and world markets.


This bias favors U.S. investors in foreign nations over U.S. producers in America, who need a lower dollar to expand exports and compete fairly with imports. Thus the high dollar has discouraged investment in domestic manufacturing, reducing manufacturing investment by \$37 billion in 2001. The overly strong dollar also has encouraged large

manufacturers to relocate overseas, where they could pay for inputs to production with undervalued foreign currencies while earning overvalued dollar revenues on sales to American domestic markets. At the same time, many small manufacturing companies, lacking the means to move overseas, have been forced to cut profits, incur losses or close their doors.

U.S. tax policies provide incentives to American firms to move factories and manufacturing jobs offshore. Foreign subsidiaries of U.S. multinational corporations (MNCs), or foreign-controlled corporations, are exempted from paying U.S. corporate income taxes until the income is repatriated from abroad. But this repatriation can be deferred indefinitely. The more extensive the network of foreign operations for an MNC, the greater likelihood of tax avoidance. In addition, taxes paid to foreign governments are credited against U.S. taxes owed. From 1996 to 2002, MNCs received \$12.7 billion in U.S. tax subsidies on their deferred income from controlled foreign operations.

Complementing these provisions in the U.S. tax code is a system of tax rules governing transfer pricing, the hypothetical prices derived for transactions of goods and services between a U.S. parent company and its foreign subsidiaries. According to the Organization for Economic Cooperation and Development (OECD), more than 60 percent of world trade occurs within MNCs as intrafirm transactions. Because of the difficulties of estimating and monitoring MNCs' reporting of transfer prices, companies have been able to shift income out of the United States. Empirical studies link the opportunities to shift income between countries through transfer pricing, thereby evading taxation, to corporate choices of investment locations.

Agenda for a Strong Manufacturing Base

ongress must take immediate steps to address this crisis. The ultimate goals are to make U.S. businesses, workers and communities globally competitive and rebuild the nation's industrial base. Policy reforms in the following areas are essential to achieve these goals.

Trade and industrial revitalization

Measures are needed to improve America's international trade position and strengthen its manufacturing industries. On one hand, we need measures that rectify the trade, dollar and tax policies that put America's manufacturing workers at a competitive disadvantage in the global economy. But even if these problems are addressed, they are not sufficient to return American manufacturing capacity to its former levels. We also need "high-road" industrial development policies that modernize and expand the nation's manufacturing industries while preserving and creating *good* manufacturing jobs—high-wage jobs with full benefits, safe working conditions and dignity and respect in the workplace. Key measures of such a policy agenda to revitalize American manufacturing include:

Trade, dollar and tax policies

- Fair trade policies that reduce the U.S. trade deficit, protect U.S. trade laws and require inclusion of enforceable workers' rights and environmental standards in trade agreements. This includes a thorough re-appraisal of U.S. trade policies and negotiating objectives, as well as opposing bilateral, regional and multilateral trade agreements that incorporate the current flawed policies, such as the U.S.-Chile and U.S.-Singapore Free Trade Agreement and the Free Trade Area of the Americas (FTAA) agreement, which do not include meaningful protections for workers' rights so that America's workers can compete fairly.

- Revised tax laws to eliminate incentives for corporations to move production overseas and punish those that do. This includes opposing any reform of the Foreign Sales Corporation (FSC) tax that would encourage the shift of more manufacturing jobs overseas. FSC should be repealed and replaced with tax incentives that help American manufacturers create U.S. jobs and meet retiree health care and pension costs. Legislation also should be enacted to ensure that American companies pay their fair share of U.S. taxes, eliminating corporate "inversion"—incentives for companies to incorporate overseas to avoid such taxes. Companies that engage in these abuses should be denied government contracts.
- Immediate intervention to address the problem of the overvalued dollar, which puts U.S.-based producers at an impossible competitive disadvantage.
- Rules to deter financial crises and large currency devaluations by reducing developing country debt, regulating financial speculation and reforming the International Monetary Fund and World Bank.

"High-road" strategies for industrial development

- Increased incentives, assistance and access to capital, especially for small- and medium-sized manufacturers, to support modernization, job retention and creation.
- Increased funding and incentives to employers for workforce training, emphasizing joint labor-management initiatives and industry skill standards.

- Measures promoting a strong industrial base for defense and homeland security, including procurement reform, enhanced “Buy American” requirements, an updated assessment of critical defense manufacturing capabilities and limits to “offsets” that drain critical technology and good jobs.
- Increased investment in public infrastructure, transportation, energy and the environment to stimulate innovation, industrial development and job creation.

Health care reform

Solving the health care crisis overall, and for manufacturing in particular, will require a substantial infusion of new public dollars as well as effective cost-containment policies. Individual tax credits and defined contribution health plans are not the answer, as they would simply shift unacceptable costs and risks onto workers and undermine the employment-based system. Key measures to bring new public money into the system, essential for easing cost and competitive pressures and preserving employer-sponsored health care, include:

- A Medicare prescription drug benefit that provides continuous, comprehensive coverage for all seniors, including those previously covered through employer-sponsored plans.
- Opposition to Medicare prescription drug proposals that discriminate against and exclude retirees with coverage under existing employer plans; a new Medicare drug benefit must not penalize employers that provide retiree health care, the primary source of prescription drugs for seniors.
- A mechanism to ensure that existing adequately covered retirees will not risk losing their benefits.
- Significant subsidies to encourage employers who have been offering benefits to active workers and retirees to continue to do so.

Labor law reform

Reforming and enforcing the nation’s labor laws are essential to addressing the manufacturing crisis, as well as for promoting good jobs for all U.S. workers. Without changes in the law, America’s workers, the economy and society will continue to pay a very heavy price, in the form of suppressed wages, enormous and widening gaps in the distribution of income and wealth, weakening of the safety net, decline in civic and political participation, unchecked corporate power and harm to the quality of life. To protect good unionized manufacturing jobs we need:

- Strengthened labor laws to prevent employer interference and suppression of workers’ rights to organize and bargain collectively, including higher penalties for employer violations of labor laws.
- A quicker and fairer process for determining union representation (including card-check procedures and employer neutrality), preventing employers from delaying and obstructing union elections through unending appeals; there should be no bans or limits on the ability of employers to voluntarily recognize unions on the basis of authorization cards or other reliable evidence of majority support for the union, or that would limit the ability of unions to enter into neutrality agreements.
- Meaningful collective bargaining rights for workers who choose union representation.
- Legal protections extended to all workers, regardless of their classification.
- To oppose bills that that would substitute “comp time” for overtime pay—undermining the 40-hour workweek and resulting in more manufacturing workers working longer hours for less pay. Priority should be given to enacting legislation giving workers the right to refuse excessive overtime.

Conclusion

Manufacturing matters! It is critical for America's future economic well-being and national security that we have policies that rebuild our manufacturing capacity and create good manufacturing jobs. The nation no longer

can afford ballooning trade deficits and deepening domestic budget crises driven by the loss of manufacturing that threaten to destabilize our economy and undermine the nation's long-term economic growth. Congress therefore must act now to revitalize America's manufacturing base.

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* *Data Source Note:* Statistical data derive from several sources: employment, earnings and layoff data from the U.S. Bureau of Labor Statistics (BLS); trade data from the U.S. Census Bureau; GDP and industry output data from the U.S. Commerce Department Bureau of Economic Analysis (BEA); and capacity utilization from the Federal Reserve Board.