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New Trade Policy Needed to Restore Health of U.S. Manufacturing

Written Statement Accompanying Oral Remarks and PowerPoint Presentation to the Washington International Trade Association (WITA) Forum on Trade and Manufacturing

by

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Domestic manufacturing is mired in the midst of a crisis unprecedented since the Great Depression. Deeply flawed U.S. trade policy is the single most important root cause of the illness, undermining U.S. manufacturing competitiveness on a global basis.

Absent a rational U.S. trade policy, U.S. manufacturing should be experiencing the best of times. Consider the following. Since 1950, U.S. Gross Domestic Production (GDP) has grown 550 percent in inflation-adjusted terms while the U.S. population has doubled from 150 million to 303 million. Since 1990, U.S. GDP has grown by a little more than 50 percent in inflation-adjusted terms while the U.S. population has increased by 54 million.

Moreover, the percentage of U.S. GDP used for consumer consumption has been above 70 percent in each of the previous six years. Noting this figure, it should not be surprising that U.S. household and federal government debt has skyrocketed to unprecedented levels. Together, household and federal debt almost have doubled over the past seven years, soaring by \$10.4 trillion to reach \$23.1 trillion, an amount 64 percent larger than the entire Gross Domestic Product (GDP). In comparison, total U.S. household and federal debt was 27 percent larger than GDP at the end of 2000. While the current record debt level is the basis for the debt crisis that now has plunged the United States into a new and possibly severe recession, in recent years it should have served as greatest stimulus to U.S. manufacturing since the need for production to fight and win World War II.

Indicators of the Manufacturing Crisis

Rather than showing strong gains in employment, capacity, output, and investment that normally would be expected in an economy experiencing the level of consumer stimulus that the United States has seen in recent years, the evidence instead demonstrates that U.S. manufacturing has slumped severely.

Last year, the United States ran a trade deficit of \$708.5 billion, including a \$498.9 billion deficit in manufacturing goods. The cumulative numbers even are more troubling. Since 1980, the

cumulative U.S. trade deficit is \$6.365 trillion, with manufacturing goods accounting for \$5.249 trillion of that figure. Of even greater concern, almost 59 percent of that trade deficit in manufactured goods, \$3.08 trillion, has been accumulated since 2001. Even the U.S. dollar's 24.2 percent fall against the U.S. Federal Reserve Board's price-adjusted "Broad" Index of world currency values since January 2002, has failed to increase U.S. exports enough to materially stanch the trade red ink.

The United States cannot continue to withstand the problems associated with runaway trade deficit indefinitely. But don't just take AMTAC's word for it, others agree:

- "The present level of the current account deficit is enormous, it is unprecedented and I believe it is unsustainable."
 - Martin Feldstein, Professor of Economics at Harvard University, former Chairman, Reagan Council of Economic Advisors
- "[T]he United States must now attract almost \$7 billion of capital from the rest of the world every working day to finance its current account deficit and its own foreign investment outflows."
 - C. Fred Bergsten, Director, Institute for International Economics
- "[O]ur trade deficit has greatly worsened, to the point that our country's "net worth," so to speak, is now being transferred abroad at an alarming rate. A perpetuation of this transfer will lead to major trouble."
 - Warren Buffet, Chairman, Berkshire Hathaway

This begs a question. How can it be that the United States, a country that possesses the most sophisticated industrial complex in the world, spends billions on research and development and product innovation, and has one the world's most advanced transportation, communication, and higher educational infrastructures, cannot run a trade surplus in virtually any manufacturing sector?

2007 U.S. Trade Deficits in Key Manufacturing Sectors

- \$ 115.7 billion in vehicles
- \$ 105.1 billion in TVs, VCRs, and other electronics
- \$ 88.9 billion in textiles and apparel
- \$ 71.9 billion in computers and office machines
- \$ 44.4 billion in "Advanced Technology Products"
- \$ 28.8 billion in furniture and parts thereof
- \$ 16.9 billion in iron and steel mill production
- **\$ 498.9 billion in all manufactured goods**

Source: U.S. Bureau of the Census and MBG information Services

The reason why the United States runs massive trade deficits in products where free trade theory posits America should have a comparative advantage is because foreign government intervention

negates comparative advantage with value-added tax schemes, manipulated currencies, state sponsored subsidies, lack of protections for intellectual property rights, below market interest rates, and non performing loans that create an absolute advantage for their manufacturers.

These foreign predatory practices often are compounded by other factors such as pennies-per-hour labor, blatant disregard for environmental protection, lack of reasonable labor rights and workplace safety standards, and lack of basic benefits such as health care.

Consequently, it should surprise no one that other key economic health indicators for U.S. manufacturing show either an industry in distress or the weakest growth on record in the last six decades.

The U.S. manufacturing sector's inflation-adjusted capital expenditures for plant and equipment have plunged dramatically. The 2006 expenditure amount of \$116.6 billion was smaller than each of the amounts for 1978 (\$120.7 billion), 1979 (124.2 billion), and 1980 (\$129.7 billion) respectively, the last three years of President Jimmy Carter's administration. Furthermore, it was considerably lower than the \$158.8 billion expenditure peak in 1997.

U.S. manufacturing capacity also has grown at a slower rate in the 2000s than in any of the past six decades. Growth was 50 percent for the 1950s, 63 percent for the 1960s, 38 percent for the 1970s, 25 percent for the 1980s, and 57 for the 1990s. Projected growth for the 2000s has fallen to a mere 16 percent or 1.6 percent per year.

U.S. manufacturing output numbers tell a similar tale as output in the 2000s has grown at a slower rate than in any decade since the 1950s. Output growth was 69 percent for the 1950s, 54 percent for the 1960s, 40 percent for the 1970s, 23 percent for the 1980s, and 56 percent for the 1990s. Projected output growth for the 2000s is an anemic 13 percent or 1.3 percent per year.

Finally, U.S. manufacturing employment collapsed between 2000 and 2003 and has yet to recover from the downturn. It now has plummeted to 13.6 million, its lowest level since May 1950 one month prior to the eruption of the Korean War.

U.S. Manufacturing Employment in Millions

Figures are for January of each year, not seasonally adjusted.

1950 – 13.122	1975 – 17.115	2000 – 17.179
1955 – 14.939	1980 – 19.132	2005 – 14.142
1960 – 15.559	1985 – 17.680	2008 – 13.638
1965 – 16.044	1990 – 17.648	
1970 – 18.254	1995 – 17.133	

Pollyannas arguing that little is wrong with U.S. manufacturing cite U.S. manufacturing productivity increases as the main reason for employment decline. Although U.S. manufacturing productivity indeed has doubled in recent years, U.S. demand for manufactured goods has tripled. Because U.S. growth in demand for manufactured goods exceeds growth in productivity, the United States should be adding manufacturing jobs instead of losing them if it were maintaining its market.

The real culprit in the loss of U.S. manufacturing jobs is the loss of markets and the loss of domestic markets to offshore producers in particular. Since 1980, U.S. demand for durable manufactured goods has soared nearly 400 percent. U.S. production of durable manufactured goods, however, only has grown by 40 percent of that total. To further illustrate this point, U.S. Business and Industry Council Research Fellow Alan Tonelson conducted a study on import penetration rates for 114 high tech and other capital-intensive industries in the U.S.

manufacturing sector. His research showed that import penetration rates for those industries jumped by 58.6 percent from a penetration rate of 21.4 percent in 1997 to 33.9 percent in 2006.¹

New Trade Policy Needed to Restore Health of U.S. Manufacturing

Considering the undeniable plight of U.S. manufacturing, comprehensive new U.S. trade policy desperately are needed.

Require Reciprocity – U.S. trade policy must be redirected to its original roots in reciprocity, a concept clearly not present in the global economy’s chief trade regime, the World Trade Organization (WTO). In the Uruguay Round, the United States agreed to lower or eliminate most barriers to its market for manufactured products without receiving commensurate market access from the rest of the world in return. Today, the average U.S. bound tariff for industrial products is 3 percent, while the average worldwide bound tariff is 30 percent.² Moreover, the average trade weighted U.S. industrial tariff stands at less than 1.7 percent.

In this regard, one significant problem is the ability of WTO members to self-designate themselves as “developing countries”, a status granting them more favorable trading privileges than self-designated “developed” countries such as the United States. The ability of WTO members to self-designate their country status must be eliminated and replaced with objective criteria that accurately measure a country’s ability to compete in the global trading arena.

Take China for example. While it may be a developing country in many respects, it is an international superpower in terms of global trade. In both 2006 and 2007 China exported more manufacturing goods to the world than did the United States. Yet under the current WTO regime, China is allowed to maintain high tariff walls and other substantial non-tariff barriers to market access as a self-designated “developing country”.

The ongoing Doha Round negotiations only further would exacerbate the lack of reciprocity afforded to U.S. producers. The Doha Round’s Non-Agricultural Market Access (NAMA) text grants numerous exemptions to developing countries such as that contained in the Hong Kong Declaration’s paragraph 14, “*Take fully into account the special needs and interests of developing countries including through less than full reciprocity in reduction commitments.*” The NAMA Chairman’s July 2007 text states, “There is almost unanimous support that a simple Swiss formula with two coefficients should be adopted.” Finally, for developed countries such as the United States, the maximum industrial tariff allowed proposed in the current NAMA negotiations is to be between 8 and 9 percent. In contrast, developing countries such as China will be allowed a tariff ceiling that would fall between 19 and 23 percent.

Offset the VAT Border Tax Disadvantage – Currently, 149 countries, accounting for approximately 95 percent of all U.S. trade, utilize a border-adjusted, value-added (VAT) tax system implemented at average rate of 15.4 percent. This tax often is among a country’s most significant revenue sources to pay for such expenditures as nationalized health care and other vital government services.

Countries utilizing value-added tax systems impose those taxes on the cost of an import plus all shipping, handling, insurance and tariff expenses. They also rebate any VAT paid on a domestically produced good that is exported. Meanwhile, the United States neither rebates the

¹ See USBIC Research Alert, *New Data Show Import Growth Depressing U.S. Industrial Output; Advanced U.S. Manufacturers Keep Losing Ground in Home Market*, by Alan Tonelson and Sarah Linden, January 8, 2008.

² Statement of Senator Charles Grassley at Senate Finance Hearing on WTO negotiations 10/27/2005

taxes paid by a producer upon the export of a good nor imposes a significant tax burden on imports.

Consequently, goods produced in VAT countries have a built-in price advantage over their U.S. counterparts. Producers in VAT countries often are able to export goods at a price that deducts the U.S. equivalent of payroll and other taxes that are used to pay for social security, unemployment insurance, and health care costs. U.S. producers not only pay those U.S. taxes in the process of manufacturing domestically produced goods, they also are forced to pay them in other countries the moment a U.S. export is slapped with a VAT. AMTAC estimates that border-adjusted VAT schemes disadvantaged U.S. producers and service providers by a staggering \$428 billion in 2006.

Ordinarily, a VAT would be viewed as an impermissible export subsidy under current trade rules. Unfortunately, in the years following World War II, the United States agreed to a loophole under the old General Agreement on Tariffs and Trade (GATT) the exempted VAT subsidies. Since allowing that loophole, use of the VAT grew from just France to almost the rest of the world, 149 countries. And as one would expect, VAT rates often have risen as tariff rates have fallen, creating a constant, but less visible barrier to U.S. exports. For the European Union (EU), the average barrier to U.S. exports has remained nearly constant at 23.8 percent since 1968. Although the average EU tariff has dropped from 10.4 percent in 1968 to 4.4 percent in 2006, the average EU VAT has risen from 13.4 percent to 19.4 percent.

Last year, Congressmen Bill Pascrell (D-NJ), Duncan Hunter (R-CA), Mike Michaud (D-ME), and Walter Jones (R-NC) introduced H.R. 2600, the Border Tax Equity Act, to offset the VAT disadvantage to U.S. producers and service providers. Its swift enactment is a key to restoring U.S. manufacturing health.

Make Currency Manipulation an Actionable Subsidy – U.S. congressional and executive inaction against blatant currency manipulation by China is inexcusable. For years that country has pegged the value of its currency, the yuan, to the U.S. dollar at an artificially low rate. Factoring inflation, the value of the yuan has risen in value by less than 5 percent against the U.S. dollar since its peg was “loosened” to a basket of currencies in 2005. This policy has enabled China to simultaneously lower the cost of its exports and raise substantial barriers to imports.

Since 2001, the year China joined the WTO, the U.S. merchandise trade deficit with that country has exploded from around \$80 billion to a staggering \$256 billion in 2007. The cumulative U.S. trade deficit with China during that same time period for manufactured goods was a staggering \$1.2 trillion!

The United States imported \$313.6 billion in manufactured goods from China in 2007. If China were undervaluing its currency by 35 percent, a figure not unreasonable to many experts, it would amount to a subsidy of nearly \$110 billion to Chinese manufacturing exporters. With subsidies like this, it should surprise no one that less productive and efficient Chinese manufacturers can ship their products halfway around the world to the United States and still undercut the prices of their U.S. competitors.

Congressmen Tim Ryan (D-OH) and Duncan Hunter (R-CA) have introduced H.R. 2942, the Currency Reform for Fair Trade Act of 2007, to discourage currency manipulation by China, Japan, and other countries. Its strongest deterrent is a provision that would make currency manipulation an actionable subsidy under U.S. countervailing duty (CVD) law. Enactment of this legislation is imperative if the United States is to reduce its manufacturing and trade policy competitiveness gap with China, Japan and others.

Separate Trade Enforcement from the Office of the U.S. Trade Representative – It is unreasonable to expect that an office who on one hand is charged with negotiating trade

agreements with other countries to then be able to turn around and impartially punish them when they run afoul of U.S. trade law. The conflicts of interest inherently are too great. As such, all enforcement of U.S. trade law should be separated from the Office of the U.S. Trade Representative (USTR).

A separate U.S. governmental entity should be set up as an independent agency or in another cabinet-level department, such as the U.S. Department of Commerce, to enforce U.S. trade law. This body would be charged with aggressively pursuing dumping, subsidy and intellectual property rights violation cases within the U.S. judicial and regulatory system and at the WTO. The anti-competitive dumping and illegal subsidy practices revealed in recent cases against China (the case on coated free sheet paper is a good example) should provide enough work to keep any enforcement agency busy for years.

Also as part of this reform, the U.S. government should reduce the cost and barriers to U.S. manufacturers attempting to bring trade enforcement cases. Presently, anti-dumping and CVD cases often cost millions for U.S. manufacturers to prosecute effectively. Even after making such a financial commitment, a favorable outcome is not guaranteed. In addition, U.S. manufacturers in product's supply chain often have almost no access to trade law remedies due to a lack of standing. Only the assembler of the final product and/or its workers, i.e. a union, usually effectively have standing to file a case. These costs and barriers deter the filing of many legitimate trade cases. The United States should consider adopting reforms to mimic the European Union where manufacturers would submit data indicating a likelihood of dumping or CVD infraction and the government then would investigate them and render a decision.

Stop Negotiating FTAs With Countries That Cannot Buy Finished U.S. Goods – Finally, the United States should stop negotiating free trade agreements with countries or economic regions that either are unwilling or unable to buy finished U.S. goods at the same rate they export to the United States.

Flawed U.S. free trade agreements demonstrably have fueled the U.S. trade deficit. Measuring U.S. government data for domestic exports³ minus imports for consumption,⁴ the U.S. trade deficit with our free trade partners has skyrocketed since 1989 from \$13.55 billion to a whopping \$187.84 billion in 2007.

U.S. Trade Deficits with FTA Partners 1989-2007

1989 (Israel + Canada): -\$13,549,305,466
1990 (Israel + Canada): -\$13,395,009,866
1991 (Israel + Canada): -\$12,206,751,399
1992 (Israel + Canada): -\$15,179,629,034
1993 (Israel + Canada): -\$19,088,159,601
1994 (Israel, Canada, Mexico): -\$25,429,628,843

³ Domestic Exports are defined as exports of domestic merchandise include commodities which are grown, produced or manufactured in the United States, and commodities of foreign origin which have been changed in the United States, including U.S. Foreign Trade Zones, or which have been enhanced in value by further manufacture in the United States.

⁴ Imports for Consumption measure the merchandise that has physically cleared Customs either entering consumption channels immediately or entering after withdrawal from bonded warehouses under Customs custody or from Foreign Trade Zones.

1995 (Israel, Canada, Mexico): -\$49,369,863,070
1996 (Israel, Canada, Mexico): -\$58,021,526,324
1997 (Israel, Canada, Mexico): -\$52,183,393,917
1998 (Israel, Canada, Mexico): -\$57,504,788,445
1999 (Israel, Canada, Mexico): -\$83,674,235,439
2000 (Israel, Canada, Mexico): -\$114,509,613,954
2001 (Israel, Canada, Mexico): -\$118,007,897,734
2002 (Israel, Canada, Mexico, Jordan): -\$123,167,746,864
2003 (Israel, Canada, Mexico, Jordan): -\$137,750,076,888
2004 (Israel, Canada, Mexico, Jordan, Singapore, Chile): -\$162,306,487,398
2005 (Israel, Canada, Mexico, Jordan, Singapore, Chile, Australia): -\$174,084,390,236
2006 (Israel, Canada, Mexico, Jordan, Singapore, Chile, Australia, Morocco): -\$189,415,360,242
2007 (Israel, Canada, Mexico, Jordan, Singapore, Chile, Australia, Morocco, El Salvador, Honduras, Nicaragua, Guatemala, Bahrain): -\$187,843,239,265

Source: U.S. International Trade Commission

Instead of seeking out negotiating partners in small or developing countries, the United States should be targeting agreements or economic alliances with countries that have lucrative consumption markets and a settled rule of law. Japan or the European Union would be examples of two good candidates. These trade partners both have sufficient large populations and high standards of living to buy sizeable quantities of U.S. exports if a good free trade agreement were negotiated and properly enforced.

Conclusion

Despite the hardships it has faced, the health of U.S. manufacturing quickly can be restored if the United States fixes its broken trade policy. Weak and inefficient U.S. manufacturers closed their doors years ago. Only the strongest and most efficient U.S. manufacturers have been able to survive in such a hostile competitive atmosphere. These companies will be well placed to ramp up new investment, reclaim lost market share, and add employment if the U.S. government removes trade policy obstacles impeding their success.

The American Manufacturing Trade Action Coalition is a lobbying organization representing domestic manufacturers. Our mission is to preserve and create American manufacturing jobs through the establishment of trade policy and other measures necessary for the U.S. manufacturing sector to stabilize and grow. Data and analysis from Dr. Charles W. McMillion, President and Chief Economist of MBG Information Services, was used in compiling this statement.

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