A War of Economic Survival

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Part One of a Two-Part Series

Many people and companies see the U.S. economy as recovering. In fact, the Wall Street managers are back to paying huge bonuses, the auto industry is back in the black after the tax payers bailed them out, and Fortune 1000 companies' balance sheets are fat with cash. If it wasn't for the unemployment rate, you would think that America is coming out of the great recession and everything will bounce back as happened in many previous recessions.

But even if GDP growth goes to 4 percent and unemployment comes down to 5 percent, I would like to make the argument that the economy is in trouble and long-term growth is really not assured. There are structural changes in the economy that are subtle but very important. The U.S. is ignoring manufacturing, budget deficits, trade deficits, China's manipulation of their currency, the decline of R&D, the loss of our technologies to China, and the decline of good-paying jobs for the middle class. As long as we can print money and borrow from the Chinese, we continue to ignore the real structural problems in our economy.

I think manufacturing is the real key to the future of the economy. Despite the political spin and the two parties basically ignoring manufacturing, a clear picture has emerged with some undeniable truths. Before jumping to the solutions, it is useful to review some of the fundamental reasons behind the decline of American manufacturing, and the fundamental problems of our economy and how they will affect the future.

Manufacturing Jobs

One of the primary and most visible issues in the manufacturing crisis is the loss of

good jobs with good wages. Since 1977, we have lost 10 million manufacturing jobs that pay on the average about $20,000 more per year then the average of other private sector jobs. The Labor Department's 10-year projection of jobs shows that the projected jobs are mostly service jobs, and 73 percent of the jobs are either low pay or very low pay. This paints a grim picture for the middle class in terms of having enough "family-wage" jobs.

Secondary Jobs

Manufacturing stimulates employment in other sectors at a greater pace than other industries. On the average, each $1 million in final sales of manufactured products supports eight jobs in the manufacturing sector and six jobs in other sectors of the economy.

Research & Development

Manufacturing performs about two-thirds of the total money annually invested in R&D in the U.S. Innovation and R&D have been the traditional strengths of the U.S. for decades. But the reduction in manufacturing companies, workers and industries is showing a reduction in R&D expenditures. And in fact, a lot of American research and development is going overseas along with production and jobs.

In December, the Chinese made a new rule requiring all foreign manufacturers with plants in China to move their R&D and patents to China. In 2010, they decided that all imported electronic goods must reveal their source codes to a government agency. Three different people were found guilty last year of selling defense secrets to the Chinese. When are we going to wake up to the fact that they are after our technologies and it is us who is allowing it to happen?

Exports

Manufacturing contributes to more than 60 percent of American exports. But with the continued decline of manufacturing, the U.S. is losing its "place as exporter to the world." The U.S. is now the number three exporter behind China and Germany. President Obama has set a goal of doubling exports in five years, but this goal cannot be attained as long as we allow our trading partners to manipulate their currencies and keep our trade deficit high.

Trade Deficit

Our trade deficit (which is the largest of any country) is not sustainable. We have been running huge deficits because foreign governments are willing to lend us huge sums of money. But one of these days, the easy money will end, and the U.S. will have to start paying its way and learn how to live within our means. And the only way we can change our trade deficits is to increase exports or reduce imports. Since manufacturing is two-thirds of all exported goods, America must grow manufacturing. But we have no chance of achieving our export goals or growing manufacturing unless we can force China to quit manipulating their currency.

State Economies

The bureau of Economic Analysis shows, “During the last 10 years, manufacturing corporations have paid 30 to 34 percent of all corporate tax payments for state and local taxes, social security and payroll taxes, excise taxes, import and tariff duties, environmental taxes and license taxes.” In light of the current crisis in state budgets, states cannot afford continued loss of manufacturing tax revenue, or they may never overcome their financial and unemployment problems.

Defense

Many industries (like aerospace, high technology, software and others) build the products that allow America to have the world’s most powerful arsenal. Basic industries, such as the chemical, petroleum, mining and electronics industries, are part of our strategic and defensive reserves. Maintaining these industries, and the suppliers and skilled workers in them, is a matter of national security.

Stealing Technologies

In just the last year, two different people were caught selling secrets of the F117 stealth technology and the B-2 bomber to China. How many technologies are they going to steal or copy before we wake up to the fact that they are going to take our technologies any way they can get them — legal or illegal?

The Threat to Other Industries

Manufacturing directly supports distribution networks, communications, transportation, utilities and trade. About 80 percent of all goods hauled by trucks and 80 percent of all goods hauled by railroads are manufactured goods. The decline of manufacturing will automatically force a reduction in these industries, as well as all of the OEMs that supply them equipment. All of these interconnected industries also have good-paying jobs with benefits, and will decline with manufacturing.

Living Standards

In the past 10 years, the living standards of the middle class have either stagnated or declined.

Outsourcing

The large companies continue to outsource and there is little effort to create U.S. jobs. In fact, the large companies that have invested in China do not want any threats to their Chinese partners that would threaten their Chinese businesses. Using organizations like the U.S. Chamber of Commerce, the National Association of Manufacturers and the Business Roundtable, they lobby Congress to oppose any legislation that the Chinese oppose. I see little hope that the multi-nationals will change their minds about outsourcing unless Chinese costs increase.

Patriotism

The giant U.S. manufacturers seem to be indifferent to the future decline of the American consumption economy. Despite the government-appointed commissions and the lip service promotions from their front associations, these companies are focused on their bottom lines and money wherever they can make it in the world.

Unfair Currency Manipulation

China continues to manipulate their currency, which is undervalued by 40 percent. This makes China very attractive for American manufacturers seeking ways to lower costs, and it makes Chinese imports superficially cheap. It also makes any attempt at increasing exports or solving the trade deficit very unlikely.

Illegal Subsidies & Tariffs

China also competes unfairly by employing illegal subsidies and tariffs. For instance, Caterpillar recently decided to build its new mini-excavator lineup in China. If the company had built the machine in the U.S. for export to China, it would have faced a 30 percent import tariff.

Trade Agreements

Trade agreements like NAFTA and the recent Korean Agreement may be good for trade, but they have not been good for well-paid manufacturing workers. These agreements have and will result in the long-term hollowing out of the middle class.

Conclusion

The long-term economic picture is actually very simple to explain. Our economy is based on 70 percent of GDP being consumption — that is, American consumers buying products in our country with their wages. If the consumers of the future can’t find good family-wage jobs, or if their incomes and wages continue to decline, then consumption will decline and so will GDP growth. The obvious solution is to create good-paying jobs that allow them to continue to consume — but that is not happening for the middle class and eventually it will catch up to us.

In a 2007 economic report, Joel Popkin says, “The success of the U.S. manufacturing sector requires a certain mass to be sustainable. This mass must be large enough to encourage R&D domestically, conducted by our scientists, and to encourage U.S. business to invest in capital goods and human capital in the United States. Once that mass has diminished below its critical value, the process by which prosperity has been generated may never be recovered. If that is permitted to occur, the growth rate of the U.S. economy may drop to half its historical average. If the U.S. manufacturing base continues to shrink at its present rate and the critical mass is lost, the manufacturing innovation process will shift to other global centers. Once that happens, a decline in U.S. living standards is all but assured.”

This statement is much closer to the true picture of what may happen in our

economy. It says that the key to GDP growth — innovation, R&D, jobs and living standards — is manufacturing.

I suggest to you readers that the current indicators of recovery mask the real structural problems facing our economy. We are fighting a war of economic survival, and our foreign trading partners, like Germany, China and India, are going to use any tactic to gain a competitive advantage to ultimately win regardless of what happens to the American economy. On the other hand, America is still stuck in the free trade “hands off” approach and is not fighting as hard as our competitors to win the war. We have been talking for years about these problems and seem very afraid of our trading partners crying “protectionism” if we take any action.

Ralph Gomory, the former head of IBM research, said the United States is in an undeclared war and only one side is fighting. Andy Grove, the ex-CEO of Intel, said in a recent article that we are in economic war and so we had better “fight to win. If this sounds protectionist — then so be it."

Tomorrow’s column will offer solutions to these problems. Michael P. Collins is the author of the book, Saving American Manufacturing*. You can find related articles on his website at www.mpcmgt.com* [1]*.*

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