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THE WTO'S CHALLENGE TO THE FSC/ETI RULES AND THE EFFECT ON AMERICA'S SMALL BUSINESSES

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

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THE WTO'S CHALLENGE TO THE FSC/ETI RULES AND THE EFFECT ON AMERICA'S SMALL BUSINESSES

WEDNESDAY, SEPTEMBER 10, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Committee met, pursuant to call, at 2:40 p.m. in Room 2360, Rayburn House Office Building, Hon. Donald A. Manzullo [chairman of the Committee] presiding.

Chairman MANZULLO. During August of 2002, a World Trade Organization arbitration panel determined that the European Community is entitled to over $4 billion of annual countermeasures against the U.S. for failure to repeal it's FSC/ETI rules, rules that level the international trade playing field by providing modest tax incentives for U.S. exporters.

Earlier this year, European Trade Commissioner Pascal Lamy announced that sanctions would begin on January 1st of next year if Congress fails to repeal the present FSC/ETI rules before the end of the year.

Within the past month, OMB Director Josh Bolten emphasized the need to act swiftly in complying with the WTO decision and stated that any legislative solution needs to be revenue neutral. The same mantra has been repeated for months in the Senate. Compliance with the WTO decision needs to be revenue neutral in order to ensure passage in the Senate.

Despite the fact that significant economic trade sanctions and possibly a trade war loom on the horizon to date the only revenue neutral solution to the WTO decision is H.R. 1769, Job Protection Act of 2003. This bill, otherwise known as the Crane-Rangel-Manzullo-Levin bill after the bill's original four co-sponsors, currently has over 140 sponsors in the House.

In brief summary, Crane-Rangel-Manzullo-Levin replaced the FSC/ETI rules with an exclusion from taxation of up to 10 percent of income for domestic manufacturers and producers. This straightforward solution is appropriate given the current crisis in domestic manufacturing, coupled with the fact that over 75 percent of the FSC/ETI benefits currently flow to domestic manufacturers.

The only other legislation solution in the House to the WTO challenge is a bill recently introduced by the Chairman of Ways and Means Committee, Mr. Thomas. Unfortunately, that bill is not revenue neutral. It would cause an additional $128 billion over 10 years, therefore is a political nonstarter in the Senate.

The Thomas bill also contains several controversial tax increases. For example, the Thomas bill would impose higher taxes on foreign-owned corporations that operate in the U.S. Foreign subsidiaries employ 13.5 percent of the domestic manufacturing workforce and account for 22 percent of all U.S. exports.

The Thomas bill tax hike would discourage further investment and put existing U.S. jobs at risk.

A great deal is at stake in the face of the WTO challenge. Our domestic manufacturing base has been hauled out right before our very eyes. Something must be done to ensure that a viable manufacturing base is preserved in the U.S., particularly for our small businesses.

Our first panel we will hear from Congressman Phil Crane and Congressman Sander Levin. These two individuals are the original co-sponsors of Crane-Rangel-Manzullo-Levin, and are to be praised for their leadership in trying to resolve the current WTO challenge.

In our second panel we will hear from several small business witnesses as well as experts who will discuss the current crisis in domestic manufacturing.

Originally, Senator Breaux of Louisiana and Senator Smith of Oregon were scheduled to appear on the first panel. These two senators circulated a letter last month signed by 42 other senators that urge compliance with the WTO decision in a manner that would, first and foremost, benefit U.S. manufacturing, which our bill does.

Unfortunately, Senator Breaux has been detained with the Medicare conference. In addition, the unexpected death of Senator Smith's oldest son earlier this week understandably changed his plans. Our sympathies are with Senator Smith and his family during this tragic time. I know I speak for all members of the Committee when I say that we grieve with the Smiths and pray for them.

I look forward to the testimony of the witnesses. On behalf of the Committee, I wish to thank the witnesses for coming, especially those who have traveled far.

[Mr. Manzullo's statement may be found in the appendix.]

Chairman MANZULLO. I now yield for an opening statement by the gentlelady from New York, Mrs. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

In the spring, this Committee held a hearing on export benefits for our domestic producers. One of these benefits is the FSC/ETI regime. This regime provide tax benefits to the exporters to help them effectively compete in the international economy. Unfortunately, the European Union lodged a complaint against this provision through the World Trade Organization.

As a result, if the FSC/ETI provisions are not repealed, the European Union have threatened over $4 billion in countermeasures per year on U.S. goods starting in 2004.

It is in our best interest to comply with international rules and avoid the billions in sanctions, but where will this leave our exporters?

Right now our exporters, many of which are small and medium-sized businesses, need help. They face a struggling economy here at home and tough competition abroad. If the FSC/ETI provisions are taken away, measures must be put in place to keep our export businesses strong and successful in the international trade arena.

This, in turn, will help our country since exporting can be a powerful engine of economic expansion and job creation.

In the first hearing, our Committee focused heavily on how the FSC/ETI repeal will hurt U.S. manufacturers. I thin it is important that in today's hearing we also look outside of the manufacturing sector and recognize how the service sector will also be affected. This is not only a manufacturing issue; it is an issue for farmers, financial service firms, and many small exporters as well.

Whatever the answer may be it must be focused on providing the necessary assistance to all those U.S. exporters that benefit from the FSC/ETI and stand to lose the most when it disappears.

As we know, right now there are two proposals to address the issue, but in this debate it is critical that we do not cast the net too wide. With our current budget and trade deficits, this nation simply cannot afford to provide tax benefits to companies that do not really need them or will not be impacted by this measure.

An answer needs to be found and fast. Our nation's exporters will face $4 billion in annual retaliatory sanctions. This will put them at an even more pronounced competitive disadvantage than the one they already face.

No one is questioning the need to act, but it is debatable what solution makes the most sense. We need a solution that will assist the largest number of our exporters with the most reasonable price tag.

But once again, a sweeping approach instead of a targeted is being favored. Only in Washington would we attempt to solve a $50 billion trade problem with an almost $200 billion solution. It is ironic that while funds for the child tax credit are unavailable, these same lawmakers can come up with twice the amount needed to create additional corporate tax breaks.

In order to solve this problem, we need a solution that will focus on all the affected sectors, helping them to recoup the costs they will lose as a result of the repeal. We cannot use this as an excuse to pass more tax cuts. That is the last thing our country and our exporters need right now.

As the deadline looms for the end to this rule, we must find a solution that secures the safety and competitiveness of our nation's exporters in today's global market by benefiting those companies that will suffer with the most good for them and for our nation as a whole.

Thank you, Mr. Chairman.

Chairman MANZULLO. And thank you.

Congressman Crane.

STATEMENT OF THE HONORABLE PHILIP M. CRANE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. CRANE. Thank you, Mr. Chairman, and Members of the Committee for inviting me to testify today. When I last appeared before this Committee, I submitted fairly lengthy testimony regarding my views on how best to address the FSC/ETI challenge that Congress must solve this year in order to avoid $4 billion in potential annual retaliatory sanctions against U.S. businesses by the EU and a $51 billion tax increase over the next 10 years on U.S. manufacturers. I will therefore keep my remarks brief, and I look forward to answering any questions you might have.

Again, Mr. Chairman, I would like to say that it has been a privilege working with you to develop legislation that will both bring us into compliance with our WTO agreements and strengthen domestic manufacturing. I believe that our legislation, H.R. 1769, the Job Protection Act of 2003, also known as Crane-Rangel-Manzullo-Levin, is the best way to address the FSC/ETI challenge.

When I last testified before this Committee on May 14th, broad bipartisan support for H.R. 1769 already existed. Since that time, an additional 80 representatives have added their names to this legislation. As it now stands, over 140 Members of Congress have cosponsored H.R. 1769, including seven Committee chairman and six ranking members, and the breakdown has been almost 50/50 Democrats/Republicans.

The reason for this support is clear: our legislation makes sense. At a time in which our nation is hemorrhaging manufacturing jobs, it would be irresponsible to raise taxes on that sector of the economy. Yet, that is precisely what some proposals would do.

H.R. 1769, in contrast, returns all of the $51 billion raised upon the repeal of FSC/ETI to the manufacturing sector from whence it came. The effective rate reduction in our bill is undoubtedly WTO-compliant, because it treats all manufacturers producing in the United States equally, irrespective whether they export. At the same time, it provide significant transition relief to current FSC/ETI beneficiaries. This transition relief is similar in scope to that which we have granted the EU in similar, long-running trade disputes.

Unlike other proposals H.R. 1769 does not impose controversial tax increases on the domestic operations of foreign companies. Foreign subsidiaries employ 13.5 percent of the domestic manufacturing workforce and account for 22 percent of U.S. exports. And as you said, Mr. Chairman, tax hikes of the kind contained in H.R. 2896 would discourage further investment and put existing U.S. jobs at risk.

This debate has become politically charged, but there is far too much on the line to allow this to denigrate in a mere political exercise. At stake are millions of manufacturing jobs here at home, as well as a potential annual $4 billion retaliatory tariffs by the EU against our businesses if we do not repeal ETI this year. We must act now to stop either of these two events from occurring.

In closing, I look forward to continuing to work with my colleagues to address our WTO commitments while ensuring that we maintain a strong manufacturing base here at home. We must insist on no less.

Thank you, Mr. Chairman.

[Mr. Crane's statement may be found in the appendix.]

Chairman MANZULLO. Thank you, Congressman Crane.

Congressman Levin.

STATEMENT OF THE HONORABLE SANDER M. LEVIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. LEVIN. Thank you, Mr. Chairman and Ranking Member Velazquez, and other colleagues, Sue Kelly, Congresswoman Kelly, and Congresswoman Sanchez.

I am really glad to be here. I have been glad to be a member of the group of four. Three of us are here today. Mr. Rangel is very much here in spirit. He will be back next week in full form. Here is why I am so glad that we are doing this.

Number one, the crisis is clear, and it is now being repeated so often maybe it is getting through. Thirty-seven straight months of job losses in manufacturing, a record since the Great Depression; 2.5 million jobs, manufacturing jobs lost since 2001. So the facts, the basic dynamic is clear.

Secondly, FSC has been an important tool. There has been some discussion about it, about whether it was broad enough, but undeniably it was an important tool for our manufacturers.

Three, our proposal addresses this need. It has a clear focus to it. Its focus is on manufacturing. Its benefits could be spread or would be spread somewhat broader than that, but it is almost a laser beam as much as my fourth point is WTO consistence. It is.

And I would ask unanimous consent from the Subcommittee if I could enter a brief description of the WTO consistency.

Chairman MANZULLO. Without hesitation.

Mr. LEVIN. You know, we have looked at this, and I think clearly it is. You know, the history of this is that the Europeans had an advantage because of their vast VAT system. And so the U.S. tried a number of approaches to try to be essentially on a level playing field with the Europeans and anybody else who had a VAT system.

When we were about to adopt this, I think it is pretty clear the Europeans acknowledge the U.S. had to do something, and the assumption was it would not challenge the FSC, which was a replacement for a predecessor. But they went ahead and did so, they challenged it, in my judgment, to gain some advantage in bargaining on other trade issues.

But we are where we are and this bill that now has 143 sponsors, a wide variety of members, is responsible to the need, is WTO-consistent.

The Chairman of our Committee has introduced a bill that, number one, is really a hodgepodge. It goes way beyond the problems in manufacturing. And when one reviews it, one sees indeed what a hodgepodge it is. I have worked on reform of international law system for a number of years. This goes way beyond any set of proposals that has had a broad base of support.

And another point is they are expensive. The bill that we have introduced and now has so many sponsors is not only WTO-consistent, it is fiscally sound, and I don't know where in the world our Chairman feels the money would come from for what would be somewhere between 128 and 200 billion, depending on its final shake.

So I just urge all of us to pull together here. The crisis is so plain. This is one of the pieces of an appropriate response to that crisis. So I am hopeful in the next weeks that this matter will be taken up, and that there will be this strong bipartisan effort successful first in the Committee, and then on the floor.

I think the manufacturers of this country are waiting for a response from the White House and the House and the Senate, and this bill here is the appropriate response.

Thank you very much.

[Mr. Levin's statement may be found in the appendix.]

Chairman MANZULLO. Do you gentlemen have time for a couple of questions?

Mr. LEVIN. Sure.

Chairman MANZULLO. The Senate Finance Chairman Grassley announced earlier this week that it intends to introduce the markup of FSC/ETI bill before the end of the month, and I was wondering if you wanted to comment on Senator Grassley's thoughts of the bills vis-á-vis the Thomas Bill and Crane-Rangel-Manzullo-Levin.

Mr. CRANE. I have not seen and read the Grassley bill yet, but what I have read about it sounds very similar to our proposal, and I think that we can anticipate that he is marching down the same path, and that we could get good support between our two chambers.

Mr. LEVIN. My reading is the same. I think it is focused, from what I read, and fiscally responsible.

Chairman MANZULLO. I had one other question that I—Congressman Levin, that I wanted to take from your written testimony, and see if you could embellish on it. It is on page 2 in the—it is the last sentence in the second full paragraph where it starts, "When you put the two together, the Thomas bill raises taxes on some domestic manufacturing activities while lowering taxes on the offshore manufacturing activities of U.S. firms. In other words, the Thomas bill effectively provides an incentive for U.S. companies to move production offshore."

Could you elucidate upon that?

Mr. LEVIN. Yes. First of all, if there is a repeal of FSC, and by the way, I think we should have been raising this issue in the WTO negotiations now underway in Cancun, but we really did not effectively do that, but if we repeal FSC and do not replace it with a proposal that addresses manufacturing, by definition you are going to raise taxes on a good part of the manufacturing processes in this country. There is no escape from it.

And the problem is deepened because of some of the reforms that he is proposing, at least within the original bill, and as I said, we need reform of the international tax laws, and we have done some of this, but this goes way beyond. And I think the way it is constructed would stimulate more offshore production and business rather than less because of the mix of proposals that he has on the international tax law structure.

Chairman MANZULLO. Thank you.

Mrs. Velazquez?

Well thank you for your testimony. Appreciate it very much.

Mr. LEVIN. Thank you.

Chairman MANZULLO. Look forward to getting a lot more cosponsors.

Mr. LEVIN. You bet. Keep this up.

Chairman MANZULLO. We will.

Mr. LEVIN. Thank you.

Chairman MANZULLO. We will.

It is good to have you all here, and the rules generally are limit your testimony to five minutes. There is a little box up there that when it is green, you are fine; when it is yellow, you are on one minute of thin ice; when it is red, it is time for the next witness. So the written statements offered by the witnesses will all be made part of the official record. Anybody else wanting to submit a statement for the official record can do so, provided that it is limited to two pages of single-spaced type, no appendices, and the type has to be at least 11 point. It is pretty specific, is it not?

Okay, our first witness is Kathryn—is it Kobe?

Ms. KOBE. Kobe, that is correct.

Chairman MANZULLO. Chief Economist for Joel Popkin and Company, and that firm recently authored a study on the condition of manufacturing the U.S.

We look forward to your testimony.

STATEMENT OF KATHRYN KOBE, CHIEF ECONOMIST, JOEL POPKIN AND COMPANY, WASHINGTON, DC

Ms. KOBE. Thank you, Mr. Chairman, Members of the Committee, I am Kathryn Kobe. I am Chief Economist of Joel Popkin and Company. We are economic consultants here in Washington, D.C., and as was mentioned by the Chairman, we recently completed a white paper on the importance of manufacturing for the Council of Manufacturing Associations. I have been asked to just outline the current state of manufacturing in the U.S.

One sign of a healthy economy is if employment is increasing, and by that standard manufacturing is not healthy right now. Since the beginning of the recession, the number of manufacturing jobs has declined by 2.4 million. That is between March of 2001 and August of 2003, and that is over 70 percent of the 3.3 million jobs lost during the time period in the private sector.

However, manufacturing was already losing jobs prior to that. It has lost about a half a million jobs between 1998 and the beginning of 2001, and we are to a point now, and I think this a more worsened point, where we have lost more jobs in manufacturing since the end of the recession than we did during the recession.

And I think that brings us to the question as to whether this is a different cycle than we have seen in the past, or whether this follows the pattern of the usual business cycle.

Because of a lot of productivity growth in manufacturing, if you had relatively anemic job growth in manufacturing but still had growth in output, you might think that the sector was somewhat more healthy than it looks right now. But we are not seeing that. In the expansions during the sixties, seventies and eighties, after 20 months of expansion you were seeing growth in manufacturing output of close to 20 percent. In the 1991 expansion, it took a little bit longer, actually several months longer, to reach that point, but even than after 20 months manufacturing output was up 80 percent.

In this expansion after 20 months, manufacturing output is up less than one percent. Manufacturing output has not grown since the end of the recession.

If we really are looking at a decline in the manufacturing sector in the U.S. rather than simply as cyclical downturn that will turn up as the economy turns up, what are we losing? I think we are losing quite a bit.

Demand for manufactured products produces more secondary growth than does any other sector in the U.S. economy. That means for each dollar of final demand in manufactured product, an additional 1.43 dollars worth of goods and services is needed to produce it.

It is also a leader in productivity growth. For the past 15 years, predicative growth in manufacturing has grown over three percent a year, and that really drives underlying productivity growth in the whole U.S. economy.

Manufacturers link the U.S. and the rest of the world. United States is the world's largest exporter of manufactured good. In 2001, it exported almost $600 billion worth of goods, and through most of the past two decades it has held its share. Through a vastly growing manufacturing trade sector, its share has remained relatively constant, between 12 and 13.5 percent.

However, in 2002, manufacturing trade increased but U.S. exports declined. Consequently, its share declined as well, and I think that is not a good sign for the manufacturing sector in the U.S.

Manufacturing has provided very well paying jobs. In 2001, salaries and benefits averaged about $54,000 in the manufacturing sector. And it offers job opportunities to a wide range of workers across the educational spectrum. It is the second largest employer for the workforce with less than a high school diploma, but also is using a lot of employees with college training as well.

But most importantly, manufacturers are a major force in inventing the future. They still conduct over 60 percent of all private sector R&D, but that is down from 80 percent just 10 years ago. In real terms spending on R&D by all private industry barely changed in 2002, and we think this is one of the major dangerous parts if we begin to lose the manufacturing sector.

The process through which R&D promotes economic prosperity is very multifaceted and very complex. I am not going to go through it today, but not only do you get direct benefits to the firms who are making investments in R&D, but you get secondary benefits through spill-over effects from R&D, and those spill-over effects are strongest in a situation where you have a pretty geographically centered manufacturing sector, so that everybody looks around and can see what the new improvements are, the new processes are. This generates new ideas in other sectors of the economy.

Consequently, if you disperse your R&D across the globe, we think there is a danger that you will not get those same spill-over effects that you are seeing now, and that will be a big loss to what U.S. manufacturing has been quite well known for, which is the new ideas, the technology innovations.

Manufacturing provides a base for many important activities in the U.S. economy, and while it will never disappear entirely, we do think that we could get to a point where we lose the critical mass and lose that important innovation part of the manufacturing process.

Thank you.

[Ms. Kobe's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Our next witness is Bryan Doolittle, Senior Vice President of Sales, Marketing and Engineering for Morton Metalcraft Company, a small business located in Morton, Illinois.

Mr. Doolittle, we look forward to your testimony.

STATEMENT OF BRIAN DOOLITTLE, SENIOR VICE PRESIDENT, MORTON METALCRAFT COMPANY, MORTON, IL

Mr. DOOLITTLE. Good afternoon, Mr. Chairman and Distinguished Members of the Committee.

I am Brian Doolittle, Senior Vice President for Morton Metalcraft, and I thank you for this opportunity to present the views of Morton Metalcraft on the future of the extraterritorial income regime and its impact on the competitiveness of U.S. small- and midsized manufacturers.

It was 40 years ago this month that Morton Metalcraft was founded in Morton, Illinois, a small town east of Peoria. Where the blood, sweat and tears of a lot of hard-working people, we have grown the business to include two facilities in the Midwest and three in the southeast.

Our 2002 sales were $117 million, and we employ approximately 1100 people. We are a contract manufacturer, providing highly engineered sheet metal parts and subassemblies to support our customers' manufacturing operations. We serve large and demanding customers, like Caterpillar, John Deere, Federal Signal and the Carrier Corporation.

As a contract manufacturer, our success is directly related to the success of these customers and the markets that they serve.

Tax incentives have been maintained by the U.S. Congress over the past 32 years to partially offset the tax advantages of our competitors The European companies enjoy through their border adjustable territorial tax systems. And while Morton Metalcraft is not a significant user of FSC/ETI, our key U.S. customers who export are.

One of the key elements of the ETI debate that appears to have been overlooked is the relationship between how the right policy choice for large U.S. companies who use ETI is directly linked to the health of U.S. small businesses who supply them. Let me explain.

Morton Metalcraft's customers are sophisticated and shop the world for parts and components that will optimize costs, quality and delivery throughout their manufacturing value chains. As a result Morton Metalcraft must compete every day against foreign competitors who are working hard to supply the parts that we currently make for our U.S. customers.

A significant change in the value chain variables, particularly cost, could mean a loss of business to foreign competitors and a loss of high dollar value U.S. manufacturing jobs. That is why the policy choices Congress makes in determining the replacement for ETI are so critically important to a long-term competitiveness of small- and medium-sized U.S. manufacturers.

The current economic climate has been difficult for small and medium U.S. manufactures, and the domestic manufacturing customers that we serve. This is evidenced by U.S. Commerce Department statistics showing 2.6 million job losses in the manufacturing sector during the past three years. This trend has had a direct impact on Morton Metalcraft's business. Since December of 2000, our revenues have declined from 148 million to 117 million, a 21 percent decline.

Our employment at the same time has been reduced from 1470 to 1100 people, a 25 percent decline. And we have watched numerous U.S. competitors, as well as other suppliers, go out of business.

As a small manufacturer, we are doing everything without our power to remain competitive against the onslaught of foreign competition during these challenging economic times. We have undertaken significant efforts to control costs and improve the efficiency of our manufacturing and business processes by embracing enabling methodologies like 6 Sigma and lane manufacturing. These rigorous processes of internal evaluation continues improvement have paid great dividends in our business, lowering break-even points by more than 30 percent.

But to stay competitive, we need to invest in new technology and have people working with that technology three shifts in order to gain the economies of scale and not the current 1.5 shifts.

With a level playing field, I am confident that Morton Metalcraft and companies like our can win against foreign competitors, and as a commercial business remaining competitive is our responsibility. What we need from Congress are the right policy actions to ensure the playing field remains level versus our foreign competitors.

That is why I strongly support your efforts, Mr. Chairman, on the Crane-Rangel-Manzullo-Levin bill. The tax rate cut of up to 10 percent that you propose for domestic manufacturers will provide a strong dose of the right medicine at the right time for small, medium and large manufacturers who have suffered under the weight of the U.S. economic slowdown.

Congress and the administration must ensure ETI legislation does not impose a substantial tax increase on U.S. production. Increasing taxes on domestic production by 5 billion annually to pay for offshore tax breaks would significantly increase the cost of doing business in the U.S.

Mr. Chairman, I applaud the efforts of you and your colleagues on the Committee to bring the voice of small manufacturers into this important debate. I look forward to continuing to work with you and your colleagues in support of the Crane-Rangel-Manzullo-Levin bill.

Thank you.

[Mr. Doolittle's statement may be found in the appendix.]

Chairman MANZULLO. Appreciate your testimony. Thank you.

Our next witness is Leon Trammell; is that right, Trammell?

Mr. TRAMMELL. Yes.

Chairman MANZULLO. Founder and Chief Executive Officer for Tramco, Incorporated, a small business in Wichita, Kansas.

Mr. Trammell, if you could pull that microphone closer to your mouth there.

Mr. TRAMMELL. All right.

Chairman MANZULLO. And we look forward to your testimony.

STATEMENT OF LEON TRAMMELL, FOUNDER AND CHIEF EXECUTIVE OFFICER, TRAMCO INC., WICHITA, KS

Mr. TRAMMELL. Thank you. Thank you, Mr. Chairman, for inviting me to appear before this Committee today.

I am Leon Trammell, Chief Executive Officer of Tramco, Incorporated, in Wichita, Kansas, sunny Wichita prefer to call it.

Tramco manufactures and sells environmentally-friendly conveyors primarily for the cereal grain processors. In essence, we take the product from the truck, rail car or ship and convey it through processing or storage and back to the truck, rail car or ship.

Tramco was founded in 1967 in a $15-a-month-building with one employee. Today, we have 120 employees worldwide, approximately 100 of which are in Wichita, Kansas, the other 20 are in our satellite sales office and factory in Hull, England. We have machines at over 45 foreign countries and all 50 states.

I would like to share with you today the positive effect the Foreign Sales Corporation offers companies like Tramco.

In 2001, 60 percent of our business was export, sales was 17 million, and our tax savings was approximately $48,000. In 2002, 50 percent of our business was export, sales were 15 million, and our tax savings was about $45,000. In 2003, 63 percent of our business will be exported, sales will be 22 million, and a tax savings of approximately $75,000.

We have been utilizing this form of tax relief since the day of DSC, which as you know, was deemed unfair. It was replaced with FSC. Now WTO has judge FSC as also being unfair. Obviously, the WTO does not want the term "foreign" in your tax relief policy.

Consequently, your job is more than an uphill battle to exclude manufacturers who are not exporters in the new tax policy.

Who wins and who loses in H.R. 1769? The winners will be all U.S. manufacturers that do not export. Tramco and other manufacturers that presently export will be the losers. As an example, Tramco this year should have an approximately $75,000 in tax savings. According to my accountants, the savings under H.R. 1769 will be about 20,000.

However, however, we support H.R. 1769. It gives much needed tax relief to the manufacturing sector though very small. Many would suggest the manufacturing sector in the United States is on life support. And if drastic measure are not taken to reform the tax relief, tort and regulatory reform, it will gradually wither and die on the vine.

In my opinion, a free market enterprise and the entrepreneurial spirit is what make these United States great. However, it is a perception of many that all businesses are greedy and untrustworthy. A very small example of that was the famous three martini lunch. I would suggest to you that the author and supports of some such comments never traveled for 30 hours, and stayed at a third-rate hotel, ate food that they could not identify or know the contents of, and only 20 percent of that could be used as a business expense. Now, do not dare have a beer to dry the dust from your throat. That is not a business expense.

Selling internationally is very expensive. An average sale for my company in the United States is $200 a call, $200 a sales call. Internationally, it is $1600.

F.S.C. helped offset some of these expenses providing a sale was made. We reluctantly accept the fact that FSC is gone and the time is of the essence to abandon this policy that the WTO has deemed unfair. We do not want a trade war nor do we want sanctions on any American products.

I wholeheartedly support H.R. 1769 and hope that this Congress's first step in saving the U.S. manufacturing sector. I would be thrilled if you would embrace Exhibit A in my written testimony regarding tax relief for the manufacturing sector.

We must jointly, both government and private sector, devise methods to allow our manufacturing sector to be competitive in the world marketplace where our competitors are not confronted with the same regulatory, tort and labor costs.

Mr. Chairman, we appreciate your leadership in finding a solution to this most difficult and complex problem. We ask you to work swiftly to bring this to an agreement to Congress.

Thank you.

[Mr. Trammell's statement may be found in the appendix.]

Chairman MANZULLO. Well, we appreciate that testimony, definitely from the heart.

Mr. TRAMMELL. I have been there in all 45 foreign countries, I might add.

Chairman MANZULLO. Do we have Exhibit A, Berry? Okay, we will make the exhibit part of your testimony.

Mr. TRAMMELL. Yes, and that was—I conjured up that. Leon Trammell was the author of that. You know, Bob Dole and Kansans all refers to ourselves in the third person.

Chairman MANZULLO. Okay. All right. Who wants to follow this act? Thank you for your testimony.

The next witness will be Owen Herrnstadt, Director of Trade and Globalization for The International Association of Machinists and Aerospace Workers.

We are happy to have you with us today, and look forward to your testimony.

STATEMENT OF OWEN E. HERRNSTADT, DIRECTOR, TRADE AND GLOBALIZATION DEPARTMENT, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS

Mr. HERRNSTADT. Thank you. Thank you, Mr. Chairman and Members of the Committee.

The International Association of Machinists and Aerospace Workers represents several hundred thousand active and retired workers in aerospace, transportation, ship building and repair, defense, electronics, woodworking, just to name a few. Our members work for multinational corporations and for small businesses producing, assembling, and maintaining almost every imaginable product in the manufacturing industry. And given our strong presence in this vital industry, we are very much grateful for the opportunity to testify before you today.

U.S. small business is highly dependent on the U.S. manufacturing industry. I think that has been well established already this afternoon. And the WTO's challenge to our tax system must not result in the further demise of the U.S. manufacturing base. Indeed, the main objectives of any replacement for FSC/ETI should focus on incentives to keep production at home, facilitating the creation and maintenance of U.S. manufacturing jobs.

Proposals that contain or preserve loopholes, giving corporations incentives to move more work out of this country, must be quickly dismissed. Moreover, proposals which contain provisions that are geared towards other tax policies which would distract policymakers from the urgent goal of facilitating the creation and maintenance of U.S. manufacturing jobs should also be quickly dismissed.

I think you have heard from a panelist already today that we are currently facing a U.S. manufacturing crisis not seen in this country in decades. The most recent data reported by the Bureau of Labor Statistics last Thursday indicate this tragic trend continues; 8.9 people unemployed. In August alone employment feel by 93,000, 44,000 of those job losses attributed to manufacturing, 431,000 manufacturing jobs lost just this year, 2.7 million manufacturing jobs lost just in the last several months. The massive numbers of unemployed, the massive numbers of people looking for work do not even begin to account for those who are discouraged from looking for work and who are otherwise part of the hidden unemployment figures.

Sharp declines in employment are occurring in almost every industry across this country. Job losses in aerospace are fairly typical. Since 1989, we have suffered over 600,000 job losses in this vital industry, approximately 1 million job losses in aerospace and related industries. Like other major manufacturing industries, aerospace is, of course, instrumental to the success and health of U.S. small business. It is small business, after all, that frequently finds their work is usually first to get moved overseas.

Clearly, this job loss is having an enormous toll on our economy. Not only our national economy is at stake, but our national security is also at stake as we see the de-skilling of the industrial sector of our country, as we see our manufacturing base become more and more dependent upon workers in other countries.

Indeed, anyone who represents men and women who have helped to build some of the greatest companies this country has to offer only to be rewarded with layoffs know the dire circumstances that we are facing here at home.

Just look at the faces of workers who have lost their jobs, feel their pain and anguish, watch them as they try to feed their families, clothes their children, and pay for skyrocketing health care insurance. Talk to them about their deep concerns for their future as they see their retirement funds rapidly shrinking.

Of course, there are many reasons for these job losses. One of the most significant reasons is a lack of a comprehensive manufacturing policy that puts workers and their communities first. Unfair trade agreements, outsourcing of production and assembly to workers in other countries, unfair competition, the continued use of offsets, that is, the transfer of jobs and technology abroad in return for sales also contributes heavily to what we are now seeing as substantial losses in manufacturing, as is tax policies that have actually given incentives to manufacturers to shift work abroad.

Given the severe decline in the number of U.S. manufacturing jobs during the past several months, it is imperative that a replacement for FSC/ETI be replaced with something that will create and maintain jobs at home.

The general approach in the Crane-Rangel-Manzullo-Levin bill makes a great deal of sense. Indeed, providing a manufacturing tax benefit for production of goods in the United States, adjusted for the percentage of a company's worldwide production that takes place domestically, certainly seems to be on the right track.

And adjusting, phasing out FSC/ETI benefits over a period of time, permitting workers and companies to adjust to the new system, also seems to make a great deal of sense and is a good approach.

Alternatives that have been offered, however, are, quite frankly, frightening to many of us who represent manufacturing workers. Giving competitive incentives to send manufacturing jobs overseas is simply unacceptable, and rewarding companies who have made use of tax havens in other countries at a time of this employment crisis or at any time is also one that is simply unacceptable.

Policymakers must not replace FSC/ETI with provisions that create opportunities for corporations to take advantage of the WTO challenge by sacrificing U.S. manufacturing workers.

By the way, I believe my time has not been set.

[Laughter.]

So I will conclude. I had about two hours prepared.

[Laughter.]

No, I kid you, I kid you. I would not do that.

We urge you to develop legislation that closes loopholes and removes tax incentives for corporations to move jobs abroad. Hundreds of thousands of U.S. manufacturing workers are losing their jobs only to see them reappear in other countries. Congress must heed the urgent call to pursue tax and other policies that will immediately reverse this shameful trend.

Thank you very much.

[Mr. Herrnstadt's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Our next witness is my constituent, Lloyd Falconer, who is both a constituent and a personal friend. His shop is at the north end of the Seward Pecatonica slab, and I live on the south end of that street, and have spent a lot of time visiting the facilities. I think that we should have had a crew out there from the History Channel on moving marvels when you moved that giant piece of machinery on those—that was quite a day from Seward, that piece of machinery coming down the street. You get excited in small towns over things like that, but you know what I am talking about. It is great to see machinery moving. You know that there is production going on.

As the name of the company implies, Seward Screw Products, his company makes screw products. They make many parts found in

Harley-Davidson motorcycles, and very much interested in your testimony, and look forward to it.

STATEMENT OF LLOYD FALCONER, SECRETARY-TREASURER, SEWARD SCREW PRODUCTS, INC., SEWARD, IL

Mr. FALCONER. Well, thank you, Congressman, and I would like to greet also the members of the Committee, and appreciate this opportunity to talk a little bit briefly about our company which you obviously know a great deal more about than the rest of the Committee members.

But I am Lloyd Falconer. I am the Secretary-Treasurer of Seward Screw Products, Incorporated. It is a family-owned corporation. We are in our fiftieth year. And we are somewhat the exception to the rule to the business manufacturing trend, but many of my friends have been very well described by prior testimony.

As you all know, there is over 3 million square feet of empty manufacturing facilities in Rockford alone let alone the rest of your district.

And we turn metal bars into parts and chips. The chips get recycled. The good parts get sold to our customers, which are nationwide. And those customers include original equipment manufacturers. Harley-Davidson was mentioned as one. And also we supply tier one suppliers who then in turn supply assemblies to the original equipment manufacturers.

While none of our products are exported directly, many of our customers do export, and we hope that they continue to export, and we hope that they will export more.

And as I have stated in the past many times and to anyone who will listen to me, I do not care if they are in business or in government or whatever, our public policy should be geared to exporting products, not jobs. And in this sense, we have been on an uneven playing field.

As a manufacturing company, we are concerned about the burdens and hurtles that the government places on business to the detriment of American companies' ability to compete in a worldwide marketplace.

But tax is just one of the impediments. I have got a long list but we will not go over them here. And it reduces our opportunities to invest in newer state-of-the-art equipment despite the fact we are doing that, but it still reduces our opportunities. Anything that can reduce those burdens will help keep us in business.

H.R. 1769 affects a significantly larger group of companies than just the limited number of multinational companies currently benefiting from FSC/ETI. Ultimately we hope that tax relief will be for all U.S. companies, and we also believe that 1769 is revenue-neutral, it is a step in the right direction because it tends to keep our manufacturing base here. It should also assist companies in the decision about relocating offshore. And also, foreign companies with manufacturing facilities located in the United States export their products around the world, and they would be eligible for the benefits of H.R. 1769.

I think you and Ranking Member Velazquez, I was not able to acknowledge you because you were out of the room, but I would like to do so now, I think you ought to be commended for making this situation clear, and I know that each one of your in your districts are not only concerned about the manufacturing business, but you are concerned about the employees, and you cannot have one without the other. A good manufacturing concern is made up of good employees, and we have to have the ways to accommodate those things.

And so we appreciate the fact that you have brought this to the forefront. We wish you well. And I hope that this can be resolved within the next month or two.

And I thank you very much for your time and allowing me to testify.

[Mr. Falconer's statement may be found in the appendix.]

Chairman MANZULLO. Well, thank you for your testimony. You know, we have been having a series of hearings every since I became the Chairman of the Small Business Committee dealing with manufacturing. Rockford, Illinois, which is the largest city in our congressional district, in 1981 led the nation in unemployment at 24.9 percent. It is a tool and dye center. And we know that when you look at orders for machine tools, these are the canary in the coal mine for manufacturing. But it is very difficult for people who are not involved in manufacturing to understand that.

I mean, for example, Mr. Greenspan in an extraordinary hearing that we had about two months ago said, and this was in the Banking Committee on which Mrs. Velazquez and I also sit, he said, well, the jobs that you lose in manufacturing, he said, you more than gain in the high-end, white-collar jobs.

I said, well, excuse me. I said, we are losing engineering jobs, accounting jobs, all types of traditional white-collar jobs to India, to Poland, to China, and Deloitte & Touche put out quite an exhaustive study that talked about that. In Business Week in its seminal article in February of this year talked about the destruction of the white-collar jobs.

It has only been because of the white-collar jobs flee that the nation has suddenly awakened to the fact that they hemorrhaging were not in manufacturing sectors, and why is that? It is only maybe about 50 congressional districts out of 435 that have an intense manufacturing sector. And until the pain is felt in other congressional districts people do not pay attention.

And so when we formed the manufacturing caucus, we have people are from downtown New York City that have very little, if any, manufacturing, but they have engineers and accountants and people that are related to manufacturing, and so the drain is just continuous.

I really have one question to ask Mr.—is it Herrnstadt? Is that how you pronounce that?

Mr. HERRNSTADT. Yes.

Chairman MANZULLO. That is, I want to refer to the last page of your testimony. It is not numbered but is it page 3? Do you want to take a look at it so I could reference it?

Mr. HERRNSTADT. Sure.

Chairman MANZULLO. It is a question based on that. It might be a little bit easier if you had it in front of you.

Mr. HERRNSTADT. Yes.

Chairman MANZULLO. Are you there?

Mr. HERRNSTADT. Yes.

Chairman MANZULLO. Okay. See where it starts, "Even more disturbing, however, the Thomas approach could present more incentives under his bill for corporations to shift manufacturing jobs out of the country."

Could you please explain your analysis of the two bills?

Mr. HERRNSTADT. Sure, and, you know, my analysis would have been similar to what Congressman Levin had talked about when he was explaining some of the alternative approaches that have taken place. I am not an expert on the Thomas bill, but one of the points that has been noted by others it the provision allowing companies to escape U.S. taxes on billions of dollars they make in overseas profits, and the provisions in the Thomas bill that would account for that.

One of the fears, obviously, is that it could provide for an actual incentive to move even more work offshore on that.

You know, this is an incredibly complicated area, and one of the things that I am trying to impress, and I think others are too, and that I am sure that you are very well aware of, is the desperate situation manufacturing workers are in these days and many U.S. manufacturers are in these days, and it just seems to me that the simplest, cleanest approach is the one that we really need to be going with. We cannot really be making guess work out of how certain things may impact on helping manufacturers and manufacturing workers in this country, and that is one of the fears that I was trying to get at in expressing that in my written testimony.

Chairman MANZULLO. Appreciate that. Thank you.

Mrs. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Herrnstadt, as Congress considers a number of proposals to replace the FSC/ETI framework, I am particularly interested in your views on an approach that will benefit manufacturers as well as other internationally active sectors of the economy without incurring substantial costs.

What is your opinion on a proposal to use the $50 billion from the FSC/ETI repeal to pay for some tax cuts for manufacturers, but also incorporate a package of international tax reforms targeted at increasing the international competitiveness of all domestic industries?

Mr. HERRNSTADT. The bottom line is simply what will have the end result of helping to facilitate the creation and maintenance of good and decent manufacturing jobs in the U.S.

The question that you ask is an intriguing one, and I think there are lots of things in there that could be worked with, but at the end of the day the real question is what will have the most dramatic, quickest response to the sector that is suffering so very deeply.

Ms. VELAZQUEZ. Thank you.

Mr. Trammell, in your written testimony you mention that Tramco, Inc. is a member of the National Federation of Independent Businesses. And NFIB, along with all the 183 companies and associations, have endorsed Mr. Thomas's bill.

Why do you believe this bill has received such wide support from the business community?

Mr. TRAMMELL. Well, I am not sure. I am also on the board of the U.S. Chamber and also vice-chair of the International Policy. But I speak here today for Leon Trammell and Tramco, no one else. And I am not sure how they came up with their position.

But as an exporter, I can tell you this bill does not help Tramco, but also, I firmly believe that if we do not help the American manufacturer we are going to see more and more go over. We have got to have some tax relief, we have to have some reform not only in tort but in regulatory. You cannot have 3,000 rules a year coming out that is good for manufacturing.

Now, some of them are probably good, but not all 3,000 are going to help the manufacturing sector.

And the people that I know, small businesses embrace this accelerated depreciation that we now enjoy for the next few years from 25,000 to 100,000 dollars. That is extremely beneficial to small companies.

If you make $100,000 in profit, by the time you settle up with the government, you do not have anything else to invest.

Ms. VELAZQUEZ. You are talking about the——.

Mr. TRAMMELL. Accelerated depreciation.

Ms. VELAZQUEZ. Yes. Even though that, I guess, that most small businesses will have loved to see that it was made permanent, and it was not. It is sunset.

Mr. TRAMMELL. Well, and we would also like to see that increased a little bit from—$100,000 sounds like a lot of money, but I would challenge my friend with Screw Products, what did that machine cost you?

Mr. FALCONER. That machine delivered was about $1.6 million until we got done, and we spent other money on top of that, well over 2 million last year—in the past year.

Mr. TRAMMELL. So this is my point, we have to go in debt to make investments to stay competitive, and we have to. And today you see old businesses going broke. You go into those old businesses and I will assure you their machinery is old. And if they do not have the money to put back in that business, it is gone.

Ms. VELAZQUEZ. Yes, I understand. That is why it does not make sense to me that the administration, especially the President, who had a $350 billion tax cut to chose from, he decided to roll with large corporations and not making those targeted tax cut permanent for small businesses.

Mr. Doolittle, there are a number of sectors that will be affected by the repeal of the FSC/ETI. The Crane-Rangel bill provides assistance for the manufacturing sector. However, there are small business exporters and small family farms, among others, that will also be affected by this repeal. What do we tell them

Mr. DOOLITTLE. I guess I would ask you to restate the question, please.

Ms. VELAZQUEZ. Well, basically what we are saying is that yes, the manufacturing sector is going to suffer, but also the family farms will suffer and small business exporters, and this will not cover, they will not be covered under this bill.

Mr. DOOLITTLE. Well, as you know, manufacturing touches really all sectors of economy, and the small retailer, the supplier down the street that supports us are all affected as we are affected. So if our customers prosper, we prosper, our suppliers prosper. You know, it is far-reaching.

I do not think that this bill, from what I can see, is meant to be an overall umbrella. It is not going to fix our economy, but it addresses a very specific segment of the market this reeling, and it needs to be addressed and addressed quickly.

Ms. VELAZQUEZ. It is real that family farms are also suffering in our country.

Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you.

Mr. King.

Mr. KING. Thank you, Mr. Chairman.

I would first state that as we have watched in this country manufacturing jobs go south, those manufacturing jobs that have gone south have then sometimes picked up and gone far to the west, and that relationship and that transition of some of those jobs is somewhat natural because we have—we led in technology, we continue to lead in technology, and as developing countries catch up in technology, they will be able to compete with us because they have got cheaper labor. When they catch up with our technology, they can sell those products cheaper. That has happened, I think, across our southern borders in a lot of areas, and then is happening again, the second transition, across the Pacific Ocean.

But I would direct my first question to Ms. Kobe, and only because I was not able to hear your testimony, but it says Chief Economist here, so I want to ask you the question of what is the impact, though, of undervalued currency with maybe, for example, the Chinese currency? What does that do to our export base? What does that do to our jobs? What does that do to the transition of jobs that because of NAFTA have gone south and now west over the Pacific Ocean? Could you talk about that a little bit?

Ms. KOBE. Well, I do think that the undervalued Chinese currency is certainly not helping this situation any, and it probably damages certain manufacturers more than others. However, the Chinese, I do not think, have any incentive to float their currency right now. They are facing a lot of their own problems in that they really must grow their manufacturing base in order to have jobs for a big Chinese population.

Consequently, I think the U.S. is going to have to negotiate very, very hard, and really keep in mind always that you are looking for a level playing field for U.S. manufacturers, and that is going to give U.S. trade negotiators a hard job to do, a harder than perhaps they have had in the past.

So I think they will have to keep the pressure on because the Chinese are not going to float their currency without a lot of pressure from abroad to do that.

Mr. KING. Is there a point in the longer term that if they prolong this undervalued currency, that the piper must be paid?

Ms. KOBE. Well, I think there is a point. I am not sure that we are there yet, and certainly the Chinese are buying goods from other countries in Asia, which perhaps helps strengthen the Asian situation.

What we would like is a bit more fair trade between Chinese products for the U.S. products, and the other direction as well where the U.S. can export to China. And I think it is going to take awhile to get there. But eventually, you know, they will have to probably float their currency or at least allow it to move somewhat more freely than they do now.

I do not see that that is going to happen in the immediate future, and that is not beneficial for American manufacturers, obviously.

Mr. KING. And do you know what our negative balance of trade is with China? It is maybe outside your field here but.

Ms. KOBE. It is relatively large. I do not know what the number is right off the top of my head, but it is quite large. I think it was perhaps a fifth of the——.

Chairman MANZULLO. It is about 125 billion in the negative trade balance, and with the EU it is 87 billion.

Ms. KOBE. It is very large, and a good part of the total trade balance is with China.

Mr. KING. Thank you very much.

And then Mr. Trammell, you discussed about the tax structure, and how there is tax advantages that are not large enough in a lot of circumstances that you laid out here and you have illustrated one of them, and we have got this huge tax code of no one actually knows how many pages it is, it changes so fast. But I do not think that anybody is going to argue that we would recreate that kind of code that we have today.

And so if we were going to start with a blank slate and rewrite this tax code, given your experience being a founder, a manufacturer, a marketer, an exporter, what kind of tax code would you write in the ideal world?

Mr. TRAMMELL. Thanks for that softball.

[Laughter.]

Mr. TRAMMELL. Exhibit A in my written, I have had a graduated escalating clause up to about 600,000, and at that point at 600,000 you would get in the top level, whatever that top level would be.

But I think for the small manufacturer you need a more graduated scale to a higher level. As an example on my—as I indicated, this is something I conjured up so I take full responsibility for it, I show this peaking at 600. This is only obviously what I would like to see, and I show the top rate at 30 percent, which is about where you are at here at 31.5 percent, I understand.

But if there is not an incentive for the small companies and the incentive being tax relief, if there are not incentives for small companies to reinvest their money in new equipment, they cannot compete. It will just be a matter of withering on the vine.

Most small, little manufacturer makes three or four percent profit. So I mean, the margin of profit is very, very, very small. And if at the end of the year you are settling up with the government, where is the money to buy new equipment?

Mr. KING. And I will say, Mr. Trammell, I have been there. I see also that Representative Crane testified ahead of this panel. I was not able to hear that testimony, but I am going to trust that he said corporations do not pay taxes.

Now, what is your response to that remarks?

Mr. TRAMMELL. I would like to send him my tax bill.

[Laughter.]

Mr. TRAMMELL. And I have a sister that also believes that, quote, "Rich people don't pay taxes," which is also another fallacy. If you make money in this country, you pay taxes.

Now, I have had people tell me otherwise and I say, will you go to jail for me? And the answer is, and I do not want to go to jail. I want to play by the rules. And in the United States if you make money, you are going to pay taxes. It is that simple.

Mr. KING. And Mr. Trammell, if we had the same tax structure for all corporations worldwide, if we had leveled this tax liability so that we had a world policy instead of a United States policy then that interferes with our relationships with the foreign trade so that you compete on a level playing field with everyone around the world with regard to tax, then would corporations pay taxes, or would they pass those along in their cost of their goods as a fixed cost?

Mr. TRAMMELL. Well, I am not sure. I am going to field that to my friend on the left.

[Laughter.]

Mr. TRAMMELL. The tax code is very simple, and I am a mechanic, an engineer. I design machines and sell machines. And I am not an accountant. But I know enough about my business to manage it, and as far as the P&L. And the tax code, the way it is written today is very simple. If you make money, you are going to pay taxes. And if you do not, according to the CPA that works for us, and files my personal account as well, when you get to a point like $100,000, then with the government and the State of Kansas 40 cents on the dollar. And $100,000 is not very much before you start divvying it up with the state and the federal government.

Mr. KING. And Ms. Kobe, on that passed buck, would you care to respond to that?

Ms. KOBE. Well, I do not think I can respond to it in any detail because I have not studied that issue specifically. I mean, I think it is a very complex answer to it in that a lot of factors determine whether taxes get passed forward or backwards, or whether the corporation pays them themselves. So I do not think there is an easy answer to that question.

Mr. KING. I want to thank you all for your testimony and thank the Chair for his time.

Chairman MANZULLO. Thank you.

Congresswoman Majette.

Ms. MAJETTE. Thank you, Mr. Chairman, and I would like to thank all of the members of the panel for being here this afternoon.

And my question is addressed to Mr. Doolittle. In your testimony you mention that as a small manufacturer you are doing everything within your power to remain competitive in the international market, and you mentioned that manufacturers need from Congress the right kinds of policies to ensure that the playing field remains level.

So besides H.R. 1769, what other kinds of policies do you think Congress could enact that would help in that regard?

Mr. DOOLITTLE. Do you have anything easier to respond to?

[Laughter.]

Mr. DOOLITTLE. My response or my testimony, what I was addressing is that this particular legislation is a piece that is needed in the manufacturing segment, and in other segments perhaps. We realize, however, that we have to look internally, we have to take costs out of our own operations, become more efficient. We need to fill up our assets, that our machines are running one shift or one and a half shifts, we need to have them running three shifts.

So I am not—I am certainly not an expert in the area that you are addressing, but I can just state that this one is one that to us addresses manufacturing in a more general scope, and touches all of is, and it is very easy for us therefore to endorse it.

Ms. MAJETTE. Well, maybe I can frame it a little bit differently. In my district and in my state, we have lost a significant number of manufacturing jobs. And from your perspective what are some of the other things that can be done to keep those jobs from disappearing?

Is it more than just the tax question? Are there other things that might be done in terms of looking at the big picture?

Mr. DOOLITTLE. Well, one has to look at the role of government, I guess, but we have heard the issue of education addressed. We need to provide tools, in my opinion, to particularly the small- and medium-sized manufacturing entities that allow them to improve their own lot, and there are lots of methodologies available that given funding I believe that companies would more aggressively pursue as an example.

Do you have something in mind that you would like me to address?

Ms. MAJETTE. Well——.

Mr. DOOLITTLE. I am not getting it.

Ms. MAJETTE [continuing]. This is my first term in Congress, and I have had the experience of being a small business owner, not in the manufacturing context, but when I was a lawyer in private practice I had a small firm. And the issues, I guess, for me always seem to be more than just putting one piece in the puzzle. And it is the big picture that I am very concerned about, particularly as we are moving—you know, we have moved from the twentieth century to the twenty-first century with all of the changes in terms of manufacturing and business development that we now have.

And so I wanted to kind of get your perspective on maybe what are some of the other pieces of the puzzle that need to be put in place so that the picture that we see is a very strong and positive picture for the United States economy.

Mr. DOOLITTLE. Well, I will defer to my cohorts up here, but what we have referenced, the panel has referenced the playing field, and I would just say that the markets we serve are recovering, some of them are recovering. Ag, which we happen to serve through John Deere, has not rebounded, construction has, others have. And so we are going to see, I think, over the next period of time a general increase. I do not think it will come bounding back, it is my opinion, but the rules are changing.

Our customers are expecting significant improvements in the way they buy product, and they are as we sit here, I believe, making decisions, putting plans in place to outsource the products that we today manufacture to low-cost countries overseas, and it is just going to take, as you know, I think, it is going to take a lot of effort to level the playing field, to make us more competitive, and we have got to—we have certainly got to look internally to a great deal.

Ms. MAJETTE. Okay, thank you. And I do not know if my time has expired, but—I did not know if there was another member of the panel that might be interested in responding.

Mr. FALCONER. Actually, I would like to respond.

First of all, I want to address some of your concerns, but I want to talk a little bit to Ranking Member Velazquez. You asked about why should not farmers be in this group. And I have stated in the past—I actually stole this from my father—that farming, mining and manufacturing are the things that—the businesses that grow the pie. In other words, they have the most bank for the buck.

And ultimately I hope that you can get farmers and others small businesses involved in this because they all need help.

And addressing your question regarding what can the government do, my list is so long you would not believe it, but the first thing is to stop placing upon business the regulations, the mandates, the onerous paperwork. I want to tell you that it is really a sin to waste precious capital in terms of not only money, but in terms of people that we spend on doing what I consider frivolous paperwork, and I am working on a particular issue right now. I am not sure where I am going with it, but I have got a pretty good idea.

We spend an inordinate amount of time filling out forms or complying with some regulation, or making sure that we are in compliance with some regulation, and I cannot tell you the stress and strain that is placed upon American businesspeople because half the time they are probably not in compliance with about 50 to 60 percent of the things that they are doing.

We need some rules and regulations that do not send us to prison. I mean, there is literally that threat out there. Or huge fines for some of the things that Congress has enacted, and that is not just the federal, it includes the state as well. They are just as guilty.

And having—you said you have been in a small business, a lawyer, I guarantee you you could not have learned all of the regulations that affected your business, I do not care if you are one person. It just is not possible. You cannot wear that many hats.

Ms. MAJETTE. Well, we had lawyers and CPAs who handled things for our firm.

Mr. FALCONER. Yes, exactly. And you were paying them to do that, right?

Ms. MAJETTE. Yes.

Mr. FALCONER. Now, that is not out defending people who need, or whatever you did as a lawyer. That is just complying with the regulations, and that is totally nonproductive. And in my mind that is one of the worst burdens that we have is unnecessary complicated paperwork that we have to do. To me, it is a sin to waste that kind of money, and when we should be trying to compete based on our intelligence, our capabilities, our work ethic, and all the good things that America has going for it.

We do not see people leaving America to live in other countries, but we see manufacturing and other businesses leaving this country, and that has to be stopped.

Ms. MAJETTE. Thank you. Yes?

Mr. HERRNSTADT. If I could respond briefly. I must point out, I think, we are talking about worker protections and under fundamental pieces of public policy that this country has been built on, particularly from the Industrial Revolution on up. I think many of us would say we need to look at strengthening some of those fundamental protections through legislative efforts, and through efforts of our own federal agencies on that, so I think we do need to be mindful of that.

The question, I think, that you have asked really goes to the crux of the issue, and it is very profound, and it goes to the issue of whether or not what we are seeing is a decline in manufacturing in this country that is either cyclical or is it structural, and the fear that many of us have is that it is indeed structural, and that the way that we need to respond as a country is a comprehensive one. It is a comprehensive one that we have not seen such a response since the Great Depression.

If you talk to my members, they will tell you that they fear for job security. They fear for rising health care insurance. They fear for being able to send their kids to good schools. They fear for state budgets that are on the decline. They fear for a awful lot of things that is out there.

So that when you ask your question, there are a lot of answers, but one of the basic fundamental answers is that there are a lot of pieces, but the pieces have to be taken as a whole to figure out this whole puzzle, and it is something that we desperately, particularly in the manufacturing sector, in the agriculture sector, in many other sectors in this country that are so desperately hurting need answers and a response to, and now.

Thanks.

Ms. MAJETTE. Thank you. Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you. There is an article, an editorial that appeared on The Washington Times. It is called "The Job Loss Recovery," and it is not just the jobless, but as recovery, so-called recovery goes on we continue to shed manufacturing jobs, 61,000 in the past month alone in manufacturing. Also lost several thousand in the service sector. They say it was unexpected the loss of 67,000 jobs in the service-producing sector, and the trend that I see going on, and I probably spend 80 - 85 percent of my time dealing with manufacturing issues, and I can talk brake presses and cold-forming machines, and high-speed hard milling machines, and talk to you about oil, and tools and dyes, and fasteners and things of that nature, is this.

The jobs that have been created have been created overseas. I mean, let us wake up. That is the bottom line. Every time you see the word "outsourcing," that equals job loss in the United States.

I was talking to a member of Congress, in fact, the members stopped by my office quite frequently with one story after the other, and I am not going to mention names because it is really not fair to the parties, but it just tears your heart out when a major corporation that is making all kinds of money, I mean, doing extremely well, responsible in the community, an anchor in the community, but the owners want to make more money.

They are not satisfied with the fact that these people are employed. They are not satisfied with the fact that they add value. They are not satisfied with the fact that they are a stable force in the manufacturing. They could just make more money by going to China. They do not need tax breaks, this company. They do not need anything. They do not need any incentive. They could just make more money by going overseas.

And what point, at what point are the companies going to wake up and say there is no longer going to be anybody left in the United States that can buy the stuff. It is being made overseas.

And I went to buy some tools, and I needed a belt sander, and so I would like to mention the name of the company, Skill makes belt sanders made in the United States. I looked for that label. It is owned by Robert Bosch Company, which I think is a German company. And you can also get a skill saw made in the United States, competitively priced to the Chinese copycat.

Now, that only indicates to me one thing: Skill is satisfied with the profit they are making and they are proud that even though they are a German corporation, which incidentally could be penalized under the Thomas bill because that is foreign direct investment in the United States, but they are proud to have the skill saw, and I do not know. What is another name for the skill saw? You know what I am talking about. The skill saw that is made in the United States.

And I went to Sears, and I looked around. I could not find a drill, I was looking for the label made in the United States. I could find the hand tools, the Craftsman, those are all made in the United States.

But I think it is time that members of Congress really tout the American companies that have made a commitment to keep manufacturing in the United States. And is it not ironic that skill saws which is owned by a German company realizes that it is important to have those tools made here. And I looked throughout—it probably took me about, oh, an hour, hour and a half, because if I do not see a label of origin on the tool, that could indicate one of two things: number one, that it is not made in the United States, or number two, it indicates that the surveys and focus groups in the United States of residents of the United States demonstrate that when they see a "Made in the USA" label they will not buy it because they think it cost more than something that is made overseas, and therefore—I mean, this is astounding. So we eventually have to take a look at the American consumer to really examine where these things are made.

I went to buy some faucets, and that is interesting, at a big store here in town. If you have a place in Washington, you do your own plumbing because it is very expensive in this city, and I do not do electricity. I mean, I cannot drown myself but I can fry myself. And went to the store, and here there were several selections. One is made in the USA, another one is assembled in the USA with U.S. and foreign products, another one was made in China, made in Mexico, and there was one box of a brand name that you could not tell where it was made but I know in fact where it is made.

And you know, if you really take a look at these things, the stuff made in the United States in most products where you have a selection is not that much more than the stuff that is made overseas.

Now that indicates to me that we can still manufacture many items here and make a half-decent profit on them. But no, if everything is bottom line, and I mean, I am a capitalist from A through Z, but if everything is bottom line, then where are we going in America?

There is a book called "The Loss of Shareholder Value" by Alan Kennedy, written in 1999, and we are going to have a hearing some time this fall and bring him in, that talks about corporate culture; that there is a sociological side of manufacturing that no one wants to talk about.

He talks in there about the change in value of those corporations. This happened over a period of years in this country when profitability of a corporation meant taking enough money to keep your workforce employed and making a reasonable profit yourself. The new definition of profit is that you have to make more than the next guy involved in the same business.

He is a capitalist, and he talks about the corruption of the corporate ethic that if everything is deemed in terms of profits, then what price do you place upon the viability of a workforce. How important are the people that work for you? Do you have an investment in them?

I know I have gone on, and I did not mean to get into that area, but the bottom line is even under the best circumstances we have in this country, there are so many companies that think we are only successful if we end up making more than the next guy and take more market share.

Anybody want to comment on that? Lloyd, your dad was a physician, and started your business 50 years ago with the patents that he made himself.

Mr. FALCONER. Yes, he was, and he believed that business was one of the things, or manufacturing was one of the things that created the wealth, and it also provided employment for local people, and he was concerned about the local people. That was his nature.

Chairman MANZULLO. Okay. Ms. Majette?

Ms. MAJETTE. Yes, and I guess if I understood what you were saying, Mr. Falconer, with respect to the fines and paperwork and the cost of all those things, you end up having to roll back into perhaps the cost of doing business.

Mr. FALCONER. Let me say we cannot do that. The only way that we can maintain our customers is to provide them, first of all, quality and delivery are a given, okay, and price, you better have a very, very, very compelling reason to try and increase your price because most of our customers are looking for anywhere from three to 10 percent reduction annually in their costs, and they do not really care how we get it.

The only way we can do this is improve productivity. But with health care costs rising, if we have got high taxes, if we have got all of these unnecessary burdens that we are funding, that is very difficult to do.

Ms. MAJETTE. So if we could provide a way of reducing, if we took action, if Congress took action to reduce the overall health care costs, would that make a difference in terms of——.

Mr. FALCONER. I don't—the only thing I would say there is tort reform is going to help probably the most. We are partially self-insured and we totally self-insure dental. And over the years we have picked up a larger and larger percentage of our employees end of the bill. Frankly, I never believed in HMOs. I do believe in second opinions. And I do not believe in caps. Therefore, if it is not good enough for me, it is not good enough for my employees. And these are the restrictions that we put on.

And I want to tell you that takes the major chunk of seven figures out of our budget or out of our pocket every year to maintain that lifestyle.

Is it comfortable? No, it is painful. This year it is a 25 percent increase, very painful. We will make some adjustments, but we will continue to do it. But that comes directly off the bottom line.

So basically the government is the one who has put the problems in our way. Now, my father was a doctor for 40 some years. I do not think he was ever sued. He delivered lots and lots of babies. And he is literally rolling over in his grave, he passed away 17 years ago, if he were to know about what is going on today. He would be fit to be tied because he was on call 24/7, 365 days a year. That is the way he viewed his practice.

Ms. MAJETTE. Perhaps it is the adjustment in the mindset of the people of justice as the Chairman was talking about the difference, that somehow the difference, of somehow the shift in the mindset of the employer, that that has changed over time, the role that they view what their role is, and there needs to be a shift in terms of the way that citizens view the health—how they should access the health care system, or how they should respond to a doctor if something goes wrong.

I mean, if the cost of that is an impediment to you, then we need to find ways of reducing that cost so that you can continue to do business and be competitive.

Mr. FALCONER. I want to tell you that the doctor today on my skinny little file is that thick. He does not have time to read it let alone to know what is in it. My father kept records of a card for whole families. It was not as big as this sheet of paper. But he knew every individual, he knew whether they took the green pill or they took the red pill or the blue pick, and we would be sitting down for Thanksgiving lunch and somebody would call up and say, hey, doc, I am out of pills, and he would go down to the office, put a package of pills between the front door and the screen door, and they would come and pick them up. Now, that is how he did business.

If he had to do business today that way, or the way we do business today, he would not do it.

Ms. MAJETTE. Because of too many government regulations.

Mr. FALCONER. Absolutely. It is nonsense. We have got to get the lawyers out of—frankly, using this as a feeding frenzy. I mean, they are some of the most entrepreneurial people when it comes to suing people, and personal responsibility, I think, is very important here. I mean it is a risk to get out of bed in the morning, but I still do it. To me, entitlements just ruin things, frankly.

Chairman MANZULLO. We could go on all day. You know, I was putting up fence with my neighbor, Lloyd, and he sliced his thumb on the barbed wire. We went to see your dad, and he gave my neighbor a tetanus shot and sewed up his ripped thumb for 15 bucks, and even 20 years ago that was hardly enough.

Mr. FALCONER. No.

Chairman MANZULLO. I just want to take this opportunity to thank you all for traveling to Washington, and participating in this hearing. Your testimony is extremely valuable. This is the heart of America speaking now of the changes that have to be made in the laws. And again, we thank you for coming, and this hearing is adjourned.

[Whereupon, at 4:20 p.m., the Committee was adjourned.]

House Committee on Small Business

"The WTO's Challenge to the FSC/ETI Rules and the Effect on America's Small Businesses"

September 10, 2003

Opening Statement of Chairman Donald Manzullo (IL-16), House Small Business Committee

During August of 2002, a World Trade Organization arbitration panel determined that the European Community is entitled to over $4 billion of annual countermeasures against the United States for failure to repeal its FSC/ETI rules—rules that level the international trade playing field by providing modest tax incentives for U.S. exporters. Earlier this year, European Trade Commissioner, Pascal Lamy, announced that sanctions would begin on January 1st of next year if Congress fails to repeal the FSC/ETI rules before the end of this year.

Within the past month, OMB Director, Josh Bolten, emphasized the need to act swiftly in complying with the WTO decision and stated that any legislative solution needs to be revenue neutral. The same mantra has been repeated for months in the Senate—compliance with the WTO decision needs to be revenue neutral in order to ensure passage in the Senate.

Despite the fact that significant economic trade sanctions, and possibly a trade war, loom on the horizon, to date the only revenue neutral solution to the WTO decision is H.R. 1769, Job Protection Act of 2003. This bill, otherwise known as the Crane/Rangel/Manzullo/Levin bill, after the bill's original four cosponsors, currently has over 140 sponsors in the House.

In brief summary, the Crane/Rangel/Manzullo/Levin bill would replace the FSC/ETI rules with an exclusion from taxation of up to 10 percent of income for domestic manufacturers and producers. This straightforward solution is appropriate given the current crisis in domestic manufacturing—coupled with the fact that over 75 percent of the FSC/ETI benefits currently flow to domestic manufacturers.

The only other legislative solution in the House to the WTO challenge is a bill recently introduced by the Chairman of the Ways and Means Committee. Unfortunately, that bill is not revenue neutral. It will cost an additional $128 billion over 10 years and, therefore, is a political non-starter in the Senate.

The Thomas bill also contains several controversial tax increases. For example, the Thomas bill would impose higher taxes on foreign-owned corporations that operate in the United States. Foreign subsidiaries employ 13.5 percent of the domestic manufacturing workforce and account for 22 percent of U.S. exports. The Thomas tax hike would discourage further investment and put existing U.S. jobs at risk.

A great deal is at stake in the face of the WTO challenge. Our domestic manufacturing base is being hollowed out right before our very eyes. Something must be done to ensure that a viable manufacturing base is preserved in the United States—particularly for our small businesses. Otherwise, the economic miracle that has occurred in the United States will be relegated to the dustbin of history.

On our first panel, we will from hear from Congressman Phil Crane and Congressman Sander Levin. These two individuals are original cosponsors of the Crane/Rangel/Manzullo/Levin bill and are to be praised for their leadership in attempting to resolve the current WTO challenge.

On our second panel, we will hear from several small business witnesses, as well as experts who will discuss the current crisis in domestic manufacturing.

Originally, Senator Breaux of Louisiana and Senator Smith of Oregon were scheduled to appear on the first panel. These two Senators circulated a letter last month, signed by 42 other Senators, that urged compliance with the WTO decision in a manner that would, first and foremost, benefit U.S. manufacturing—which our bill does.

Unfortunately, Senator Breaux has been detained with the Medicare Conference. In addition, the unexpected death of Senator Smith's oldest son earlier this week understandably changed his plans. Our sympathies are with Senator Smith and his family during this tragic time.

I know I speak for all Members of the Committee when I say that we grieve with the Smiths and pray for them.

I look forward to the testimony of the witnesses. On behalf of the Committee, I wish to thank you all for coming, especially those who have traveled far. I now yield for any opening statement by the gentle lady from New York, Ms. Velázquez.

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Opening Statement of Congressman Philip M. Crane
Hearing before the U.S. House of Representatives
Committee on Small Business
Wednesday, September 10, 2003, 2:00 p.m.

Thank you, Mr. Chairman, and Members of the Committee for inviting me to testify today. When I last appeared before this Committee, I submitted fairly lengthy testimony regarding my views as how best to address the FSC/ETI challenge that Congress must solve this year in order to avoid $4 billion in potential annual retaliatory sanctions against U.S. businesses by the E.U. and a $51 billion tax increase over the next ten years on U.S. manufacturers. I will therefore keep my remarks brief, and I look forward to answering any questions you might have.

Again, Mr. Chairman, I'd like to say that it has been a privilege working with you to develop legislation that will both bring us into compliance with our WTO agreements and strengthen domestic manufacturing. I believe that our legislation, H.R. 1769, the Job Protection Act of 2003, also known as Crane-Rangel-Manzullo-Levin, is the best way to address the FSC/ETI challenge.

When I last testified before this Committee on May 14th, broad bipartisan support for H.R. 1769 already existed. Since that time, an additional 80 Representatives have added their names to this legislation. As it now stands, over 140 Members of Congress have cosponsored H.R. 1769, including 7 Committee Chairmen and 6 Ranking Members.

The reason for this support is clear: our legislation makes sense. At a time in which our nation is hemorrhaging manufacturing jobs, it would be irresponsible to raise taxes on that sector of the economy. Yet, that is precisely what some proposals would do.

H.R. 1769, in contrast, returns all of the $51 billion raised upon the repeal of FSC/ETI to the manufacturing sector from whence it came. The effective rate reduction in our bill is undoubtedly WTO-compliant, because it treats all manufacturers producing in the United States equally, irrespective of whether they export. At the same time, it provides significant transition relief to current FSC/ETI beneficiaries. This transition relief is similar in scope to that which we have granted the E.U. in similar, long-running trade disputes.

Unlike other proposals, H.R. 1769 does not impose controversial tax increases on the domestic operations of foreign companies. Foreign subsidiaries employ 13.5% of the domestic manufacturing workforce and account for 22% of U.S. exports. Tax hikes of the kind contained in H.R. 2896 would discourage further investment and put existing U.S. jobs at risk.

This debate has become politically charged, but there is far too much on the line to allow this to degenerate into a mere political exercise. At stake are millions of manufacturing jobs here at home, as well as a potential annual $4 billion in retaliatory tariffs by the E.U. against our businesses if we do not repeal ETI this year. We must act now to stop either of these two events from occurring.

In closing, I look forward to continuing to work with my colleagues to address our WTO commitments while ensuring that we maintain a strong manufacturing base here at home. We must insist on no less.

Thank you, Mr. Chairman

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The Hon. Sander M. Levin
Ranking Democrat, Ways and Means Trade Subcommittee
Testimony before the Committee on Small Business
Hearing – The WTO's Challenge to the FSC/ETI Rules and the Effect on America's Small Businesses
September 10, 2003

Thank you, Chairman Manzullo and Ranking Member Velázquez. Mr. Rangel wanted very much to be here today, he has done a lot of work on this issue, but unfortunately, he is unable to attend. I appreciate the opportunity to be before the Committee today to discuss the WTO's challenge to the FSC/ETI rules and the effect on America's small businesses.

America's manufacturing sector is in a crisis. There have now been 37 straight months of manufacturing job losses – – the longest such stretch since the Great Depression. Since January 2001, the U.S. economy has lost 3.3 million private sector jobs, of which 2.5 million were in manufacturing. In Michigan this has been particularly devastating. Michigan has lost 162,300 manufacturing jobs. This is a loss of 18% of the state's manufacturing employment, or 1 out of every 6 factory jobs.

In many cases, these are not temporary job losses. A recent study published by the Federal Reserve Bank of New York states that many of the jobs lost are not coming back. One factor explaining these permanent U.S. job losses is the increasing movement of U.S. production facilities offshore and the increasing use of offshore out-sourcing.

Against this backdrop of a manufacturing crisis and increasing shifts of production for the U.S. market to foreign countries, the United States is faced with the Foreign Sales Corporation (FSC)/Extraterritorial Income (ETI) dispute with the European Union (EU). The FSC/ETI program was designed to correct for a flaw in WTO rules. Under those rules, the EU is allowed to rebate its VAT taxes at the border, but the United States may not rebate its corporate taxes at the border. In other words, U.S. goods bear the full burden of the U.S. tax system when they are exported, while goods from the EU and other countries get a rebate on part of the domestic tax burden when they are exported. The FSC/ETI program was designed to restore the appropriate balance for firms that manufacture in the United States and export abroad by providing tax benefits to these firms.

Unfortunately, correction of this flaw in WTO rules has not been actively pursued in the present WTO negotiations. This means that we must repeal the FSC/ETI program or face the possibility of sanctions from the EU. Repeal of the FSC/ETI program, however, means a tax increase of about $50 billion on the U.S. manufacturing sector – at a time when that sector is reeling and least able to afford it.

Accordingly, I was very proud to join with my colleagues Mr. Crane, Mr. Rangel and Mr. Manzullo when the four of us jointly introduced H.R. 1769, the Job Protection Act of 2003. This bill really sets an example of the type of broad bipartisan coalition that is possible when we work together on trade issues – it now has 139 co-sponsors from both sides of the aisle. The bill would repeal the FSC/ETI program to comply with WTO rulings, but replace it with a new program for companies that manufacture and produce in the United States. And, the bill is fully WTO-consistent; I respectfully request unanimous consent to insert into the record with my testimony a short document that discusses the WTO-consistency of the bill. Moreover, the Crane-Rangel-Manzullo-Levin bill provides a higher tax deduction for companies that keep their production in the United States. This bill would promote U.S.-based manufacturing <u>and</u> would provide an incentive to keep production activities in the United States <u>and</u> would be essentially revenue neutral.

In contrast, Mr. Thomas has introduced a competing bill. This bill includes a number of provisions aimed at the manufacturing sector, but it also includes hidden tax increases on foreign subsidiaries in the United States. More importantly, the Thomas bill uses FSC/ETI repeal – money that benefits manufacturers that produce and provide jobs in the United States – to help pay for about $100 billion in tax cuts for the offshore activities of U.S. firms. When you put the two together, the Thomas bill raises taxes on some domestic manufacturing activities, while lowering taxes on the offshore manufacturing activities of U.S. firms – in other words, the Thomas bill effectively provides an incentive for U.S. companies to move production offshore.

That does not make any sense.

I have been a strong supporter of sensible international tax reform in the past and will continue to be so in the future, but in my view, the Thomas bill actually sets back this effort. By creating this trade-off between tax benefits for manufacturing in the United States and tax benefits for manufacturing offshore, the Thomas bill makes for bad policy and bad politics.

Manufacturing is so important to this nation and is under so much pressure that it is critical to focus on its needs and not blur or undercut this focus by combining it with other issues.

A recent Dear Colleague claimed that the Thomas bill provides greater benefits to U.S. manufacturers than does the Crane-Rangel-Manzullo-Levin bill; but this is a mirage. It is only because the bill has a total cost of $200 billion. That price tag does not only mean that the Thomas bill is fiscally unsound; the bill is also a non-starter.

We are now hearing that the U.S. deficit will be about $500 billion this year; and that there will be a ten-year on-budget deficit of $3.8 <u>trillion</u> dollars. A bill that purports to add $200 billion in additional tax cuts on top of this is making promises that cannot be kept, being a non-starter in the Senate. Also, OMB Director Bolten has stated that a FSC replacement bill will need to be revenue neutral. Which part of the Thomas bill would most likely be reduced or eliminated? The answer to this question might be evident in the FSC repeal bill Mr. Thomas introduced last year, H.R. 5095, which contained no benefits for U.S.-based manufacturing activities, only tax cuts focused exclusively on the offshore operations of U.S. firms.

The Crane-Rangel-Manzullo-Levin bill is essentially revenue neutral. Rather than using the FSC/ETI repeal as a pretext for un-affordable tax cuts that largely benefit U.S. firms with offshore operations, our bill matches almost on a dollar-for-dollar basis, repeal of FSC/ETI with a replacement tax program that remains true to the goal of helping the U.S.-based manufacturing sector.

The Crane-Rangel-Manzullo-Levin bill is the right answer to the FSC/ETI problem. Globalization does mean economic change. It does not mean, however, that the United States inevitably will lose its manufacturing base to others. It is critical that we take active and sound steps to shape the course of globalization and not passively accept whatever occurs. The Crane-Rangel-Manzullo-Levin bill is an important ingredient of an active policy and we must not be deflected from achieving its adoption.

I thank Chairman Manzullo for his leadership on this issue and I urge the Committee to support the bill we jointly introduced. Thank you very much.

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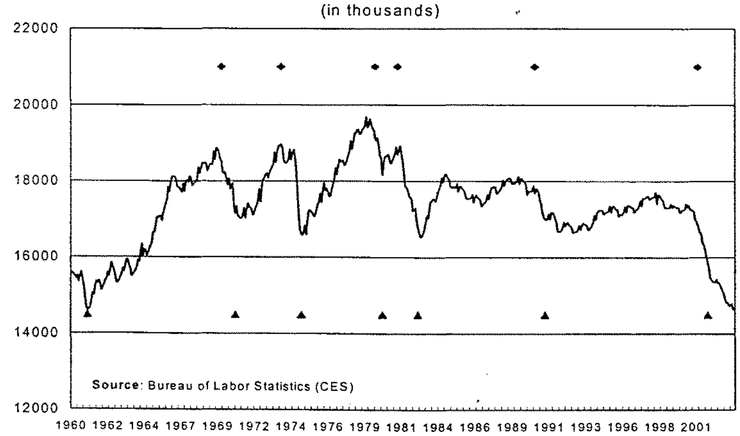
Testimony Before the House Small Business Committee
September 10, 2003

Good morning, my name is Kathryn Kobe and I am the Chief Economist of Joel Popkin and Company. We are economic consultants based here is Washington, DC. Joel Popkin and Company recently completed a white paper on the importance of manufacturing to the U.S. economy for the Council of Manufacturing Associations. This testimony is drawn from the research JPC conducted for that paper.[1]

I have been asked to outline the current state of manufacturing in the U.S. The basic data on job losses in manufacturing paint a stark picture of a sector that is struggling for survival. In March 2001, the U.S. reached the official end of the economic expansion that began in March 1991 and entered its first recession in over a decade. Since the beginning of the recession, the number of manufacturing jobs has plummeted, declining by 2.4 million jobs between March 2001 and August 2003. That is over 70 percent of the 3.3 million jobs lost in the private sector during that time period. However, the manufacturing sector was losing jobs well before the official start date of the downturn. The sector lost over a half million jobs between 1998 (when the number of

Chart 1: The Number of Manufacturing Jobs in the U.S.
(in thousands)



[1] The full paper is available for download from the JPC website, www.jpcecon.com.

manufacturing jobs peaked for this expansion) and early 2001.[2]

How unusual is this job loss during a recession? The chart above tracks the number of manufacturing jobs in the U.S. between January 1960 and August 2003. Along with the number of jobs the chart shows the peaks and troughs of the business cycle (peaks are marked by the diamonds at the top of the chart and troughs by the triangles at the bottom of the chart). It is clear, that manufacturing employment in the past has shown steep declines during the periods of recession and tended to recover relatively quickly once the trough of the recession had passed. However, beginning in the 1980s, the number of jobs gained during the recovery period has been noticeably smaller. During the most recent expansion manufacturing jobs showed few gains, in March 1991 there were 17.1 million manufacturing jobs and by March 1998 (the high point for manufacturing jobs during the expansion) the total was only 17.6 million. One has to go back to 1958 to find a time when the number of manufacturing jobs is as low as it is today and back to the 1940s to find the number of production jobs in manufacturing this low. Job losses in manufacturing between 1979 and late 1982 were over 2.8 million, similar to the size of job losses that are being seen now. However, by late 1982 when that recession ended, both production jobs and total jobs in manufacturing were beginning to increase. Whereas the latest numbers show that more manufacturing jobs have been lost since the end of the recession in November 2001 than were lost during the recession itself. In a normal recession, one would expect to have seen some increase in the number of jobs in manufacturing by the time the economy is this close to the 2-year mark of the recovery.

Manufacturing has been a significant success story in the area of labor productivity. Consequently, a stable level of manufacturing jobs or even a reduction in manufacturing jobs might reflect growth in productivity without a decline in manufacturing output. However, manufacturing's share of GDP has also fallen over this time period. In 1991, the manufacturing sector produced 17.4 percent of U.S. current dollar GDP. It was still producing 17.4 percent of a growing nominal dollar GDP in 1995. Since 1995, manufacturing's share of GDP has shown sharp declines and by 2001 (the latest information available) its share was only 14.1 percent. While the 2002-

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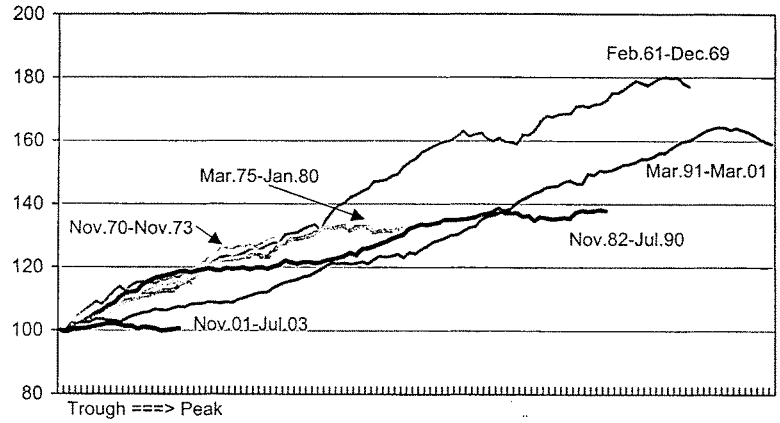
[2] The data on the number of jobs in manufacturing was revised on June 6, 2003 when the BLS changed to using the North American Industrial Classification System (NAICS) for its Current Employment Survey Statistics. The chart and the numbers in the text are based on a consistent definition of manufacturing based on NAICS. Under the old definition, manufacturing has a larger number of jobs, primarily because publishing was a part of manufacturing under the old definition. However, the size of the decline in the number of manufacturing jobs is similar regardless of which data are used.

2003 estimates will not be available until next spring, other measures of the manufacturing sector would indicate that its share may have declined further since then.

Chart 2: Manufacturing Production Growth during Recent Expansions
(Cumulative Increase in Manufacturing IP Index from Trough to Peak)

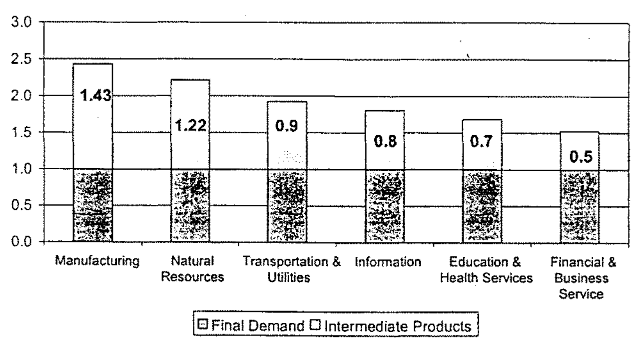


The NBER recently set a date for the trough of the recession that began in March 2001 at November 2001. Chart 2 compares manufacturing output of this expansion to those of the previous five expansions, using the industrial production index for manufacturing. The chart shows the growth in output from trough to peak of the respective economic expansions. [3] In the expansions during the 1960s, 1970s and 1980s, manufacturing output rose almost 20 percent during the first 20 months of recovery. The recovery from the 1990-91 recession took about twice as long to reach that point, but had still increased almost 8 percent during the first 20 months. The recovery in manufacturing output during this expansion is lagging even the poor start of the 1991 recovery. Manufacturing output is up less than 1.0 percent over the past 20 months and is in fact lower now than it was a year ago. By all of these measures the sharp decline in manufacturing appears to be more than just part of the usual cyclical pattern of a downturn in the economy.

[3] Peak and trough months are determined by the National Bureau of Economic Research's Business Cycle Dating Committee.

A dynamic economy is constantly undergoing changes and readjustments among companies and among industries. What benefits has the manufacturing sector contributed to the U.S. economy that are potentially at risk as the sector downsizes? The first is manufacturing's many links to the rest of the economy. The manufacturing sector has the highest multiplier of any major sector in the economy. That means that for each dollar of final demand for manufactured products, an additional $1.43 worth of goods and services is needed to produce that output. Those additional goods and services come from other manufacturers in the form of parts and supplies, and from sectors of the economy outside of manufacturing. The major service-producing sectors has significantly smaller multipliers. An increase of a dollar in the final demand for information services requires only $0.80 worth of additional output from other sectors of the economy, an increase in the demand for financial and business services requires even less additional output, $0.50 worth. Consequently, when the demand for

Chart 3: Multipliers for Selected Sectors of the Economy



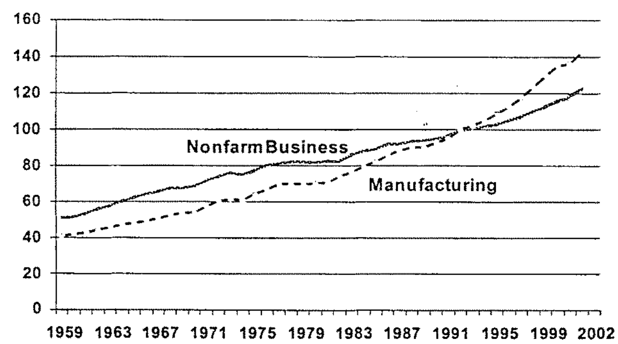
Source: Bureau of Economic Analysis

manufacturing output grows it produces more secondary demand for other goods and services than does any other major sector and when manufacturing demand shrinks, so does the demand for the goods and services that are needed to support it.

Manufacturing has long led U.S. industries in productivity growth. Gains in productivity raise a country's standard of living. In the past fifteen years – which include both years of economic expansion and recession – output per hour in the U.S. private non-farm economy rose at an average annual rate of 1.9 percent. That productivity performance was substantially a result of gains in manufacturing labor productivity, which rose 3.1 percent per year.[4] In the same timeframe, total nonfarm multi-factor productivity – the productivity of labor and capital combined – advanced 0.9 percent annually. For the manufacturing sector the rise was 1.6 percent per year. Durable manufacturing turned in an exceptionally strong multi-factor productivity increase of over 2 percent per year, reflecting the technological breakthroughs in the manufacture of high-technology electronic goods.

Manufacturers are the major dynamo of R&D. Over the past 20 years, manufacturing has performed almost 60 percent of all R&D in the United States. The

Labor Productivity in U.S. Nonfarm Business and Manufacturing
(1992=100)



Source: Bureau of Labor Statistics

National Science Foundation estimates total U.S. R&D spending in 2002 at $291 billion.[5] Of that amount, R&D performed by private industry is estimated at $213 billion. Detailed 2002 R&D totals by industry have not yet been published, but R&D performed by manufacturing industries is estimated at $127 billion, more than 60 percent of the

[4] Bureau of Labor Statistics, U.S. Department of Labor, Productivity and Costs
[5] "Slowing R&D Growth Expected in 2002," National Science Foundation *InfoBrief* (NSF 03-307), December 2002.

total private R&D, and about 45 percent of all R&D performed in the United States.[6] In 2000, manufacturing industries financed (as well as performed) about 55 percent of all private R&D.[7]

The process through which R&D promotes economic prosperity is multi-faceted and complex. The first avenue is through direct benefits to firms from their R&D investments. Those direct benefits, or the potential benefits a rival might gain from R&D, are the primary driver of firm-financed R&D. Inventions being turned into innovations and those innovations producing an incentive for other innovations is what William Baumol, in his book *The Free-Market Innovation Machine*, refers to as the cumulative nature of innovation or as "innovation breeding." [8] However, not all the positive impacts of R&D accrue just to the firm that is financing it. The second path by which R&D makes an impact on the economy is through "spillovers" whereby R&D performed by one firm benefits other firms without direct compensation for the innovation. The third is the feedback from R&D and its spillovers to improve manufacturing products, processes, and distribution networks. The fourth is through the widely discussed multiplier – the effect of one industry's investment on other industries.

R&D spillovers are an important factor in this process. Spillovers come about when parties derive benefits from the R&D without having to fully compensate the company conducting the research. Spillovers are often characterized in one of three ways, but these pathways often interact and increase their combined effect.[9] One way is through "market spillovers," in which the marketing of a new product creates benefits to market participants other than the innovating firm. Often this is through a new technology that is embodied in products newly developed or improved by R&D. However, because producers fail to capture all of the improvements in the prices they charge for those new goods, cost-free benefits accrue to competitors and customers, or are handed back to suppliers. [10] A second kind is termed a "knowledge spillover." This is the transmission of knowledge from an R&D activity that can be used by other economic agents in a virtually cost free manner. A third kind is a "network spillover." It occurs when R&D benefits are enhanced in value by the development of a related set of

[6] Estimates of manufacturing sector R&D are based on detailed 2000 distributions applied to 2002 industry totals.
[7] The remainder of the funding came primarily from the federal government; however, the federal government's financing of R&D performed by industry has been virtually unchanged in recent years.
[8] *The Free-Market Innovation Machine*, William J. Baumol, Princeton University Press, 2002.
[9] "The Importance of 'Spillovers' in the Policy Mission of the Advanced Technology Program," by Adam B. Jaffe, *Journal of Technology Transfer*, Vol. 23 (2), pp. 11-19.
[10] The potential for market spillovers of R&D has been quantified in a forthcoming NIST paper, "Inter-Industry Diffusion of Technology That Results From ATP Projects" (GCR # 03-848).

technologies. Thus, extra benefits may accrue to an innovation if related technological innovations also take place. For example, the existence of a modem allows greater benefits to be derived from computers, and the more people one can communicate with in that network the greater those benefits.

It is widely recognized that spillover effects are magnified the more interdependent the parties are and the closer their geographic proximity. A recent paper by Michael Orlando discusses the importance of proximity, both technological and geographical, to the spillover process. He finds that spillovers within a manufacturer's own very narrow sector tend to be much less sensitive to distance than are those from outside that narrow sector, although a combination of geographic and technological nearness seems to be advantageous. However, the impact from spillovers originating outside the manufacturers' narrow sector tend to decrease rapidly with distance.[11] Therefore, firms are more likely to benefit from spillovers when R&D takes place geographically near to them than they are if it occurs on the other side of the world, especially with regard to the benefits from more generalized R&D.

But recent numbers show weakness in manufacturing's R&D efforts. Manufacturers accounted for 62 percent of private R&D in 2000 – $124 billion – and manufacturers financed 90 percent of that total themselves.[12] However, the $11 billion increase in R&D spending between 2000 and 2002 represents only half the recent pace of R&D spending. In real terms, spending on R&D by all of private industry barely changed in 2002. And the National Science Foundation reports that manufacturing R&D input has barely grown for the past decade, only 5.6 percent (0.5 percent per year) in the 1989-1999 period. So while at 62 percent the manufacturing share of industry R&D is still high, that is much weaker than past performance. Manufacturing's share was 80 percent just 10 years ago and 95 percent 20 years ago. At first glance, one could conclude this is a result of the rapid growth of the services sector, and as Chart 5 shows there is an increase in non-manufacturing R&D.[13] However, the slowdown in the real growth of total R&D and the slowdown in goods-related R&D will impact the beneficial effects of the externalities that accompany new innovations in manufacturing.

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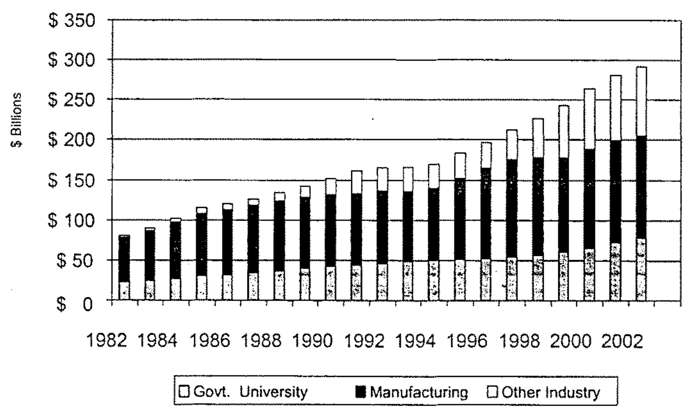
[11] "On the Importance of Georgraphic and Technological Proximity for R&D Spillovers: an Empirical Investigation," by Michael J. Orlando, Federal Reserve Bank of Kansas City, July 2000.

[12] The remaining funds come from federal government sources. "U.S. Industrial R&D expenditures and R&D-to-Sales Ratio Reach Historical Highs in 2000," National Science Foundation *InfoBrief* (NSF03-306), December 2002.

[13] Detailed tables on nonmanufacturing R&D indicate a large proportion of the expenditures take place in the network industries, trade and information services.

There are also indications that the U.S.' R&D expenditures as a share of the total R&D conducted by industrialized countries have begun to shrink. In 1984, the United States accounted for about 48 percent of total OECD R&D expenditures (in real terms) but by 1998 that share had fallen to less than 44 percent. And while the United States still spends more, by far, on R&D than any other OECD nation, it ranks only fifth in the world when ranked on R&D expenditures as a percent of GDP. [14]

Chart 5: R&D Expenditures by Performing Sector



Source: National Science Foundation

If the U.S. manufacturing base shrinks too much this innovation process is put at risk. A very small and diffuse manufacturing sector does not promote the same level of R&D activity. As the U.S. manufacturing base downsizes it promotes a shift in R&D and investment to other global centers where the critical mass necessary to conduct it exists and is growing. If this happens, a decline in the U.S. long-term economic growth rate is all but assured. National Institute of Standards and Technology economist Gregory Tassey puts the importance of domestic R&D into a broader perspective:

[14] *Science and Engineering Indicators--2002*, National Science Foundation, Chapter 4.

> Changes in competitive dynamics are altering the reward/risk ratio for R&D investments within and between technology life cycles. As life cycles compress, R&D at the company level no longer can exist in isolation of a supporting network. Corporations increasingly require access to R&D conducted by other firms in their supply chains and to the broader technology infrastructure provided by a national innovation system. If domestic R&D resources are not available, U.S. companies do not hesitate to form research partnerships with foreign companies, outsource R&D overseas, or directly invest in foreign research facilities. These research relationships often lead to follow-on foreign manufacturing relationships. Thus, the maintenance of an effective domestic R&D network is essential for attracting domestic and foreign R&D funds and subsequent manufacturing, which increases domestic value added and hence economic growth.[15]

This importance of the role of R&D also is recognized by the U.S.' trading partners. As part of its proposed auto policy, China would require international auto makers to foster R&D facilities within China.[16] This would not be the first instance of U.S. R&D moving off shore.

The ability to fund new private R&D spending comes largely from the profits that a company can plow back into its business. Thus, the available cash flow of manufacturing firms is closely linked to their ability to perform R&D work as well as make new capital investments. One measure of the cash flow available for such investments is the depreciation charges of a company plus the profits it retains rather than distributes as dividends to its shareholders.[17] Between 1999 and 2001, this measure of manufacturing corporate cash flow fell by almost 20 percent, to 25 percent of total corporate cash flow in the United States. In the late 1980s manufacturing accounted for almost 40 percent of all corporate cash flow in the U.S. economy. This puts severe limitations on companies' abilities to make the necessary investments to spur future innovations and growth. Cash flow varies with the business cycle and thus the recession is one of the reasons for the recent slowdown in R&D. Although it is not the only reason.

One area in which innovations have helped the U.S. is in its manufactured exports. Manufacturing R&D is an important driver in spurring growth in U.S. exports.

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[15] "R&D and Long-Term Competitiveness: Manufacturing's Central Role in a Knowledge-Based Economy," by Gregory Tassey, National Institute of Standards and Technology, February 2002, p. 9.
[16] "China's New Auto Policy Favors Local Companies," *Wall Street Journal*, June 3, 2003.
[17] In the early 1990s, manufacturing was paying out almost 30 percent of all corporate dividend payments to shareholders in addition to retaining enough earnings to fund its investment programs. Manufacturing's share of dividend payments declined to about 20 percent of the total corporate dividend payments in 2001. Bureau of Economic Analysis, U.S. Department of Commerce.

Exports of R&D-intensive goods are a growing share of overall goods exports by the United States. In 1980 exports of such goods accounted for about 19 percent of all manufactured exports in the United States; by the late 1990s that share had grown to about 27 percent.[18] However, by definition goods high in R&D content are those embedding new and better ideas. The world buys U.S. exports because they are "the better mousetrap." To maintain the growth in such goods requires a sizable continuous stream of investment in R&D, and a sizable manufacturing sector to innovate, produce, and sell those goods abroad.

The United States is the world's largest exporter of manufactured goods. In 2001, it exported almost $600 billion worth of goods. U.S. manufactured exports have more than doubled since 1990, and manufactured goods account for 82 percent of the United States' total merchandise exports and three-quarters of all its exports. Through most of the past two decades U.S. manufactured exports as a share of world trade have remained relatively constant – 13 percent in 1980, 12.1 percent in 1990 and 13.5 percent in 2001. At the same time trade has become an increasingly important part of the economies of the United States and other nations around the world. [19] But despite the growth in goods exports, the merchandise trade deficit has been negative since 1976. Goods exports as a share of U.S. GDP peaked at about 8 percent in late 1997 but has retreated to about 6 percent since then. This reflects declining goods exports in 1998 (due to the Asian currency crisis), some recovery in growth in the 1999-2000 period, and then a sharp decline in goods exports in 2001 and 2002. This last decline partially reflects the impact of the recession on our trading partners and the terrorist attacks in the United States in September 2001; but that is not the only cause. While the decline in U.S. exports in 2001 corresponded to a decline in total world trade, the same cannot be said for 2002. World merchandise trade increased 4 percent last year, while U.S. merchandise exports continued to decline.[20] Consequently, after two decades of relative stability, the U.S. share of world manufactured exports declined to about 11 percent in 2002. That reflects a worsening of the U.S. position vis-à-vis other nations producing manufactured exports.

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[18] R&D intensive goods as defined in this case are biotechnology, life science technologies, opto-electronics, information and communications, electronics, flexible manufacturing, advanced materials, aerospace, weapons, and nuclear technology.
[19] The U.S.'s manufactured imports share of world trade has grown tremendously during this time period increasing from 11.2 percent in 1980 to 15.4 percent in 1990 and was 19.4 percent in 2001. *International Trade Statistics, 2002*, World Trade Organization.
[20] "Trade Recovered in 2002, but Uncertainty Continues," WTO, April 2003.

America's success as an exporter has prompted other countries to build their own base for manufacturing exports. As world trade burgeoned in the 1990s, increasing from $4.2 trillion to $7.9 trillion, manufactured goods as a share of total world exports also increased from about 70 percent of the world's merchandise trade to about 75 percent. U.S. businesses and consumers have benefited from the availability of many foreign-manufactured products; thus, traded goods have become an increasingly large share of the American market. The sum of U.S. exports and imports of manufactured goods are now equal to 40 percent of U.S. domestic production of manufactured goods. In 1987 that share was 20 percent.[21] Continued growth in U.S. exports is vital to enabling the United States to trade with the rest of the world. [22] Exports earn foreign currency, and foreign-currency earnings support jobs and allow the United States to purchase foreign-made imports.

The strong U.S. dollar overseas is blamed for handicapping export growth and encouraging the growth of imports. The recent weakening of the dollar should be helpful to U.S. goods manufacturers. A rise in their exports should follow. But the balance of trade impact of the dollar's recent decline will probably not be as large as some have anticipated. That is because the decline is being driven by the 16 percent depreciation of the dollar against "major" currencies of the world – those that are traded on exchanges outside of their own countries. But those countries only account for 56 percent of U.S. trade.. The other 44 percent reflects trade with countries, such as China, whose currencies are not defined as major currencies. If one looks at exchange rates applicable to the other 44 percent of U.S. trade, as shown in Chart 6, it is clear that the dollar has been increasing in value against them – almost 2 percent in the past year.[23] Imports from those countries account for 46.5 percent of U.S. imports, but only 40.7 percent of U.S. exports. The differential for China is even larger. China bought 3 percent of U.S. exports in 2002, but was the source of 11 percent of U.S. imports.[24] In the absence of the Chinese government's intervention in the value of its currency

[21] Based on U.S. Department of Commerce data on manufactured exports and imports and manufacturers' shipments.

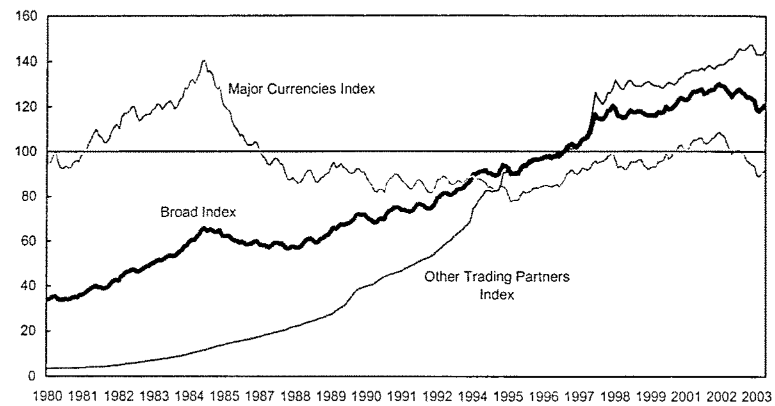
[22] The U.S.' large current account trade deficit is sustainable only as long as foreign investors are willing to continue to buy assets in the U.S. in the form of stocks and bonds. The U.S.' strong economic base and stable political situation have been the basis for attracting that investment in the past. However, there are never any guarantees that foreign investors will continue to accumulate dollar holdings in their foreign exchange reserves at the same rate they have in the past.

[23] Many of the currencies in this index are pegged to the dollar and the exchange rate for those currencies show little month-to-month variation. The other currencies in the index tend to devalue against the dollar.

[24] In general China's exports and imports boomed in 2002, each growing in excess of 20 percent overall. WTO figures show China was virtually tied with France for the spot of fourth largest exporter of merchandise in the world in 2002

against the dollar, U.S. exports to China would presumably be higher and imports from China lower.

Chart 6: Federal Reserve's Nominal Dollar Indexes



U.S. exports of services have grown significantly in recent years, but were still less than half the size of goods exports in 2002. Consequently, it is doubtful the United States can depend solely on trade in services to offset a serious decline in goods exports. In addition, U.S. providers of business services are facing increasingly strong competition as foreign producers of services begin to staff U.S. call centers and provide programming services to U.S. companies. These jobs represent U.S. service imports and offset U.S. service exports. Consequently, the solution to the trade deficit is unlikely to be found solely with service sector exports.

There are several other benefits that manufacturing provides the U.S. economy. A further discussion of those can be found in "Securing America's Future: The Case for a Strong Manufacturing Base" on JPC's website.

The final comment for this testimony returns to where it began. Jobs are lost when the manufacturing sector shrinks. What type of jobs are lost and what sorts of adjustments do those workers face? Manufacturing provides well-paying jobs with benefits to its workers. In 2001, salaries and benefits averaged about $54,000 in the manufacturing sector compared to an average of $45,600 for the private sector overall.[25] Manufacturing offers job opportunities to workers across the educational spectrum – employing more than its relative share of the workforce with no more than a high school diploma, but also employing a large number of college-trained employees. In 2000, manufacturing had on its payrolls 16 percent of the workforce without a college degree, the second largest employer of that group in the country.[26] However, manufacturing also employed 12 percent of the workforce who had at least an associate's college degree, the second largest employer among the major industries of that group as well.[27]

Two factors have made the manufacturing sector attractive to workers with all levels of education. One is the pay and benefits, and the other the educational and training opportunities provided by employers. The latest Labor Department surveys on employer training were conducted during the early and mid-1990s. Those surveys indicated over half of manufacturing employees needed training to qualify for their jobs. About 13 percent of the workers received formal job training, 30 percent received informal job training, and 26 percent trained in a school environment.[28] About 38 percent of manufacturing workers also took skill-improvement training, the majority receiving their training through either formal or informal on-the-job-training. Manufacturing and infrastructure industries were leaders in the percentage of training time, about 40 percent of formal training time, that was devoted to production, communications and quality training.[29] However it is accomplished, training provides an important investment in human capital needed for future growth and productivity improvements. But as manufacturing downsizes, there is a growing scarcity of entry-level openings in manufacturing. While the average age of workers in manufacturing is only slightly higher than it is for the nonfarm economy as a whole – 41 years compared to 38 years – the distribution of workers is noticeably different. In 2000 (before the latest job losses), 19 percent of workers in manufacturing industries were below the age of 30, whereas for the economy as a whole, 28 percent of workers were younger than 30.[30]

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[25] Average compensation per full-time-equivalent employee. Bureau of Economic Analysis, U.S. Department of Commerce.

[26] Retail trade is the largest employer of workers without college degrees. BLS reports that in December 2002 wage levels in manufacturing were $17.33 per hour compared to $9.57 per hour in retail trade.

[27] The largest employer of people with less than a college degree is the retail services industry and the largest employer of people with at least an associate's degree is the educational services sector. *Current Population Survey* 2000.

[28] *How Workers Get Their Training: a 1991 Update*, Bureau of Labor Statistics, U.S. Department of Labor, August 1992. Some workers received more than one type of training.

[29] "1995 Survey of Employer Provided Training," Bureau of Labor Statistics, U.S. Department of Labor, Table 5.

[30] Calculations from the 2000 *Current Population Survey*

This reflects the lack of job growth in the manufacturing sector in recent years but also presages a potential skill shortage for the future. When the older manufacturing workers retire there may not be anyone to replace them since there has not been a steady stream of younger workers encouraged to enter the pipeline and gain the important job-specific skills.

The information available on the impacts on workers who have been displaced from their jobs comes from BLS' Displaced Workers Survey. Plant closures accounted for 50-60 percent of the job displacements in manufacturing for workers with three or more years of tenure during the period from January 1993 through December 2001.[31] That compared with 45-50 percent for the non-manufacturing sectors of the economy. On average each year from 1993 through 1998, 177,000 manufacturing workers with three years or more of tenure lost their jobs due to plant closures. From January 1999 through December 2001 that rate increased to 230,000 workers per year.[32] The rate of reemployment for long-tenured employees (three years or more at their jobs) in manufacturing is also relatively low. Less than half of those workers return to manufacturing jobs; the rate of re-employment in non-durable manufacturing is even lower, with only about a quarter of those losing jobs in non-durable manufacturing re-employed in non-durable manufacturing.[33] Long-tenured, full-time manufacturing employees who do find new full-time jobs, in any industry, tend to take a pay cut. The latest information on the impact on pay of a job loss has not yet been published, but in 1998, that loss of pay averaged about 10 percent, over twice as large as the average for re-employed workers overall.

Manufacturing provides a base for many important activities in the U.S. economy. While manufacturing will probably never disappear entirely, one can not determine how much of the sector can disappear before the critical mass that fuels the innovation process is lost. Under any circumstances, the loss of a large part of the manufacturing sector will be felt throughout the U.S. economy.

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[31] The reason for plant closures cannot be identified in these surveys. Consequently, all of these job displacements cannot be positively linked to outsourcing overseas. However, many of the industries with increasing import penetration shares are also industries in which a large percentage of the job losses are due to plant closures.

[32] *Displaced Workers Survey*, Bureau of Labor Statistics, U.S. Department of Labor.

[33] These rates cover workers who lost their jobs due to plant closures, lost shifts or slack work. Consequently, the rates of re-employment among workers whose jobs were lost due to plant closures is undoubtedly somewhat lower than these.

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Testimony of
B. Doolittle
Senior Vice President
Morton Metalcraft

Before the
United States House Small Business Committee
September 10, 2003

Good morning Mr. Chairman and distinguished members of the Committee. I am Brian Doolittle, Senior Vice President for Morton Metalcraft Co.. Thank you for the opportunity to present the views of Morton Metalcraft on the future of the Extraterrorital Income (ETI) regime and its impact on the competitiveness of U.S. small and mid-sized manufacturers.

Forty years ago this month Morton Metalcraft Co. was founded in Morton, Illinois – a small town east of Peoria. With the blood, sweat and tears of lots of hardworking people we have grown the business to include two facilities in the Midwest and three in the Southeast. Our 2002 sales were $117 million and we employ approximately 1,100 people. We are a contract manufacturer, providing highly engineered sheet metal parts and subassemblies to support our customers' manufacturing operations. We serve large, and might I say demanding, customers like Caterpillar, Deere & Co., Federal Signal and the Carrier Corporation. As a contract manufacturer, our success is directly related to the success of these customers and the markets they serve.

The current ETI regime – as well as its predecessors, the Domestic International Sales Corporation (DISC) and the Foreign Sales Corporations (FSC), have been cornerstones in maintaining the competitiveness of U.S. manufacturers. Congress first created the DISC in 1971 to level the playing field for U.S. companies large and small. These tax incentives have been maintained by the U.S. Congress over the past 32 years to partially offset the tax advantages our competitors in European countries enjoy through their border-adjustable territorial tax systems. These systems generally exempt from tax income earned outside the home country and rebate value-added activities for products exported outside the home country. Without an offset to these territorial regimes, U.S. companies are left at a significant competitive disadvantage because our products will carry the full cost of the U.S. worldwide tax system, while the European products will only carry a partial burden associated with their tax systems.

Morton Metalcraft Co. is not a significant user of FSC/ETI, but our key U.S. customers who export are. One of the key elements of the ETI debate that appears to have been overlooked is the relationship between how the right policy choice for large U.S. companies who use ETI is directly linked to the health of U.S. small businesses who supply them. Let me explain.

Morton Metalcraft's customers are sophisticated and shop the world for parts and components that will optimize cost, quality, and delivery throughout their manufacturing value chains. As a result, Morton Metalcraft must compete every day against foreign competitors who are working hard to supply the same parts we make for our ~~the~~ U.S. customers. A significant change in the value chain variables – particularly cost -- could mean a loss of business to foreign competitors and a loss of high-dollar-valued U.S. manufacturing jobs. That's why the policy choices Congress makes in determining the replacement for ETI are so critically important to the long-term competitiveness of small and medium sized U.S. manufacturers.

The current economic climate has been extremely difficult for small and medium U.S. manufacturers and the domestic manufacturing customers we serve. This is evidenced by U.S. Commerce Department statistics showing 2.6 million job losses in the manufacturing sector during the past three years. This trend has had a direct impact on Morton Metalcraft's business. Since December of 2000, our revenues have declined from $148 million to $117 million – a 21% decline. Our employment has been reduced from 1,470 to 1,100 – a 25% decline. And we have watched numerous U.S. competitors, as well as other suppliers, go out of business.

As a small manufacturer, we are doing everything within our power to remain competitive against the onslaught of foreign competition during these challenging economic times. We have undertaken significant efforts to control costs and improve the efficiency of our manufacturing and business processes by embracing enabling methodologies like 6 Sigma and Lean Manufacturing. These rigorous processes of internal evaluation and continuous improvement have paid great dividends in our business -- lowering break even points by more than 30 percent. But to stay competitive, we need to invest in new technology and have people working with that technology three full shifts to gain economies of scale– not just the current one and a half.

With a level playing field, I am confident Morton Metalcraft Co. can win against our foreign competitors – and as a commercial business remaining competitive is **our** responsibility. What we need from Congress are the right policy actions to ensure the playing field remains level versus our foreign competitors. That's why I strongly support your efforts, Mr. Chairman, on the Crane-Rangel-Manzullo bill – H.R. 1769. The tax rate cut of up to 10% that you have proposed for domestic manufacturers would provide a strong dose of the right medicine, at the right time for small, medium and large manufacturers who are suffering under the weight of the U.S. economic slowdown.

Congress and the Administration must ensure ETI legislation does not impose a substantial tax increase on U.S. production – as proposed in H.R. 2896. Increasing taxes on domestic production by $5 billion annually to pay for offshore tax breaks would significantly increase the cost of doing business in the U.S. If H.R. 2896 is enacted, our large multinational customers would be forced to consider moving more production offshore to stay competitive. Since most businesses buy parts and components close to locations where they manufacture, Morton Metalcraft Co.and other small businesses would lose out to our foreign competitors -- the only real winners here! The unfortunate result of such actions would disproportionately affect small manufacturers because – unlike large businesses – we do not have the flexibility to restructure to take advantage of offshore tax breaks.

Mr. Chairman, I applaud the efforts of you and your colleagues on the Committee to bring the voice of small manufacturers into this important debate. Its comforting to know someone in Washington cares about the plight of small manufacturers during this time of crisis in manufacturing. I look forward to continuing to work with you and your colleagues in support of the Crane-Rangel-Manzullo bill.

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Revision #1 9/08/03

Statement of Leon Trammell, Founder and Chief Executive Officer of TRAMCO INC, of Wichita, KS. Speaking on behalf of Tramco Inc.

Oral Testimony before the house committee on small businesses.

September 10, 2003

Mr. Chairman, thank you for inviting me to appear before this committee today. I am Leon Trammell, Chief Executive Officer of Tramco Inc. of Wichita, KS. Tramco manufactures and sells environmentally friendly conveyors primarily for the cereal grain processors. In essence we take the grain from the truck, rail car or ship and convey it through processing or storage and back to the truck, rail car or ship.

Today, I will be speaking on behalf of Tramco Inc. and it's 100 plus employees.

Tramco was founded in 1967 in a $15.00 a month building with one employee. Today, we have approximately 120 employees worldwide, approximately 100 of which are in Wichita, KS the other 20 are in our satellite sales office and factory in Hull, England, and sales office in the Netherlands. Tramco has machines in 45 foreign countries and all 50 States.

I would like to share with you today the positive effects, the Foreign Sales Corporation offers companies like Tramco.

In 2001 our gross sales were approximately 17 million, 60% was foreign sales, which gave us a tax savings of approximately 48 thousand dollars.

The following year 2002 our gross sales were approximately 15 million with approximately 50% going to foreign sales and a savings of 45 thousand dollars.

In 2003 our gross sales will be approximately 22 million dollars with approximately 63% foreign sales and a savings for Tramco of approximately 75 thousand dollars.

We have been utilizing this form of tax relief since the days of DISC, which as you know was deemed unfair, it was replaced by FSC. Now the WTO has judged FSC as also being unfair. Obviously the WTO does not want the term foreign in any tax relief policy. Consequently your job is more than an up hill battle to exclude non-exporters in the new tax policy.

Who wins and who loses with CRM HR 1769. The winners will be all US manufactures that do not export. Tramco and other manufactures that presently export will be the losers. As an example Tramco this year should have an approx $75K tax savings. Under the CRM HR 1769 the savings would be less than $20,000. However we support the CRM HR1769, it gives much needed tax relief, though very small. Many would suggest the manufacturing sector in the United States is on life support, and that if drastic measures are not taken in the form of tax relief, tort and regulatory reform it will gradually wither and die on the vine.

In my opinion, the entrepreneurial spirit is what made these United States great. However, it is a perception of many that all businesses are greedy and untrustworthy. A very small example of that was the famous three-martini lunch. I'd suggest the author and supporters of some such comments never traveled for thirty hours, slept in a third rate hotel, or ate food that they did not know the contents or the identity, of and only 20% of the cost of the food may be used as a business expense. Don't dare have a beer to quench the dust from your throat, that's not an expense item at all. Selling internationally is very expensive. An average sales call for Tramco in the US is $200 per call. Internationally it is $1600.

FSC helped offset some of these expenses providing a sale was made. We reluctantly accept that the FSC is gone and that time is of the essence to abandon this policy that the WTO has deemed unfair. We do not want a trade war nor do we want sanctions on any American products.

I whole-heartedly support HR 1769 and hope this is Congress's first step in saving the US manufacturing sector. I would be most thrilled if they would embrace exhibit A in my written testimony regarding tax relief for the manufacturing sector.

We must jointly, both government and private sectors devise methods to allow our manufacturing sector to be competitive in the world market place, where our competitors are not confronted with the same regulatory, tort and labor costs.

Mr. Chairman we appreciate your leadership in finding a solution to this most difficult and complex problem. We ask you to move expeditiously to bring this agreement to Congress.

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Testimony of
Owen E. Herrnstadt, Director
Trade & Globalization Department
International Association of Machinists and Aerospace Workers
before the
Committee on Small Business of the
United States House of Representatives
September 10, 2003

Mr. Chairman, Ms. Velazquez, and members of the Committee, the International Association of Machinists and Aerospace Workers (IAM) represents several hundred thousand active and retired workers in North America in a variety of industries including aerospace, defense, transportation, shipbuilding and repair, woodworking and electronics, just to name a few. IAM members work for multinational corporations and small businesses producing, assembling and maintaining almost every imaginable product in the manufacturing industry. Given our strong presence in this vital industry, we are grateful for the opportunity to testify before the Committee on Small Business as it examines the effect of the World Trade Organization (WTO) challenge to the Foreign Sales Corporation/Extraterritorial Income (FSC/ETI) rules on U.S. small businesses.

U.S. small business is highly dependent on the U.S. manufacturing industry. The WTO's challenge to our tax system must not result in the further demise of the U.S. manufacturing base. Indeed, the main objectives of any substitute tax policy should focus on incentives to keep production at home, facilitating the creation and maintenance of U.S. manufacturing jobs. Proposals that contain loopholes giving corporations incentives to move more work out of this country must be quickly dismissed. Moreover, proposals which contain provisions that are geared towards other tax policies which would distract policy makers from the urgent goal of facilitating the creation and maintenance of U.S. jobs, should also be quickly dismissed.

Currently, U.S. manufacturing is in the midst of a crisis not seen in decades. The most recent data reported by the Bureau of Labor Statistics confirms what we at the IAM have known for over two years: the number of jobs in the U.S. manufacturing industry are disappearing at an alarming rate. According to last Thursday's unemployment figures, the number of unemployed stood at 8.9 million. In August alone, employment fell by 93,000 with manufacturing alone accounting for 44,000 job losses. As the BLS Commissioner said in her statement: "Job losses continue to be pervasive --some 2.7 million manufacturing jobs have been lost, including a decline of 431,000 this year."[1] The massive numbers of unemployed who are officially reported doesn't even begin to reflect the real number of those who are unemployed because they are simply too discouraged to look for work.

Sharp declines in employment are occurring in almost every industry in this country. The massive job losses in the aerospace industry are typical. Since 1989, over

[1] See, "Commissioner's Statement on the Employment Situation", September 5, 2003.

600,000 jobs have been lost in the aerospace industry and over one million jobs have been lost in the aerospace and related industries. Like other major manufacturing industries, the U.S. aerospace industry is critical to the health of U.S. small businesses. As this industry declines, many of the smaller contractors that depend on aerospace are the first to be hurt. The decline of small business in this sector and the U.S. jobs they support is staggering as more and more U.S. work is outsourced to other countries.

Clearly, these dramatic job losses have an enormous effect on our nation's economy. Unlike other recessions, however, there is a sincere concern that job losses suffered during this recession will not come back. A recent article that appeared in the Washington Post notes that "[T]he vast majority of the 2.7 million job losses since the 2001 recession began were the result of permanent changes in the U.S. economy and are not coming back."[2]

Anyone who represents men and women who have built some of the greatest companies in the world only to be rewarded with a layoff knows what dire circumstances we are facing. Just look at the faces of workers who have lost their jobs. Feel their pain and anguish. Watch them as they try to feed their family, cloth their children and pay for skyrocketing health care insurance. Talk to them about their deep concern for their future as they see their retirement funds disappear.

Of course, there are many reasons for these job losses. One of the most significant reasons is the lack of a comprehensive manufacturing policy that puts workers and their communities first. Unfair trade agreements, outsourcing of production and assembly to workers in other countries, unfair competition, and the continued use of offsets -- that is the transfer of jobs and technology abroad -- are all just some of the related reasons why the U.S. is currently suffering such enormous job losses in manufacturing.

Given the severe decline in the number of U.S. manufacturing jobs during the past several months, it is imperative that any replacement for the FSC/ETI facilitate the critical need to create and maintain manufacturing jobs at home

The general approach taken by the Crane-Rangel-Manzullo-Levin bill, makes a great deal of sense. Basically, this bill would provide a tax benefit for production of goods in the United States, adjusted for the percentage of a company's worldwide production that takes place domestically. In effect, this approach could create a tax incentive to keep production in the United States. The legislation would also phase out FSC/ETI benefits over a period of time, permitting workers and companies to adjust to the new system.

A new bill offered by Representative Bill Thomas, Chairman of the House Ways and Means Committee, would repeal the FSC/ETI and replace it with a myriad of corporate tax cuts. This approach should be rejected. Among other things, it is filled with a series of corporate tax cuts that, at a minimum, distract policy makers from the

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[2] Washington Post, September 5, 2003; noting a Federal Reserve Bank of New York study.

clear objective of enacting a tax policy that would facilitate the creation and maintenance of U.S. manufacturing jobs. Even more disturbing, however, the Thomas approach could present more incentives for corporations to shift manufacturing jobs out of the country. Policy makers must not replace FSC/ETI with provisions that create opportunities for corporations to take advantage of the WTO challenge by sacrificing U.S. manufacturing workers.

Companies are moving U.S. manufacturing jobs out of this country with increasing frequency. U.S. workers who built these companies are then left behind to face almost insurmountable obstacles as they try to put their lives back together.

As a replacement is crafted for the FSC/ETI, the IAM urges Congress to enact a tax policy that focuses on keeping production at home and facilitating the creation and maintenance of U.S. manufacturing jobs. We also urge you to develop legislation that closes loopholes and removes tax incentives for corporations to move jobs abroad.

Hundreds of thousands of U.S. manufacturing workers are losing their jobs only to see them reappear in other countries. Congress must heed the urgent call to pursue policies that will immediately reverse this shameful trend. A replacement for FSC/ETI in the wake of the WTO challenge that will create a tax incentive that encourages domestic manufacturing and that will facilitate the creation and maintenance of good and decent manufacturing jobs here at home is one solution that should be supported.

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September 10, 2003

Testimony submitted at The House Committee on Small Business

Chairman Donald Manzullo

RE: H. R. 1769

Thank you Chairman Manzullo for inviting me to testify on H. R. 1769 and to address the issue of "The WTO's Challenge to the FSC/ETI Rules and the Effect on America's Small Businesses."

I am Lloyd Falconer, Secretary-Treasurer, of Seward Screw Products, Inc., located in Seward, IL. Seward Screw Products, Inc. is a manufacturing company that supplies Original Equipment Manufacturers and Tier One suppliers with custom machined parts, used in assemblies by our customers. Some of our customer's finished product is exported. Seward Screw Products, Inc. does not export directly.

I have stated in the past, and continue to state that our public policy should be to "Export products, not jobs." This can not be achieved on an uneven playing field. As a manufacturing company we are concerned about the burdens and hurdles that the government places on business to the detriment of American companies' ability to compete in a world-wide market place. Taxes are just one of the major impediments, as it reduces our opportunities to invest in newer state-of-the-art equipment. Anything that can reduce those burdens will help us stay in business.

H. R. 1769 affects a significantly larger group of companies than just the limited number of multi-national companies. Currently, over 75% of the benefits of FSC/ETI flow to domestic manufacturers. Ultimately, tax relief for all U. S. companies should be a priority.

I believe that H. R. 1769, which is revenue-neutral, is a step in the right direction because it attempts to keep our manufacturing base here. It should assist companies in their decision about relocating offshore. Also, foreign companies with manufacturing facilities located in the United States export their products around the world and they would be eligible for the benefits of H. R. 1769.
Thank you for allowing me to testify at this hearing.

Lloyd Falconer