

**THE UNITED STATES AS GLOBAL COMPETITOR:
WHAT ARE THE ELEMENTS OF A NATIONAL
MANUFACTURING STRATEGY?**

HEARING
BEFORE THE
SUBCOMMITTEE ON
ECONOMIC POLICY
OF THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
ONE HUNDRED ELEVENTH CONGRESS
FIRST SESSION
ON
EXAMINING WHAT POLICIES CONGRESS SHOULD CONSIDER TO HELP
REVITALIZE U.S. MANUFACTURING

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JULY 17, 2009
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FRIDAY, JULY 17, 2009

U.S. SENATE,
SUBCOMMITTEE ON ECONOMIC POLICY,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 10:08 a.m., in room SD-538, Dirksen Senate Office Building, Senator Sherrod Brown (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN SHERROD BROWN

Senator BROWN. The Subcommittee on Economic Policy will come to order. Thank you for joining us, all of you, those of you in the crowd, and especially our three witnesses, whom I will introduce in just a moment.

Not too long ago, middle-class families worked hard, played by the rules, and had something to show for it: A good wage, a secure job and home, and the belief that their children would have a future full of opportunity. Our Nation and our economy relied on workers throughout the country to build the cars and the appliances and lay down the rail lines and the highways in our country. We relied on workers to build aircraft and computers and semiconductors and more high-tech manufactured goods. Their work put them squarely—which they earned. Their work put them squarely in the middle class. Too often, that is no longer the case.

Until recently, if you look at actions by Congress, until the economy got so much worse, if you look at what makes the news, you would hardly know that our Nation's largest economic sector has been in serious decline. Perhaps years of relative prosperity and economic bubbles hid the fact that our country's industrial base has been struggling to survive.

Since 1987, manufacturing's share of GDP has declined by some 30 percent. That is almost exactly the percentage increase in the financial services industry over that same period. For far too long, the prevailing belief guiding our economic and trade policy in Washington was that an advanced economy like ours no longer needs a strong manufacturing sector. In fact, we have heard CEOs and policymakers say that the offshoring of manufacturing industries is part of a natural economic process that fosters new technologies and resources.

Perhaps now, finally, Washington has caught on to the fact that manufacturing builds a strong middle class and a strong Nation. The risks associated with allowing U.S. manufacturing to wither on the vine, the risks to our economic securities, the risks to our energy future, the risks, in fact, even to our national defense are too great to sit on our hands and let it happen. For decades, manufacturing has led the economy out of recession because it tends to respond quickly to changing economic conditions.

A few weeks ago, a *New York Times* headline read, "Once a key to recovery, Detroit adds to the pain." The auto industry contributed significantly to past recoveries, including the 1981–82 recovery. But this time, we cannot expect autos to lead the way.

In Ohio, a rich auto supply State, our challenge is to help those and other suppliers to retool for the industries that are attracting significant investment like wind and batteries and medical IT. We will be squandering an opportunity to bolster our economy and secure our energy independence if most of the clean technology, though, is made outside of America.

That brings us to today's hearing. What we are considering today are the elements of a national manufacturing strategy. What policies should Congress consider to help revitalize U.S. manufacturing? Manufacturing towns across the country deserved an answer to this question years ago. Now that it is being asked in corporate board rooms and in the highest levels of Government, maybe the answers will finally come.

Last month, the gathering of top CEOs in Detroit said that America cannot count on consumer spending and Wall Street to maintain our high standard of living. General Electric CEO Jeffrey Immelt said his company has outsourced too much and that the U.S. needs to double the percentage of American workers engaged in manufacturing from 10 to 20 percent. Yet while promoting manufacturing may make sense from a public relations perspective during this economic crisis, it is what major American companies must do—it is what they do, not what they say, that counts.

Today we are fortunate to have witnesses with us who can talk about how we got to this point and how we can restore our global competitiveness. To restore competitiveness to keep our middle class thriving, we need a new national manufacturing strategy that fosters an environment in which our manufacturing sector can grow, can diversify, and can compete on a level playing field in the global marketplace.

To help give shape to a national manufacturing strategy, I would like to propose five areas of focus for today's discussion and beyond. This is not an exhaustive list, to be sure. Just a starting point.

One, innovation. We must create a predictable climate for investment in research and development and establish an Innovation Research Fund for work in clean energy, information technology, defense, and aerospace. There is a building on Oberlin College's campus—about 10 miles from where I live—that was built perhaps 5 years ago. It was at that point the largest totally solar-powered building on any college campus in America, yet all the solar panels were built in Germany and Japan because we did not make enough of them in our country and because investors were looking for a more predictable tax system than they had in the United States to

invest money in a largely capital-intensive business. That needs to change.

Number two, supply chains. Give supply manufacturers the tools to transition from contracting industries such as autos to growing industries like clean energy. Invest in the Manufacturing Extension Partnership as outlined in the Investments for Manufacturing Progress and Clean Technology Act. The National Innovation Marketplace, as announced by Vice President Biden, is also a positive step in that direction.

Number three, job skills. We need sector-based systems that link highly skills workers with emerging industries to promote long-term competitiveness. That means job training in areas of work and job skills developed by local businesses and unions and community colleges and workforce investment boards—people by region who know best about their region.

Number four, coordination. When there is a natural disaster, the Federal Government has a strategy and has resources to rapidly assist communities in need. When there is a massive disruption in the economy due to layoffs, there is no similar national strategy to assist businesses and workers and communities. I propose an Office of Community Economic Adjustment modeled after the Defense Department's Office of Economic Adjustment in response to base closings, which coordinates support for communities faced with a base closure.

And, last, fair trade. Without strong enforcement of our trade laws, our trade deficit continues to grow. We need to defend against unfair trade, initiate more cases at the WTO, and through existing trade agreement tools, we need to ensure that our trade negotiators and trade negotiations yield meaningful access for our producers. We must not allow our Nation to become dependent on other countries for manufactured goods. Our role in the global economy and the security of our country depend on our ability to produce our own energy, equip our own military, and sustain our own infrastructure. The stakes are that high.

I will introduce the members of the panel now, and we will start with Mark Zandi, and then we will work our way across.

Mark Zandi is the Chief Economist and Cofounder of Moody's Economy.com. It is a division of Moody's Analytics and provides economic research and consulting services to business, governments, and other institutions. Dr. Zandi directs the company's research and consulting activities. He focuses on macrofinancial and regional economics. Dr. Zandi was an economic adviser to the John McCain campaign for President. He has provided advice to the Obama administration and regularly testifies in front of this Committee and other committees in the Congress, or this full Committee and other committees. His most recent testimony has been on the economic impact of the fiscal stimulus and the merits of providing Government aid to the vehicle industry. Dr. Zandi received his Ph.D. at the University of Pennsylvania and received his B.S. from the Wharton School at the same university.

Leo Hindery, Jr., is Managing Director of InterMedia Partners and chairman of the Smart Globalization Initiative at the New America Foundation. Mr. Hindery has been recognized as International Cable Executive of the Year, Cable Television Operator of

the Year, one of Business Week's Top 25 Executives of the Year, and one of the cable industry's 25 Most Influential Executives over the past 25 years. He is the Managing Partner of InterMedia Partners, a media industry private equity fund manager which he first founded some 20 years ago. Through most of the 1990s, he was President and CEO of AT&T Broadband. From 2001 to 2004, Mr. Hindery was Chairman and Chief Executive Officer of the YES Network, the Nation's largest regional sports network, which he founded in the summer of 2001 as the television home of the New York Yankees. Mr. Hindery is Chairman of the Smart Globalization Initiative at the New America Foundation.

Mr. HINDERY. For which he still apologizes for.

Senator BROWN. For which he should still apologize, correct.

Mr. Scott Paul is Executive Director of the Alliance for American Manufacturing. Welcome, Scott. He is the founding executive director of the alliance, which was launched in April 2007. AAM is a unique partnership between the United States Steelworkers and leading U.S. manufacturers. It has published reports on the effectiveness of domestic trade laws and manufacturing. The alliance has sponsored several successful "Keep It Made in America" tours and events, including an 11-State bus tour focused on the auto sector, town hall meetings on manufacturing issues, and a nationally televised Presidential candidates forum on manufacturing. Prior to forming the alliance, Mr. Paul was the principal lobbyist for the Industrial Union Council, was a trade lobbyist at the AFL-CIO where he led the labor movement's legislative initiatives on trade, manufacturing, and foreign policy issues. He worked on Capitol Hill for 15 years, beginning with an internship for Senator Richard Lugar, Indiana Republican, to 2001, to serving as the chief foreign policy and trade adviser to House Democratic Whip David Bonior from Michigan.

So if you would like to begin, Mr. Zandi. Thank you for joining us, and thank you all for joining us. Dr. Zandi.

**STATEMENT OF MARK ZANDI, CHIEF ECONOMIST AND
COFOUNDER, MOODY'S ECONOMY.COM**

Mr. ZANDI. Thank you, Senator. Thanks for the opportunity to be here today. I am an employee of the Moody's organization, but the views I express today are my own.

I will make eight quick points in my remarks this morning.

First, the recession continues on. It is 18 months in length. But aside from the housing market, manufacturing has suffered more in this recession than any other sector of the economy. The statistics are grim. Industrial production is down 17 percent from the peak in December of 2007. That is the largest decline in industrial production in any recession since World War II. Capacity utilization in manufacturing hit a record low. We got a data point for June, I believe yesterday, and it is at an all-time low.

Manufacturing capacity is actually declining, which is very rare. The only other time that has happened was a brief period in the immediate wake of the tech bust earlier this decade.

And, of course, employment continues to slide. We have lost 5 million jobs since the beginning of this decade, and employment in

manufacturing is now back to where it was just prior to World War II.

Another very amazing statistic to me, industrial production, real value-added manufacturing, has actually declined in this decade. There is only one other decade that comes close, and that is the 1930s' Great Depression, and in that decade we actually eked out a small gain in manufacturing. Just to highlight the severity of the situation.

Point number two, the unprecedented decline in manufacturing in this downturn is the result of a number of things: the collapse of the housing and vehicle markets, a deep recession throughout the global economy—of course, many manufacturers sell their goods overseas—and draconian cuts by U.S. businesses in their investment in technology and other equipment. The longer-running decline in manufacturing is also related to the loss of market share to global competitors in this decade. Of course, that has been almost entirely due to losses vis-a-vis trade with the Chinese.

Point number three, manufacturing has played an outsized role in our business cycle, both in recessions and early recoveries. The average decline in GDP, peak to trough, in recessions since World War II is 2 percent. Manufacturing is responsible for over half that decline.

In the first year of economic recovery, manufacturing was responsible on average for one-fifth of the growth. In the first year of the last economic recovery coming out of 9/11, it contributed more than half of the economic growth. A very significant contributor to our business cycle.

Point number four, manufacturing will not be able to contribute to growth in the early stages of this economic recovery. The problems are very severe in the vehicle and housing markets. The vehicle industry will improve, will see better sales off these incredibly low levels, but not enough to provide any significant lift to manufacturing and to the broader economy.

Housing, similarly, it will improve off its current very low levels. Construction is at a World War II low. But the improvement will be very modest because there is a tremendous amount of excess housing inventory, a lot of vacant housing out there in the country. And as a result of that, we are not going to see a measurable pick-up in activity, and that is going to constrain manufacturers that provide supplies to the housing industry.

So the problems in the vehicle and housing industries will limit the ability of manufacturing to play its traditional role of helping drive the economy out of a recession and into recovery.

Point number five, manufacturing's importance to the broader economy goes well beyond its share to GDP and employment. It is clearly vital to national defense. It is instrumental to the living standards of lower- and middle-income households, and many smaller metropolitan area and rural communities across the country depend on their manufacturing base. Manufacturing is also vital to research and development, innovation, and ultimately the ability of the economy to grow. It is key to underlying productivity growth. If the manufacturing sector is not healthy, then that will impair productivity growth and, therefore, the long-term growth in our living standards.

Point number six, there are number of things policymakers should not do and should do in response to the manufacturing downturn. The most obvious thing policymakers should not do is to erect trade barriers. I think that would be very counterproductive, particularly in the current economic environment. I think policymakers globally have done a very admirable job ensuring that protectionist sentiment does not boil over despite rising unemployment throughout the world economy. But the risks are quite high and will remain very high. Erecting trade barriers would undermine any recovery and be very counterproductive.

Now, having said that, I think it is very important for policymakers to continue to guide the chase to allow their currency to appreciate. They began revaluation 4 years ago. They have allowed the yuan to appreciate about 17 percent. That has been very helpful. That has contributed to a slowing in our trade—the deterioration in our trade deficit with China. But, nonetheless, they have more work to do. The yuan is still undervalued, by my calculation, somewhere between 20 and 25 percent. I think it would be appropriate if the Chinese allowed the yuan to appreciate 3 to 5 percent *per annum* over the next 5 years. That would be significant. It would allow their manufacturers to transition in an orderly way and also give some much needed and well-deserved relief to U.S. manufacturers.

Point number seven, policymakers should implement policies that reduce the costs of doing business for manufacturers. To lower labor cost, I think policymakers could invest in technical and community schools. We underinvest in that form of education, which is very key to many smaller communities and to developing skill sets that are necessary for manufacturers. I think also facilitating the use of work share programs would be very helpful. Unemployment insurance is very, very costly, and, of course, layoffs are even more costly, and work share would be productive. And, of course, health-care reform is vital if it lowers the growth in health-care costs going forward.

To lower the cost of capital, policymakers could establish direct lending from the SBA—I think that would be very helpful; CIT's situation highlights the necessity of that during the current crisis—and establish other lending facilities to finance investment in clean energy and other technologies.

To lower the cost of transportation, telecommunications, and energy, I think it is important for policymakers to support consistent public investment in infrastructure. The Build America bonds that were issued as part of the fiscal stimulus plan I think have been very successful.

Finally, point number eight, I think targeted industrial policies to specific manufacturing industries have not been successful in stemming the long-term decline of these industries. To be sure, we do not have a lot of historical experience with targeted IP, but looking at our record and at the record of other developed economies, I do not view it as very helpful. A much more efficacious policy effort is to facilitate lowering the costs of production and opening up global markets to all businesses, with special attention to and consideration of these costs and markets that are important to manufacturers.

So, in conclusion, the severe slide in the Nation's manufacturing base will constrain the ability of the overall economy to rebound from this Great Recession. And it certainly jeopardizes the financial well-being of many lower- and middle-income households in many communities across the country. Policymakers should carefully consider this when designing and implementing future economic policy.

Thank you.

Senator BROWN. Thank you very much, Dr. Zandi.

Mr. Hindery.

**STATEMENT OF LEO HINDERY, JR., MANAGING PARTNER,
INTERMEDIA PARTNERS**

Mr. HINDERY. Mr. Chairman, thank you for this honor, and in the short time I have, I hope to discuss with you and your colleagues the largely jobless economic recovery that we have underway and what I believe, as I think you do, is the desperate need for a national manufacturing and industrial policy. I have lengthier comments, and I would ask with your indulgence that they be placed into the record.

The concern that I have is that these two issues are greatly tied together. President Obama has recently affirmed his Administration's belief that the economic stimulus plan will actually save or create only 3.5 million jobs over 2 years. Yet this number represents only a quarter of the 13.3 million jobs that have effectively been lost since the recession began in December of 2007 and just 12 percent of the more than 30 million workers already effectively unemployed, when you include those workers who are either part-time of necessity, marginally attached, or in the labor force reserve because they have quit the labor force out of frustration.

The reason this hearing is so very important is because our economy, as you have noted, is mostly hemorrhaging jobs in the very sector—manufacturing—that must grow in order for us to move permanently away from debt-financed consumption as the principal engine of economic growth.

Despite these facts and despite the overhang that they represent, aside from the emergency restructuring of Chrysler and GM, with respect, the Administration has not yet developed a national manufacturing and industrial policy, a genuine policy designed to simultaneously ensure the competitiveness of U.S.-based businesses and to grow high-value jobs in America. Congress and the Administration working together need, in my opinion, to immediately enact such a policy, a formal one that puts American workers first, and, Senator, as comparable to the policies of our major trading partners. And as you have noted, we need to integrate this policy with efforts to be the world's dominant manufacturer of green technologies and components, and I applaud you, Senator, and your former colleagues in the House, Congressmen John Boccieri and Space, for sponsoring the Investments for Manufacturing Progress and Clean Technology, or IMPACT, Act.

I believe—and this is perhaps the most important part of my comments—that two things are holding the U.S. back from having our own manufacturing and industrial policy and that we need to quickly disabuse both of them.

First, again, with respect, some in the Obama Administration wrongheadedly believe that one job is as good as another, whether it is in manufacturing or service. However, even simplest comparison of the two sectors shows that: compensation in manufacturing jobs is 20 percent greater than in nonmanufacturing jobs; service jobs do very little, as that chart behind you will show, to help our balance of trade, and mostly they just move incomes around the country; and manufacturing overall has by far the largest multiplier effect of any job sector in the country, creating \$1.40 of additional economic activity for each \$1.00 of direct spending but, most importantly, creating two-and-a-half jobs in other sectors for each job in it.

Second is the deep concern on my part that these same individuals assume, with no supporting evidence whatsoever, that new jobs associated with exported services will make up for past and future manufacturing job losses. In fact, large-scale, high-quality service jobs are heavily dependent on a strong manufacturing sector, and they do not readily substitute for good manufacturing jobs.

In addition to throwing its full weight behind a new national industrial policy, the Administration must also be willing to pick winners in the economy and then support them, despite a pretty apparent aversion to doing so, because frankly all other developed nations and China do so every day, to great effect. They need to fund, Senator, a 10-year not a 2-year program of significant public investment in order to upgrade and rebuild our Nation's infrastructure. They need to adopt, consistent with the Without rules, Buy America requirements related to all Federal procurement. America, we now sadly know, is the only Nation—the only Nation among the major developed nations and China without a significant “buy domestic” program, and we need to enact major corporate tax reform, including the reduction of corporate income taxes and payroll taxes and the movement to a value-added tax, or a VAT, to replace that lost revenue.

I believe, contrary a bit to Mr. Zandi's comments, than a national industrial policy cannot succeed without complementary trade policies that prevent other economies from gaining unfair competitive advantages.

I believe, Senator, that we need to immediately move away from these decades of misguided trade policies. We need to demand agreements that have meaningful labor and environmental standards, but especially those that forbid illegal subsidies and currency manipulation. And, with respect, I think we need to dispense once and for all with “one size fits all” agreements that ignore significant differences in levels of development, forms of government, and reciprocity.

But, most important, we need a fundamental reexamination of our relationship with China. Challenging China over its unfair trade practices is not just necessary for the future of U.S. manufacturing jobs, it is also critical world economy. The global economy, Senator, simply cannot function if the third largest individual economy runs current account surpluses on the order of 8 to 10 percent of GDP, as China has done year after year.

I look forward to the questions and answers, and, again, it has been an honor to appear before you. Thank you very much.

Senator BROWN. Thank you, Mr. Hindery.
Mr. Paul, thank you for joining us.

**STATEMENT OF SCOTT N. PAUL, EXECUTIVE DIRECTOR,
ALLIANCE FOR AMERICAN MANUFACTURING**

Mr. PAUL. Mr. Chairman, thank you for inviting me to testify today on behalf of the Alliance for American Manufacturing.

As you mentioned, we go on the road a lot, and I can tell you from our experience that manufacturing has seen elements of a recession and a downturn for most of the last 10 years, and it has been precipitous. It has really been turbo-charged over the last 19 months when the rest of the economy has experienced recession. It is clear that bold solutions are required to revitalize manufacturing.

Our latest contribution to the debate is a book called "Manufacturing a Better Future for America." We delivered it to every Senate office, and we commend it to you for reading. We think it takes a good comprehensive and fresh look at many of the issues that we are talking about today.

We all know something is terribly wrong with this economy. But if the solution of Congress is simply to regulate or re-regulate the financial services sector industry, we are missing the bigger picture, and the response will ultimately be unsatisfying.

There are much more deep, structural issues that we have to address. Otherwise, this horrible positive feedback loop that we have between consumer debt, subsidized Chinese imports, lost American jobs, the U.S. current account deficit going up, growing Chinese currency reserves which number over \$2 trillion, inflating more American debt and new bubbles, that cycle will only be reinforced, and we will be back where we started from 5 years from now.

We knew that this type of economic strategy was doomed to fail. The warnings came not only from labor leaders, from domestic manufacturers, and an insightful group of elected officials; they came also from very conservative economic quarters. But they were ignored. Well before this new, great recession began, Warren Buffet said, "Our trade deficit has greatly worsened, to the point that our country's 'net worth,' so to speak, is now being transferred abroad at an alarming rate. A perpetuation of this transfer will lead to major trouble."

Martin Feldstein, Chairman of President Reagan's Council of Economic Advisers, said, "The present level of the current account deficit is enormous, it is unprecedented, and I believe it is unsustainable." And they were right.

The result of growing current account deficits has been more manufacturing job loss and a healthy share of the blame for the economic collapse this Nation experienced last year. Some say the total number of manufacturing jobs has been falling anyway, and that this isn't such a bad thing as we transition to a new economy. Mr. Chairman, I believe that is a dangerous and misguided view.

Manufacturing employment has dropped precipitously since China entered the World Trade Organization in 2001, and our bilateral trade deficit has exploded with that nation. We have concluded that—outside of recessions—the single most detrimental factor to manufacturing employment in the United States has been

the expansion of our one-sided trade relationship with China. China is certainly not our only competitor engaged in unfair, predatory, and protectionist policies, but the scale of their activities swamps that of many of our other trading partners and is in need of immediate attention.

Other explanations for this decline in manufacturing, while conforming to orthodox economic views, are not satisfying. The decline of manufacturing employment and manufacturing's share of GDP are not inevitable, they are not desirable, nor can they be explained solely through theories of churning capitalism, advances in productivity and technology, high compensation costs, or other sorts of inefficiencies. I think we can discredit all of those explanations.

Consider this: More than 40,000 factories have shut down over the last decade. They weren't making buggy whips. In fact, in many cases they were making very high-tech products. They were manned by some of the most efficient workers in the world. Even the supposed growth sectors of our future—advanced technology products and clean energy—we are already running trade deficits that are dramatically increasing.

The failure of our domestic and international trade policies to support manufacturing must be quickly reversed. We urgently need a national manufacturing strategy.

This is hardly a radical concept. Alexander Hamilton constructed America's first industrial policy in 1791. We had one until the end of World War II. Globalization and economic approaches such as a strong dollar policy favoring domestic consumption have helped to steadily erode manufacturing as a percentage of gross domestic product, private sector employment, and other key measures. If today's leaders spent more time studying Hamilton and less time studying Smith and Ricardo, I do not think we would be facing the prospects of a jobless recovery.

The idea of a manufacturing strategy is also not a partisan one. President Reagan—spurred on by a Democratic Congress—adopted a flurry of measures to counter a grossly imbalanced trade relationship with Europe and Japan in the 1980s. The Plaza Accords, which raised the value of currencies relative to the dollar, had a positive effect in lowering our trade deficit. Key Government investments in the semiconductor industry and other technologies spurred their development and commercialization. President Reagan signed into law enhanced Buy America requirements for certain infrastructure projects to boost domestic employment. His Administration implemented the Market Oriented Sector Specific—or MOSS—talks with Japan that focused on market access with measurable results.

Yesterday, U.S. Trade Representative Ron Kirk delivered a message outlining the beginning of a new enforcement approach as part of our overall trade agenda, and I believe there is a strong difference between trade enforcement, strong trade rules, and protectionism. And I view this news as being very welcome.

If we take a dash of Reagan and a dash of this trade enforcement and add some other ingredients, we have the foundations of a manufacturing strategy. We need to raise the value of China's yuan relative to the dollar up to market-based levels, we need to invest in value-added manufacturing such as clean energy, and I can tell you

we strongly support your bill, and we join Leo Hindery in joining in supporting the IMPACT Act; We need to make sure that are our trade partners, especially China, live up to their obligations to gain access to this market.

Finally, we need to keep Buy America requirements in place so that tax dollars are reinvested in our economy and that infrastructure spending benefits accrue not only to the construction industry in the United States but also to our manufacturers.

I am going to summarize a couple of other key planks of manufacturing before I conclude my remarks.

It is not inevitable that we will develop the new industries without public assistance. The semiconductor, the Internet, the railroad network that we see in the United States today, all had a healthy dose of public assistance, and there was a strong public investment that was made in them. If we invest in those types of prosperous industries, the new energies as well as traditional manufacturing, if we also continue a public investment in infrastructure where we have a \$2.2 trillion deficit of infrastructure needs over the next 5 years, and we have a strong Buy America requirement attached to it, that will produce growth.

We also need to view certain issues before the Congress through a manufacturing frame, and I am going to conclude with this. The climate change legislation that the Senate will consider, there will be an issue dealing with global competitiveness. We need to strongly consider the interests of energy-intensive, import-sensitive manufacturers in this through border adjustment and allowances and get the right solution. Otherwise, we will not accomplish either of our objectives, which are lowering global levels of greenhouse gases and boosting the domestic economy.

President Obama, when he was speaking to the G20 Summit in London in April, talked about balance and how the United States could not be the world's consumer; and that if everyone realized there needs to be balance in policies, we would be much better off. A manufacturing strategy is a key part of achieving that balance, and we welcome the opportunity to work with you to help achieve that.

Thank you very much.

Senator BROWN. Thank you, Mr. Paul.

Dr. Zandi, Mr. Hindery referred to the effective unemployment rate is much higher than the official statistics. The Government today said the unemployment rate in my State is now over 11 percent. We are not nearly the highest in the country. We are above the average, but not nearly the highest. He counts the effective rate prior to this recent announcement of unemployment rates at 18.7 percent.

What do you make of the Bureau of Labor Statistics' determination of official unemployment? And what do you make of Mr. Hindery's effective unemployment rate discussion and assertions?

Mr. ZANDI. Well, the official unemployment rate is 9.5 percent, and then the Bureau of Labor Statistics also publishes alternative measures of unemployment and underemployment. If you consider official unemployment at 9.5 percent and then add in workers that are working part-time for economic reasons, workers that are discouraged and, therefore, not looking for work and, therefore, not

counted as unemployed, then you get a measure of underemployment that is very similar to Mr. Hindery's estimate of excess capacity in the labor market, underemployment in the labor market. So I think it is very consistent with that data and with those measures.

Senator BROWN. Should we be talking more in those terms? Should the Government adjust the way that it talks about unemployment? I think following from Mr. Hindery's comments, not just today from op-eds he has written and from his comments in the past that I have watched, it follows that if the unemployment rate released by the Government is under 10 and the effective unemployment rate is twice that, Government would probably step in more and do more, and there would be more of a concerted effort by Government and the private sector to deal with the much more troubling unemployment rate than the already 9-plus percent.

Does that follow in your mind?

Mr. ZANDI. Yes, well, I think it would be useful for us to focus on these broader measures of underemployment, yes, not only unemployment and underemployment, but lost hours. That is the other way people are losing compensation. Hours worked per week are at record lows.

Senator BROWN. And there is little discussion of that in the official statistics, right?

Mr. ZANDI. They are part of the official statistics, but that is not what many of us focus on when we talk about what is going on in the labor market.

But I think one of the reasons why we are focused on the official unemployment rate, which is bad and terrible just as it is, is that we have a long time series and we can compare it historically all the way back to World War II, the Great Depression; whereas, these alternative measures of underemployment we only have back to the early 1990s. And, therefore, we do not have as much historical context, so we do not know how—it is harder to conclude definitively it is as bad as we think it is.

But I think no matter how you cut the data, no matter how you look at it, it is about as bad as it has ever been—as bad as it has been since the Great Depression.

Senator BROWN. Talk to me, although you can make the argument that if we do not—now that we are starting to collect those—not starting, but that we have had some years of collecting the underemployed numbers, that there is no better time than the present to begin to start talking about those. So the historic record, the historic context is built, so we can make those determinations.

Dr. Zandi, you had said that manufacturing, as I suggested in my opening statement, it is sort oversized or over—you did not use the term "oversized."

Mr. ZANDI. Outsized.

Senator BROWN. Outsized, I am sorry. Outsized, going in and out of recession, and that this year, coming out of this recession, manufacturing, because of housing and autos especially, will not play as big a role.

How can we drive the economy—when we drive the economy into recovery, how can we use manufacturing better? How we can help assist that shortfall that you project?

Mr. ZANDI. Well, I think the principal reason for this shortfall is what is happening in the vehicle and housing industries, and those are very significant, long-running, almost near intractable problems. So we are not going to be able to lift those two sectors out of the current downturn easily or quickly. So it would be difficult to get those sectors contributing in the way that they have historically.

Now, it is possible that we may be able to provide a little bit more lift in other parts of manufacturing that have less serious, more fundamental problems. Technology would be a good example of that. I think the prospects for tech, broadly defined, are quite good—tech manufacturing. So that would be computer technology, semiconductors, satellites, sophisticated instrumentation, sophisticated materials. These are things that I think will be in significant demand, and not only here in the United States but globally.

So, you know, I think if we could focus policy on trying to help those industries move out of the recession, that might provide a little bit more lift and allow manufacturing to contribute more to the overall economic recovery.

But it is going to be very difficult to do anything quickly to make a big difference in the next year or two because of the problems in the vehicle and in the housing industries.

Senator BROWN. Are there ways that we can help stimulate demand, especially in the housing and auto side? The Congress, as you know, passed the Cash for Clunkers, which I was actually speaking today with the CEO of General Motors before I came over here about this hearing, but about a couple other things. And one of the things we need to do is move quickly, you know, once we put something out there that this is going to be available to consumers, make sure that it is in place so people are not waiting to buy cars in this case. Those are my words, not his.

Is there anything—or give me an assessment or any ideas about what we do to stimulate that part of the economy especially so that people—because, obviously, if there is more demand for auto production and appliances and all that comes from housing that this economy—that manufacturing can play a bigger role in driving us into the recovery, if you will.

Mr. ZANDI. Yes, very good points. In the case of housing, one policy effort that is in place now as part of the stimulus is the housing tax credit up to \$8,000 for the purchase of a home if you close on that home by December 1st. It might be worth it, after we see how this works over the next couple months, to expand and to extend that credit. Right now the credit is for first-time homebuyers only. It could be, if it is effective, expanded to all homebuyers, and that may be helpful in working off some of that excess inventory that I alluded to or mentioned earlier that is limiting the ability of housing construction to increase and, therefore, increase the demand for manufactured product.

Senator BROWN. Is there a danger if all of a sudden, if we start—if we start talking about extending that tax credit to people other than just first-time homebuyers, that that in some sense stops home purchases or slows home purchases until we actually enact it?

Mr. ZANDI. Yes, that would be a possibility.

Senator BROWN. The danger of talking about this in some sense without actually doing it quickly.

Mr. ZANDI. Yes, that would be a clear risk, yes. So it may be that—and I think it would be also useful to see how this works. I would not short-circuit this process now, because the benefit of that tax credit should be hitting in the next couple, 3 months.

Senator BROWN. So there is not evidence yet that it is working or not working?

Mr. ZANDI. No. We do have some experience with incentives that have been provided in various States. California, for example, had a tax credit for purchases of new homes, and that seemed to have worked quite well in jump-starting new home sales in the State of California. So I would counsel to wait until we get toward the end of the year to see how this tax credit worked, and then at that point, if things do not seem to be engaging and improving, then think about expanding that credit and extending it.

Similarly with the Cash for Clunkers. I believe the way the program works, you can take advantage of that beginning at the end of this month through November 1st. I believe that is the case. So there is a lot of debate how effective that program is going to be. I think it would be worthwhile to see, in fact, if we do see a pick-up in sales as a result of the Cash for Clunkers over the next couple, 3 months. And if it does work, if it seems to be jump-starting vehicle sales and providing all the other benefits that the program is intended to provide, then it might make sense to expand and/or extend that as well into 2010 to try to generate more sales, which would help with respect to production and manufacturing activity.

Senator BROWN. You had said—and then I want your answer and then go to the other two panelists on this question also. You had said some things we should not do from Congress and the Administration and, that is, erect trade barriers.

Then you went on to say that we need to correct the undervalued Chinese currency. How do we ratchet up efforts—I mean, you had said, I believe, 5 percent a year would be, if not ideal, maybe attainable. I am not sure what you meant exactly by that. But how do we ratchet up efforts if it is, in fact, desirable, as Mr. Paul suggested—and I know Mr. Hindery has said it in the past—to get China to correct its undervalued currency? Do we need a more aggressive SED? So we need legislation in Congress? Should we move faster than the hoped-for 5 percent? Should we be satisfied with 5 percent currency?

Clyde Prestowitz, before some of this currency has slowly moved up in valuation, said it was as much as, I believe, 70 percent undervalued. That number was challenged by some economists, but others didn't.

What is your thought on that?

Mr. ZANDI. I think the Chinese have made good progress in the 4 years since they began the revaluation of the currency. As I mentioned, the currency is revalued by 17 percent. They have slowed that process over the past year given the global financial and economic situation, and I think that is understandable given the uncertainty and the volatility in global financial markets and—

Senator BROWN. Understandable from their viewpoint, the Chinese.

Mr. ZANDI. Yes, I think so.

I think as the crisis fades—and it is already seeming to face—the Chinese economy is gaining traction, in part because of their very large stimulus and monetary policy efforts. If we get into next year and they begin revaluing, allowing the currency to appreciate in an orderly way—I mentioned 3 to 5 percent *per annum*—then I think that would be the most desirable response from their perspective. And, you know, I think it would provide relief to our manufacturers as well. It would be a reasonable way of going about doing it.

If they follow along that path, then I think there is no need to try to put more added pressure on them because it might, in fact, be counterproductive.

Senator BROWN. You would be satisfied, you would consider it a victory for U.S. manufacturing, the U.S. economy, the U.S. Government, all of us, if China did 5 percent a year for the next 3 or 4 years? You would consider that satisfactory?

Mr. ZANDI. Yes, I would.

Senator BROWN. OK.

Mr. ZANDI. And let me say just one other thing. The deterioration in trade with Chinese has, indeed, contributed significantly to the erosion in our Nation's manufacturing base since the beginning of the decade, but it has not played a significant role in the erosion of manufacturing in this economic downturn over the last 18 months. It has not been the key factor.

Senator BROWN. Nor has the current account deficit?

Mr. ZANDI. No. In fact, the current account deficit has narrowed quite substantially.

Senator BROWN. I understand it has narrowed, but that—I am sorry. I did not make my question clear. You do not believe—from your statement, you are suggesting the current account deficit as existing and as has grown, particularly up until a year ago, that that has played little role or no role in the economic situation now, the economic downturn?

Mr. ZANDI. What matters in terms of manufacturing is the change in the current account deficit. When you see the current account deficit growing, that is a real problem for manufacturing. It is a very significant constraint on the broader economy.

The narrowing in the current account trade deficit over the past year, year and a half, suggested that the pressure from trade and manufacturers is alleviated.

Senator BROWN. Well, I guess I will ask it another way. Let us go back to October. The fact that we have had a \$2-billion-a-day overall trade deficit which China—it is about a third that, I believe. Are you saying that has little to do with our severe economic problems today?

Mr. ZANDI. The way I would put it is that I think the current account deficit and the growing of the current account deficit in the first half of the decade—it peaked in 2006, 2007—was a major contributing factor to our economic problems today, yes, on many different levels, most directly through its impact on the manufacturing base because of the erosion in the trade deficit, indirectly because of the fact that those dollars we sent overseas in the form of trade came back in the form of investment in securities that

drove the housing boom and bubble, so forth and so on. So I agree entirely with that view.

I think, though, that in the current downturn of the last 18 months, the trade and current account deficits have actually narrowed and actually have helped to cushion the blow on our economy and on the manufacturing base. And so the problem in the last 18 months in this recession has not been trade in China.

Senator BROWN. And I think that has little to do with any trade policy as much as it does less demand from American consumers, correct?

Mr. ZANDI. And also, I think, the revaluation of the currency by the Chinese, that that has played some role. And if they allow it to appreciate another 15, 20 percent over the next 3 to 5 years, we will see the benefit of that in the form of further improvement in our trade situation with the Chinese.

Senator BROWN. You seem, Dr. Zandi, a good bit more polite toward the Chinese than they are toward us, but that is certainly your right.

Mr. Hindery and Mr. Paul, I would like your comments on Dr. Zandi's comments, especially on China and on the issue of—and be a bit prescriptive, if you would, both of you, on the currency issue, what you suggest, and take his comments and the questions where you want, and then I will come back with another series of questions.

Mr. HINDERY. Senator, thank you. Let me, if I might, I am just going to go back in reverse order from your questions to Mr. Zandi and his answers.

Just very clinically, the Chinese currency manipulation has on the surface been abated. I can suggest to you that it has been offset, more than offset by increases and by China policies and by the furtherance of illegal subsidies. And the Chinese are not without insight to our political environment, and as we have called them to question on their currency, they have begun to take baby steps to the wall and made up for every baby step with more Buy China, as Mr. Paul can testify, particularly in the area that is covered by your IMPACT Act. We are seeing very conscious efforts to Buy China. That is one of the reasons, I think, Mr. Paul and I argue for Buy America. But we have also seen a furtherance of the illegal subsidy behavior.

What we need is a USTR that looks at trade barriers across the board, not just in the traditional Reagan era tariff environment, or the Nixon era, and include subsidies and currency manipulation as a pronounced trade barrier.

On the state of the economy, which was the middle question, 30 years ago we partitioned this country and put about half of its wealth in the hands of a very few million taxpayers and particularly weighted toward roughly 300,000 taxpayers. We took the other half of the wealth, and we left it with the other 140 million taxpayers. We fueled that with auto and housing through credit bubbles. And the old saw is: Every time the economy sputtered, we juiced up auto and we juiced up housing.

The reason I spend so much time on effective unemployment is with 30 million Americans effectively unemployed today, immediate resuscitation of housing, Senator, and of autos is a pipe dream. It

is not going to work. Nor is it going to work that we are going to comfortably pay for health-care reform or comfortably pay for climate change. When 30 million, 20 percent, of your workforce is unemployed, as Mr. Zandi comments, when the full-time workforce is working 33.1 hours a month, we have lost all overtime—

Senator BROWN. A week.

Mr. HINDERY. A week. I am sorry. We have lost all overtime. We dropped to 40. We plummeted through 40 and we have stopped at 33.1 hours.

Senator BROWN. What was that number in good economic times in the late—

Mr. HINDERY. It was 46 because of overtime components that actually drove the—

Senator BROWN. The average full-time worker in the U.S. in the late 1990s was working 46 hours a week?

Mr. HINDERY. It was, because—

Senator BROWN. Do you agree with that number, Dr. Zandi?

Mr. ZANDI. You are adding in the overtime hours.

Senator BROWN. Of course, yes.

Mr. ZANDI. Yes, but even that—well, it is a matter of—that sounds high.

Senator BROWN. It was certainly over 40.

Mr. HINDERY. It was over 40, Senator.

Senator BROWN. OK.

Mr. HINDERY. The reason that, again, I raise that is I do think there are immediate responses that we can take. One of them is the IMPACT Act that you have pushed through both this body and the House. Infrastructure, as both Mr. Paul and I have testified, a 10-year fulsome program as opposed to a 2-year meager program, and one that is of particular moment, has a great deal of advantage to this country would be building retrofits. It is domestic content, it is immediate, and it would go a long way to solving both the energy issue but also the employment issue.

Let me finish by the imperative—and I would make one change from what Mr. Paul said. I would not call it a “strategy.” I would call it a “policy.” The absence of a policy of manufacturing and industrial policy allowed us yesterday to let CIT fail as a financial institution it would appear today. This is an institution that funds roughly 60 percent of the small and medium-sized businesses in this country. But it did not garner the attention that Goldman Sachs and the Bank of America and Citibank did because it does—we do not have a national industrial and manufacturing policy.

The reality, Senator, that 90,000 out of the remaining 282,000 manufacturers in this country are by every measure gravely at risk of failure over the next 24 months is ignored because we do not have a national policy.

And so absent that gaping issue, with all respect, none of these questions, none of these concerns rise to the moment of this hearing, which, again, is why I think this is one of the seminal hearings that could happen up here on the Hill. Without a national industrial and manufacturing policy, we cannot fix this economy. We cannot fix that chart.

Thank you.

Senator BROWN. Mr. Paul, your thoughts.

Mr. PAUL. I will speak to the currency issue first. I think that it takes a multipronged approach to be effective with China, and I agree with Mr. Hindery's assessment that what China has given in terms of slight revaluations in the currency, it has taken away in other export rebates and subsidies and other sorts of incentives that are provided to domestic producers to make up the difference. And so I think the comparative level of subsidy that Chinese producers are receiving has remained essentially the same.

Most economists whom we work with on this issue I think estimate there is still about a 30-percent difference in the currency rate from what it should be based on market levels.

I think that a congressional response is helpful. I think that currency manipulation should be considered to be countervailable. I do think that an aggressive trade case should be brought, and it should be initiated either by Congress, or it could come from the Administration as well.

I also think that a global multilateral effort is required along these lines similar to the Plaza Accords in the 1980s. And I do think that we need the involvement of the European Union and some other major industrialized nations to pressure China, because, otherwise, China has done a particularly adept job of playing trade partners off of each other.

I think that we need to assemble a coalition to do this, but I think that it takes a number of these efforts together to effect the change that we need.

The last component of a successful strategy would be—as Ambassador Kirk outlined yesterday, and that I think that we need to expand on—is aggressive trade enforcement. Again, this is not protectionism. This is countering protectionism and mercantilism, and the failure to honor a contract which China agreed to when it gained greater access to our market in 2001.

This relief has been long overdue for U.S. manufacturers, and I think that the urgency of this is a—it makes it imperative to take action in the Congress within the Administration in a multilateral effort as well.

I wanted to say one word about the auto issue, which I think is very important. The number of paychecks connected to the auto industry, even though there are only about 200,000 assembly jobs, is staggering. Probably 7 million direct, indirect, and induced jobs are dependent on a healthy auto economy in the United States. And I do worry about the approach that has been taken because I think it may be shrinking the auto production base in the United States to a point where large sectors of the related and allied manufacturing economy are going to suffer. Twenty percent of the steel market is in autos right now, and as you know, everything from rubber to paper to semiconductors, healthy demand for that depends on a thriving auto industry.

It certainly needs to retool, but it needs to be part of a strategy moving forward to build the next generation of clean energy vehicles. And I will say this will not happen through market forces alone.

In every country where an industry like this has been incubated, it has been done with public assistance and with public investment and with a strategy in mind. And it is going to take an American

strategy as well; otherwise, we are going to lose out on the opportunity.

Senator BROWN. Thanks, Mr. Paul. Each of you has mentioned trade protectionism, Buy America in your answers in some way. I would like each of you for 2 minutes—and I will start with Mr. Paul and work this way—to make your best case for or against a strong Buy America provision in the next stimulus, if there is another stimulus, or just in U.S. law generally. Make your best case either for or against a strong Buy America provision. Let us start with you, Mr. Paul.

Mr. PAUL. It is a great question, Mr. Chairman. There are a couple of very strong reasons to include domestic sourcing requirements.

First, they work. Economists at the University of Massachusetts at Amherst have shown that if you have a strong domestic sourcing requirement, you create 33 percent more manufacturing jobs than you would otherwise.

Infrastructure investment in general is a very good form of stimulus because just by definition most of that money is going to stay in the United States for construction. What may not stay in the United States is materials. To the extent that you can guide it to the U.S., you are going to create more manufacturing jobs that way.

Second, it has been longstanding U.S. policy. We have had domestic sourcing requirements since 1933. They were used to build the Interstate Highway System. President Reagan expanded them in the early 1980s in the midst of a recession. They have been part of virtually every major infrastructure spending bill that the Congress has done, and there is no reason to change that right now, especially since there is strong evidence that they work and they do not raise costs of projects.

Third, everyone else does it. I mean, there is a—the U.S. is a leader in opening global procurement markets, including its own. However, very few countries are actually part of these agreements, and most countries have carved out major exceptions in their domestic procurement markets. China is not even a party to the Government Procurement Agreement.

We were well within our trade legal rights to enact strong Buy America requirements, and it is a—it does not have a dramatic effect on trade flows globally. If you consider the amount of two-way trade that takes place across our borders every year, the domestic procurement market is a small portion of that, but the value-added for manufacturing is something that is worth doing.

Senator BROWN. Thank you.

Two minutes, Mr. Hindery, on that question.

Mr. HINDERY. Senator, I love Mr. Paul's number three, which is everybody else is doing it. I think that is the fundamental issue, and that chart behind you shows the consequence of our not doing it.

Let me just take a slightly different tack. There are two principles overriding, I think, our jobs policies in this country today, and I think both of them need to be disabused. One is that a job is a job, and the second is that we can make up for, as I said in

my testimony, the loss of manufacturing jobs with exported services.

Both of those are just explicitly and implicitly in error. They are held by senior members of this Administration, and they are simply wrong. And we can argue and show why they are wrong.

Where Mr. Paul is taking you is that if you believe they are wrong, then you believe that we cannot as an economy survive with 8.7 percent of our employees working in manufacturing and only 11.7 percent of our GDP being manufacturing. A meaningful way to increase both of those percentages would be with Buy American, which, again, everybody else is doing.

I am very conscious of our obligations, as I know, Senator, you and your colleagues are, under WTO. But Mr. Paul has described, and correctly, that we can have Buy American policies, abide by our trade agreements and principles, and everybody else, Senator, as he said, is doing it.

Senator BROWN. Thank you.

Dr. Zandi, for or against strong Buy America policy?

Mr. ZANDI. I would be opposed to a strong Buy America policy in, let us say, another stimulus package. I think it would be counterproductive. I think one of the reasons why we did not suffer a more severe economic downturn, something more akin to the Great Depression, was because policymakers were able to forestall rising protectionist sentiment in legislation here in the United States in the stimulus package that we are currently working through and overseas; that if protectionist sentiment had boiled over and we saw barriers erected in various forms—quotas, tariffs, Buy America provisions—that would lead to a much more serious collapse in global trade and would, in fact, have resulted in a much more serious economic downturn.

In fact, I think there are many reasons for the 1930s' Great Depression, one of which was the increase in trade barriers across the globe during that period. So I think that would be very counterproductive.

Moreover, I do not know that it is necessary. I think we are doing measurably better in our trade with the rest of the world. I think the U.S. dollar was significantly overvalued back earlier in the decade. China's entry into the global economy in 2002 with the WTO was a very significant dislocation of manufacturers all across the globe, and it was very wrenching. But I think with the now more appropriately valued dollar and the Chinese now recognizing that they now need to play a more responsible role in the global financial system and in the economy, we are seeing improvement in our trade balance, and I think we will continue to do so going forward, that we are much better positioned in that regard.

Then, finally, I think Buy America is incredibly difficult to implement. I am not even sure what it means. You know, I can understand it in the context of infrastructure spending and steel. I think that is easier to see and to understand. But once you move beyond that, it gets very difficult to know what does it really mean. Most of the products and services that we produce are the result of coordination and cooperation among businesses and people that work all across the globe.

Just take my business. I have got people working in—my very narrow business within the Moody's organization, I have got people working in London, in Sydney, in China, and, you know, every day we are coordinating working together.

So what I produce here, is that American or—I mean, what does it mean?

So, you know, I think it just incredibly difficult to implement, so I would—you know, I think what you did in the stimulus package was fine, it was OK. I mean, I understand it, and I think it makes some sense. It was reasonable. But I think if you strengthen that somehow in some way or broaden it, I think that would be counter-productive.

Mr. HINDERY. Senator, I had 21 seconds left in my 2 minutes. Can I just offer one quick comment?

Three weeks ago, the U.S. Chamber of Commerce gave a major speech decrying Buy America provisions of any sort. In that very week, China announced formally, publicly, with no embarrassment, its own Buy China policy related to all of the energy issues covered by the IMPACT Act, 80 percent and 90 percent domestic requirements on wind and solar.

Senator BROWN. So that begs the question. Dr. Zandi, do you think that other countries are doing strong buy domestic, stronger than we are? Or do you not accept that as something they actually are doing?

Mr. ZANDI. You know what, I think probably they do. They probably do, although I think what is really important is are they strengthening their own “buy my country” provisions. And I do not think they are. In fact, I think that goes to one of the most admirable things about the policy response to the current crisis, and that is that we seem to have a G20, G8 meeting every other month, and I think largely because we want to make sure that nobody does that, strengthens those protectionist rules and laws and regs that they have, because if they did, this would become tit for tat, and it would hurt global trade in our global—

Senator BROWN. So how do you account, then, when you make that statement, that China exports—you know, China's is the world's largest solar panel manufacturing country. They export over 95 percent of their output to the U.S. and Europe. Then they implement a 90-percent “China-made equipment” to do that. How do you reconcile that with what you say the discipline of the G20 seems to be exerting?

Mr. ZANDI. Well, I would submit that they have been doing that all along. I mean, this is no worse or better than what they have been doing from time immemorial.

What I am arguing is that it is not becoming worse, and that is what really matters. You could get into a situation where we provided a much stronger Buy America provision. It will reverberate across the globe. The Chinese, the Europeans, the South Americans would respond, and I think it would under—potentially could under—

Senator BROWN. If you are already doing it, and we are not to the same degree, that is OK in terms of not erecting barriers to dampen economic output or cause us more economic problems in this recession.

Mr. ZANDI. No, it is not OK, but I do not want to do more damage.

Senator BROWN. The answer is worse, the response is worse.

Mr. ZANDI. Yes. And I think that if they can continue to show progress that they are moving away from these policies, then I think the best policy response is to allow them to do that.

Senator BROWN. When I hear “if they show progress,” that suggests patience, and there is—and it always suggests to me when I think about China and patience, I think of when Chou En-Lai was asked when he was—I think you will know this story. When he was a Chinese leader 25 years ago, he was asked what he thought of the French Revolution, and he said, “It is too early to tell.”

[Laughter.]

Senator BROWN. And I think that they are perhaps a more patient people than we are.

Do these numbers, Dr. Zandi, concern you very much?

Mr. ZANDI. Yes, they do. And I do think they represent why we are in this mess on lots of different levels, that that represents a loss—a lot of those lost manufacturing jobs and production. That represents all those dollars going overseas that came back in the form of investments in our Treasury bonds, our mortgage securities, our CDOs, and contributed to the surge in consumer borrowing and the mortgage crisis and led to the financial crisis.

I think this imbalance is symbolic and highlights the imbalance that led to the situation we are in. I entirely agree with that.

Senator BROWN. Do you think that, understanding these three entities—EU, Japan, and China—were not covered by these trade agreements, if not trade model, that trade agreements with NAFTA, CAFTA, and what we did with PNTR with China was—did that feed into that, the models of trade we do, not NAFTA *per se* in those three, but the NAFTA trade model? And, generally, did those contribute or did not make the situation slightly or markedly better?

Mr. ZANDI. I think the most fundamental thing that happened was China’s entry into the WTO. That was the key that—

Senator BROWN. Did we make a mistake in the way we facilitated—not try a value-laden word there—the way we facilitated their entry, did we make a mistake in setting the rules and building the road in the way that we did for their entry?

Mr. ZANDI. Certainly, in hindsight, yes, we made a mistake. We did not—I do not think anyone recognized in 2002 when they entered into the WTO what would happen over the course of the subsequent almost decade. I do not think we—

Senator BROWN. Well, there were 190 House Members who voted against it. There may not have—maybe not predicting *per se*. OK.

Mr. ZANDI. Right. But, you know, I think that could have been handled differently, yes.

Senator BROWN. OK. On a more softball question for all of you—not that I am that hard, but you have all talked about manufacturing. Elizabeth Warren came to see me the other day—I think you all know her—and she is a brilliant woman who has pretty much—I heard her sort of predict what housing was going to do to us 2 years ago. She predicted 2 years ago what housing would do

to us today and what housing led to and Wall Street greed and all of those things together. But she told me a statistic that even as recently as 2 years ago, almost half the students at Harvard—undergraduate, not MBA students, Harvard Business School, but close to half the students graduating from Harvard undergraduate were going to into finance one way or another. Almost nobody I know thinks that is a good thing for our society, our country, or, frankly, perhaps even for those students.

But how do we make manufacturing more attractive to young people? You have thought about this, I know, as much as anybody, Mr. Paul. I would like the answer from all three of you. And I will preface it again with this.

I was speaking with a gentleman who—it was a confidential conversation, so I will not tell you his name, but somebody that was—yesterday, who was brilliant in starting businesses, manufacturing and otherwise. And he was talking about how when he was a kid he went into an auto manufacturing plant and was taken—he is an engineer now, although he does not practice engineering *per se*, but how he was taken by how the human mind can put together the complexities of auto manufacturing so that the windshield comes in at the right time, with the suction cups putting it on the car, how the paint shop works, all of that. And anybody who has never been in an auto plant, it is an incredible thing to watch.

How do we get people, how do we get a 15-year-old high school kid, a middle-school kid, whatever, how do we get that person wanting to be an engineer, wanting to be a mathematician, wanting to go into the sciences, then wanting ultimately to go into manufacturing, you know, as a community college graduate to operate at a—you know, it is an \$18-an-hour job or as an engineer designing part of it. How do we get people to want to do that?

Mr. PAUL. It is the right question to ask, Senator, and we have thought a lot about it. There are a couple of things that need to be done.

First, it is clearly changing the image, the outdated image that many Americans have of manufacturing. If you get a young person into a plant today, there is a “Wow” factor that you cannot replace any other way if they see it firsthand. And if you have been in a steel plant, you know, in the last 5 or 6 years, it is dramatically different than your father’s or your grandfather’s steel mill. It is high-tech. It is highly efficient. The same with the auto industry, or nearly any other kind of manufacturing that you will find in America today.

Unfortunately, the images that you see when you go to a Hollywood movie, if a worker is portrayed, he is portrayed as somewhat of an uneducated, overweight guy who lacks ambition. If you see a factory in a Hollywood image today, it is most likely abandoned, and there is a sequence in an action movie that is moving through an abandoned factory.

And so the image is something that we need to alter, and that is partly on the industry and the workers and we need to do that.

We also need to have the right sort of educational skills and training policies to move people into these high-value sort of industries. Too often our training policies move people into the first job and not the right job. Too often our schools look to achieve their

standardized test objectives and do not prepare young people for careers, especially those who are not necessarily going to go on to a 4-year college degree. And so I think that is an important component of it as well.

I think also there needs to be—and this is the issue that we are talking about today. There needs to be a job market for them. We need to develop the right set of policies, an industrial policy, a manufacturing policy, that says this is going to be a bigger part of our GDP, it needs to be, because part of this happens due to market forces, part of it certainly happens due to the types of Government policies, the types of tax, trade, and other sorts of policies that we have in place that effectively discriminate against one sector of the economy or the other.

And what we need to understand as policymakers as well is that we are not saying that we need to have a manufacturing economy alone. We need to be saying that we need to have a diverse economy, and if there is anything that shows us that, it is the last 18 months that we have experienced. We need a diverse economy. But we need to understand, as Dr. Zandi says, that manufacturing plays an outsized role, and we need to recognize that and promote that.

Senator BROWN. Thank you.

Mr. Hindery.

Mr. HINDERY. Senator, I love this question. I grew up as a sheet metal journeyman and a merchant seaman, and the problem, with all respect to Mr. Paul, is not image. It is certainty. We have a national finance policy, a national finance industry policy. We saw it in the hands of Secretary Paulson, and now we see it in the hands of Secretary Geithner. We have a policy for that industry. We do not have a policy for this industry. And young people are not ill-advised or uninformed. They look at an industry path that says certainty or uncertainty.

And when I left college as a journeyman sheet metal worker, having spent a couple of years in the Merchant Marine, neither of those careers presented uncertainty. I just took my skill set and went toward business. Today, I would not have that same opportunity, that same perspective.

I think, in closing on that, I think we have compounded the issue dramatically through compensation. I have written much about the problem of compensation in this country. When the average CEO for a century made roughly 20 to 25 times what his or her average employee made, career choices were done psychically and skill-wise. They were not done financially. We have now seen that number jump to 400 on the corporate side, and we have seen counterparts on the finance industry side. Those young women and men at Harvard, the decision they made was, on the one hand, compensation; it was obscene, and they could capture it. And the other is they could capture it in an industry that is clearly loved, clearly has the attention of this Administration and this Congress, or they could go, as I had a chance when I left Stanford Business School, to Procter & Gamble or Colgate or GM or Ford, and they said, "Are you crazy?" That is the decision process in all of 40 years.

Senator BROWN. Dr. Zandi, how do we get more young people interested in manufacturing?

Mr. ZANDI. I think if you lowered their cost of education, I think that would help. That would be very helpful. I think part of the problem is that it is increasingly difficult to pay for the education and training you need to be a skilled worker. And if Government can lower that cost, that would be something to attract young people into the industry. And I mentioned technical schools, community college; you know, I think those are very cost-effective ways of providing those skill sets in that form of education.

The other key thing, I think, is to broaden the definition of "manufacturing." I think we are thinking about this pretty narrowly. It is not just the person on the factory floor. It is the engineer, it is the designer, it is the quality control, it is the credit risk management. It is the people who hedge the currency risk and the trading that the manufacturer has to do to bring in supplies and export.

So, you know, it is not—in fact, the folks that work on the factory floor are increasingly going to be a small proportion of the people who work in actual manufacturing. So I think if we lower the cost of education and training and provide the education for these kinds of other jobs that are involved in the manufacturing process, I think manufacturing will be just fine.

Let me just broadly say one other thing. You know, to me it is a little confusing as to where manufacturing ends and services begin. Take the iPod. What really makes the iPod the iPod? Is it the physical thing that we have produced here, or is it the music that goes into the iPod? The Web site that we created to pull down the music into the iPod? The people who financed the production of the factory that produces—I mean, to the commercials that go on TV, and you listen to the music and go, "I want that thing."

So, you know, the thing that really makes it a product that is valuable is all of those things, and you cannot separate them. So I think part of the problem is we have gotten into this box where we think manufacturing is one thing and services are the other. They are increasingly the same thing. I do not know how you separate them.

Senator BROWN. That is a very good point, and thank you for that. I was actually thinking about that as you were talking, because we in some sense do separate them. We too often do the design—you know, if you take an iPod, its packaging says "Designed in California," but it is actually manufactured in China. And I do not want to get into that as the hearing will conclude, but where we as a Nation go and we so often provide the intellectual fire power and the skills and the creativity to design these products, so many of them, and then we do not commercialize them well. We certainly do not often manufacture them here. And that is perhaps a whole other hearing and whole other set of questions. But I think the integration of that would certainly serve us well all across the board there.

I thank you all for being here. Thank you for your candor and your good answers, and thank you for your service to this country in what you are doing to contribute to all that we are doing. Thank you all.

The Subcommittee is adjourned.

[Whereupon, at 11:30 a.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF MARK ZANDI
CHIEF ECONOMIST AND COFOUNDER, MOODY'S ECONOMY.COM

JULY 17, 2009

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify on such an important matter in a time of economic and financial crisis. I am an employee of the Moody's Corporation, but my remarks today reflect my personal views.

I will make eight quick points in my remarks this morning:

1. The economic crisis continues, and aside from housing, manufacturing has suffered more during this period than any other sector of the economy. The statistics are grim. Industrial production has fallen over 17 percent since peaking a year-and-a-half ago, capacity utilization is at a record low, manufacturing capacity is falling, and close to 80 percent of manufacturing industries are suffering consistent declines in manufacturing production and employment. Manufacturing's problems began long before the current recession. Industrial production has actually declined during this decade. This is the worst performance on record. Even during the decade of the 1930s' Great Depression, production eked out a small gain. Manufacturing employment has been declining even more sharply, losing more than 5 million jobs this decade. The less than 12 million currently employed in manufacturing—accounting for less than 10 percent of total payroll employment—is the lowest level since just prior to World War II.
2. The unprecedented decline in manufacturing during this downturn is the result of the collapse of the vehicle and housing industries, a deep recession throughout the global economy, and draconian cuts by U.S. businesses in their investment in technology and other equipment. The longer-running decline in U.S. manufacturing is largely due to the loss of market share to global competitors; since the turn of this decade, most of the decline in market share has been to Chinese manufacturers.
3. Manufacturing has played an outsized role in economy-wide recessions and supporting growth early during economic recoveries. Real GDP has fallen by an average of 2 percent peak to trough during recessions since World War II, with manufacturing contributing well over one-half of the decline. In the first year of recovery, manufacturing has been responsible for over one-fifth of the growth in GDP. In the first year after the recession in 2001, manufacturing accounted for almost one-half of total GDP growth. Manufacturing's large role in the ups and downs in the business cycle results from the impact of large inventory swings and the high interest-rate sensitivity of many manufacturing industries.
4. Manufacturing will not be able to contribute as much to the economy's growth in the recovery from the current downturn. The problems in the vehicle and housing industries will not abate quickly. Vehicle sales and production and housing construction will rise from their currently extraordinarily depressed levels in the next 12 to 24 months, but only very modestly. Weighing on vehicle sales and production will be the lingering effects of the GM and Chrysler bankruptcies and the spent-up demand created by sales levels above those that could be supported by underlying demographic, wealth and income trends during the strong sales years earlier in the decade. Housing construction and thus the demand for manufactured construction supplies will also be constrained by the large amount of excess housing inventory built up during the housing boom and bubble.
5. Manufacturing's importance to the broader economy goes beyond its share of GDP and employment. It is vital to national defense, lower- and middle-income households that rely on manufacturing's relatively high-paying jobs, and many smaller metro area and rural communities across the Nation in which the factory is one of the largest employers. Manufacturing is also important to research and development, innovation, and ultimately the economy's productivity growth and the growth in the Nation's living standards. It is also important to note that manufacturing will need to play a more important role in the Nation's longer-term economic growth, as the most significant growth opportunity for U.S. businesses lies in selling to customers overseas. U.S. manufactured goods must be a large part of what we sell to them.
6. There are a number of things policymakers should and should not do to address the manufacturing downturn. The most obvious thing policymakers should not do is to erect trade barriers to limit trade in manufactured goods. This would be very counterproductive, particularly at this time, when the global economy is in recession and protectionist sentiment is building nearly everywhere. A trade war could very well ensue, derailing prospects for recovery here and elsewhere. However, policymakers should work to guide the Chinese to continue revaluing the yuan once global

financial and economic conditions stabilize. The yuan has appreciated by 17 percent since the revaluation process began 4 years ago, but the currency remains 20 percent to 25 percent overvalued against the dollar. This gives Chinese manufacturers an unfair competitive advantage in global markets.

7. Policymakers should implement policies that reduce the costs of doing business for manufacturers. To lower the cost of labor, policymakers could invest in technical schools and community colleges, facilitate work share programs to reduce the cost of unemployment insurance and worker layoffs, and more aggressively establish and fund worker retraining efforts. Health-care reform that results in slower growth in health-care costs is also very important. To lower the cost of capital, policymakers could establish a direct lending program at the SBA and perhaps even establish lending facilities to help finance investment in clean energy and other technologies. To lower the cost of transportation, telecommunications, and energy, policymakers could provide consistent support to public investment in transportation networks, the Internet backbone, and the electric grid. As a potential example of this support, Build America bonds issued as part of the current fiscal stimulus have been very successful.

8. Industrial policies directed to specific manufacturing industries have not been successful in stemming the long-running decline of these industries. To be sure, there has not been extensive historical experience with such policies here in the U.S., but what experience we do have and what we have learned from the experience of other developed economies suggest that such targeted industrial policies are not productive. A much more efficacious policy effort is to facilitate lowering the costs of production and opening global markets for all businesses, with special attention to and consideration of those costs and markets generally most important to manufacturers.

In conclusion, the severe slide in the Nation's manufacturing base will constrain the ability of the overall economy to rebound from the current Great Recession. It also jeopardizes the financial prospects of many lower- and middle-income households, the economic well-being of many communities across the country, and even the innovation and technological progress necessary to power the broader economy's long-term growth. Policymakers should carefully consider this when designing and implementing economic policy.

PREPARED STATEMENT OF LEO HINDERY, JR.

MANAGING PARTNER, INTERMEDIA PARTNERS

JULY 17, 2009

Mr. Chairman, other Subcommittee Members, I am Leo Hindery and I am Chairman of the Smart Globalization Initiative at the New America Foundation, where I spend my time on jobs and trade issues. Occupationally, I am an investor in media companies, and I was formerly CEO of AT&T Broadband and its predecessors, Tele-Communications and Liberty Media. It is an honor for me to appear before you.

I want to discuss our largely jobless economic recovery and desperate need for an all-of-government national manufacturing and industrial policy.

President Obama has recently reaffirmed the Administration's belief that the economic stimulus plan passed by Congress in February will "save or create" 3.5 million jobs over 2 years. There's obviously a huge difference between a job that's saved and one that's created—the Labor Department does not even collect data on "jobs saved," nor does anyone else—but much more important, 3.5 million jobs represent only a quarter of the 13.3 million jobs effectively lost since the recession began in December 2007 and just 12 percent of the more than 30 million workers already effectively unemployed.

I would offer that it is important that Congress always consider in its deliberations the millions of unemployed workers not included each month in the BLS's determination of the officially unemployed, specifically those workers who are either part-time of necessity, marginally attached, or in the "labor force reserve" because they have quit the labor force out of frustration. In the past, the number of "un-counted" unemployed almost never exceeded a third or so of those who were officially counted, albeit still a very large number. However, right now, there are actually 800,000 more uncounted unemployed workers than counted ones, making the total number of effectively unemployed workers an unprecedented 30.2 million instead of the official 14.7 million and the effective unemployment rate 18.7 percent instead of 9.5 percent. And yet as numbing as these numbers are, I believe we are going to see additional significant net job losses for at least another 18 months.

We are already deep into a jobless recovery, and in the process we are headed toward an economic base so weakened that it will be incapable of sustaining a vibrant middle class. There is also the reality that this jobless recovery will be particularly susceptible to a new downturn because of the way it is already feeding back on itself, actually worsening in some cases the circumstances that originally triggered it. Finally, a jobless recovery means there will be little or no relief for State and local governments whose budgets have been hard hit by falling tax revenues.

When nearly 19 percent of workers are already effectively unemployed and while even the Nation's current full-time workers are working only 33.1 hours a week—the fewest hours on record since the BLS began counting in 1964—and seeing their wages reduced at an average 6.2 percent annual rate, significant and timely job retention and creation must be an urgent priority, on a par with health-care reform. Right now, neither initiative can take a back seat to the other, as both are integral to true economic recovery.

And the reason this particular hearing is so important is because the massive job-creation deficit we face really tells only the macro side of our sad employment story. We need to be just as worried about the fact that our economy is mostly hemorrhaging jobs in the very sector—manufacturing—that must grow in order for us to move permanently away from debt-financed consumption as the principal engine of economic growth.

Since the recession began, manufacturing has lost 13 percent of its workforce; manufacturing industries now represent just 11.7 percent of GDP, after being 15.5 percent as recently as 1996 and much higher earlier; people working in manufacturing now account for only 8.7 percent of the jobs in the country; a quarter of the Nation's 282,000 remaining manufacturing companies—90,000 in all—are now deemed severely “at risk”; and we have run an average trade deficit in manufactured goods of more than \$500 billion over the past 5 years.

Yet despite 30 years or so of extreme neglect, our now depleted manufacturing sector still accounts for a critical 60 percent of all exports from the U.S. and for 70 percent of the Nation's entire R&D.

However, aside from its emergency restructuring of Chrysler and GM, the Administration has not developed an all-of-government national manufacturing and industrial policy designed to simultaneously ensure the competitiveness of U.S.-based businesses and grow high-value jobs in America.

Congress and the Administration, working together, need to immediately enact such a policy, one that puts American workers first and is comparable to the policies of our major trading partners. We also need to integrate this policy with efforts to be the world's dominant manufacturer of green technologies and components, and I applaud you, Senator Brown, and your former colleagues in the House, Congressmen John Bocchieri and Zack Space, for sponsoring the “Investments for Manufacturing Progress and Clean Technology” or IMPACT Act.

The need for an elaborate American industrial policy was first widely observed as far back as the early 1980s, and by 1993 some in the Clinton administration and especially some enlightened members of Congress tried to enact such a policy. Regrettably they failed, and now 16 years later, we sit here in 2009 still without one.

Even if some in leadership today don't understand and accept this basic imperative, America's main trade competitors certainly do. All of the other members of the G20 have such policies, and they are using them today to great effect to resuscitate their broken economies and further weaken ours. Germany, Japan, and South Korea especially are doing everything possible to preserve their manufacturing bases, while China, which consistently accounts for 60 percent of the U.S. trade deficit in manufactured goods, is aggressively accelerating its efforts to grow its manufacturing sector.

To this latter point, while the U.S. was losing 1.4 million manufacturing jobs from 2002 to 2006, manufacturing employment in China during these 5 years was increasing by 10 percent to 112 million, which is about 100 million more than the total number of manufacturing workers left in America—and this trend is now only worsening.

I believe that two things are holding the U.S. back from having its own manufacturing and industrial policy—and we need to quickly disabuse both of them.

First, some in the Obama administration, as well as others of influence outside the Administration, wrong-headedly believe that one job is as good as another, whether it is in manufacturing or service. This is simply not true, and even the simplest comparison of the two sectors shows that:

- Compensation in manufacturing jobs is 20 percent greater than in nonmanufacturing jobs;

- Service jobs do very little to help America's balance of trade, and mostly just move incomes around the country; and
- Manufacturing overall has by far the largest multiplier effect of any job sector in the country, creating: \$1.40 of additional economic activity for each \$1.00 of direct spending; on average, 2.5 jobs in other sectors for each job in it; and, at the upper bounds, 16 jobs for each high-tech manufacturing job.

Second, these individuals assume, with no supporting evidence whatsoever, that new jobs associated with exported services will make up for past and future manufacturing job losses. One Administration official even said recently that America's export future resides, and I quote, in exporting "consulting and legal services, software, movies, and medicine." It is naive to speak so optimistically of these nonmaterial activities, and it is simply wrong to view exported services as ready substitutes for good manufacturing jobs, since large-scale high-quality service jobs are heavily dependent on and correlated to a strong manufacturing sector. The reality is that in the future, high-quality service jobs are at least as much at risk of being offshored as are manufacturing jobs, with India and China especially keen on seeing such jobs domiciled on their own shores.

To offer just one big example of what the failure to have our own manufacturing and industrial policy has wrought, the State of California, which is now confronting the largest annual budget deficit in the history of the Union, would in fact have a dramatically smaller deficit, or maybe even none at all, if in the State manufacturing workers today represented simply the same share of total workers as they did in the year 2000, which was 12.8 percent. Instead, however, California lost, over this period, more than 400,000 manufacturing jobs which, after considering multiplier effects, would have benefited the State on the order of \$300 billion of cumulative income taxable wages.

In addition to throwing its full weight behind an all-of-government manufacturing and industrial policy, the Administration must also be willing to:

- "Pick winners" in the economy and then support them, despite its apparent aversion to doing so, because frankly all other developed nations and China do so every day, to great effect. The Administration moved modestly in this direction with its proposals to encourage private investment in wind and solar energy and by making targeted Federal investments in building retrofits, smart grids and meters, and clean transportation systems. However, it needs to do much, much more if we are to create new comparative advantages in these and other industries, and particular attention needs to be paid to associated training, access to low-cost energy, and financing provisions for small and medium size manufacturers.
- Fund a 10-year (not the current 2-year) program of significant public investment to upgrade and rebuild our Nation's infrastructure, which would provide the much-needed foundation for higher-value added production and advanced business services.
- Adopt, consistent with WTO rules, "Buy American" requirements related to all Federal procurement, especially procurement associated with new investments in infrastructure and green energy initiatives. Federal purchases make up about 20 percent of the economy, yet America appears to be the only nation among the major developed nations and China without a significant "buy domestic" procurement program.
- Enact major corporate tax reform to make incentives for corporations to create jobs here and eliminate the incentives for them to relocate manufacturing jobs, as well as service jobs, abroad. This should include reducing the corporate income tax and payroll tax and moving to a value-added-tax or VAT to replace that lost revenue.

A national industrial policy cannot succeed, however, without complementary trade policies that prevent other economies from gaining unfair competitive advantages. The trade deficits accumulated just during the Bush administration—a whopping \$4.7 trillion—were a major cause of the loss overseas of 5.3 million manufacturing jobs and more than 2 million service jobs, and they made the U.S. economy about \$1.5 trillion smaller today than it would have been otherwise.

We couldn't afford these economy-zapping job losses then, and we certainly can't afford them now. Notably, even today's recession-shrunken trade deficit of 2.5 percent of GDP will subtract more from the demand for U.S. goods and services than the economic stimulus plan will add, and in normal times our trade deficits consistently aggregate an even more economy-draining 5 percent or so of GDP.

The Administration and Congress should, I believe, immediately move away from our decades of misguided trade policies and demand trade agreements that have meaningful labor and environmental standards and forbid illegal subsidies and currency manipulation. We also need to dispense with “one size fits all” trade agreements that ignore significant differences in levels of development, forms of government, and reciprocity.

At the same time, we need meaningful trade policy coordination among especially the G8, and we need it to counter the confusing statement out of the Administration recently that “floating exchange rates mean that economic policies don’t have to be harmonized among nations.” Of course, they do!

And on an overall basis, right now the major “surplus nations”—specifically, China with its enormous \$2 trillion of foreign currency reserves, Germany and the oil-exporting nations—also need to immediately deploy a significant portion of their accumulated foreign reserves where doing so will most stimulate the world economy, whether it be within their own economies, overseas, or, in order to assist the poorer countries, in a combination of long-term development loans and Official Development Assistance or ODA.

Most important when it comes to trade and globalization, however, we need a fundamental reexamination of our relationship with China.

China’s massive trade surplus with the United States—a staggering \$277 billion of manufactured goods just in 2008—is the result of its severely undervalued currency, massive subsidies to its own manufacturers, and elaborate policies to induce foreign corporations to shift their production facilities and technology to it. These policies have already cost us millions of jobs, and they will keep costing us jobs until they are fixed.

Challenging China over its unfair trade practices is not just necessary for the future of U.S. manufacturing jobs, however—it is also critical for the world economy. The global economy simply can’t function if the third-largest individual economy runs current account surpluses on the order of 8 to 10 percent of GDP, as China has done consistently for the past few years.

In closing, these are truly unprecedented times, and thus looking at past business cycles and responses is likely to be of only very limited relevance and utility. To address the current desperate situation, we need, as soon as possible, an Emergency National Summit on Manufacturing, to be attended by relevant Cabinet officers, the bipartisan leadership of both Houses of Congress, and a small number of the top corporate and labor leaders on this issue. And we especially need an activist executive branch and Congress willing to turn around the excessive *laissez faire* and de-regulatory approaches of the last eight and, in some cases, the last 30 years, and to enact a national manufacturing and industrial policy that matches and competes fairly with the industrial policies of our major trading partners, especially China.

Thank you, and I am happy to answer any questions you may have.

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PREPARED STATEMENT OF SCOTT N. PAULEXECUTIVE DIRECTOR,
ALLIANCE FOR AMERICAN MANUFACTURING

JULY 17, 2009

Mr. Chairman and Members of the Subcommittee, I want to thank you for taking the time to study manufacturing and global competitiveness, and for inviting me to testify on behalf of the Alliance for American Manufacturing.

First, I would like to introduce the Alliance for American Manufacturing. We are a partnership formed in 2007 by some of America's leading manufacturers and their workers to explore challenging public policy topics such as international trade, health and retirement security, and global competitiveness. AAM works in a cooperative, nonpartisan way, bringing together labor and management, Democrats, Republicans, and Independents, to work for one goal: Strengthening American manufacturing and therefore our Nation's economic and national security. Our mission is to provide policymakers like you with useful analysis of the issues, as well as innovative policy ideas to move us toward effective solutions.

Over the past 2 years, we've visited with tens of thousands of workers and hundreds of manufacturers to see what's happening on the ground firsthand. As you can imagine, the news is grim. That's because, for manufacturing, this recession began about a decade ago. Over the past 19 months, this decline has been turbocharged. It's clear that bold solutions are required to revitalize manufacturing, which is why we have sought to collect the wisdom of innovative thinkers around the Nation.

To that end, we published a book this week titled "Manufacturing a Better Future for America," copies of which have been provided to each Senator. With contributions from 10 leading academics and experts, the book takes a comprehensive look at some of the major issues facing manufacturing today: international trade, an array of subsidies offered by our global economic competitors, the consequences of the offshoring of research and development, the shocking lack of support for investment in advanced manufacturing, the appalling state of skills and training programs, the challenges for domestic manufacturers in globalized supply chains, and the consequences of deindustrialization on society, communities, and our defense industrial base.

Even without reading this book, we all know that something has gone terribly wrong with the U.S. economy. But chalking up the blame to a few bad apples on Wall Street and their risky financial instruments, and responding by simply providing appropriate regulation in the financial services sector, will ultimately be unsatisfying. There are much deeper, structural issues which must be urgently addressed. Otherwise, the positive feedback loop between consumer debt, subsidized Chinese imports, American job loss, the U.S. current account deficit, and growing Chinese currency reserves reinvested in American debt, thus inflating new bubbles, will only be reinforced.

Some of us warned that this day would come. We knew that an economic strategy predicated on replacing wage growth with debt and credit to maintain a certain standard of living was doomed to fail. We knew that this Nation could not replace manufacturing jobs and their multiplier effect, as well as their positive impact on the trade balance and wealth generation, with lower-wage service and retail jobs. We knew that our national security would begin to suffer if we did not have a vibrant enough manufacturing base to resupply our troops and provide the armaments for the future. We knew that if our leaders viewed international trade as a foreign policy tool and a path to cheap imports, rather than as an essential element for economic growth and domestic production, the consequences would be disastrous.

The warnings came not only from labor leaders, domestic manufacturers, and an insightful group of elected officials—they came also from very conservative economic quarters. Well before this new, great recession began, Warren Buffet said "Our trade deficit has greatly worsened, to the point that our country's 'net worth,' so to speak, is now being transferred abroad at an alarming rate. A perpetuation of this transfer will lead to major trouble." Martin Feldstein—former Chairman of President Reagan's Council of Economic Advisors—said, "The present level of the current account deficit is enormous, it is unprecedented and I believe it is unsustainable."

The result of growing current account deficits has been more manufacturing job loss and a healthy share of the blame for the economic collapse this Nation experienced last year. Some say that the total number of manufacturing jobs has been falling anyway, and that this isn't such a bad thing as we transition to a new economy. Mr. Chairman, I believe that particular view is dangerous and misguided.

Contrary to a widely held analysis, manufacturing employment held steady from 1982 to 1999, hovering around 17.2 million jobs, with ebbs and flows in downturns

and recoveries. There were a number of reasons for this stability, including more aggressive trade enforcement and currency policies in the 1980s and more domestic investment in the 1990s. But manufacturing employment has dropped precipitously since China entered the World Trade Organization in 2001 and our bilateral trade deficit has exploded. We have concluded that—outside of recessions—the single most detrimental factor to manufacturing employment in the United States has been the expansion of our one-sided trade relationship with China. China is certainly not our only competitor engaged in unfair, predatory, and protectionist policies, but the scale of their activities swamps that of many of our other trading partners and is in need of immediate attention.

Other explanations, while conforming to orthodox economic views, are not satisfying. The decline of manufacturing employment and manufacturing's share of GDP are not inevitable, desirable, nor can they be explained solely through theories of churning capitalism, advances in productivity and technology, compensation costs or inefficiency.

Consider this: more than 40,000 factories have shut their doors over the last decade. They weren't making buggy whips; they were manned by some of the most efficient workers in the world. To wit, we already have large and growing trade deficits in advanced technology and clean energy, even though these supposedly represent "new economy" sectors and the jobs of the future in the eyes of many.

The failure of our domestic and international trade policies to support manufacturing must be quickly reversed. We urgently need a national manufacturing strategy.

The idea of a manufacturing strategy or industrial policy is hardly a radical concept. Alexander Hamilton constructed America's first industrial policy in 1791. Setbacks during the War of 1812 due to a lack of domestic capacity to build naval vessels and military equipment cemented the determination of the Federal Government to grow manufacturing, a policy that continued until the end of World War II. Globalization and economic approaches such as a strong dollar policy favoring domestic consumption have helped to steadily erode manufacturing as a percentage of Gross Domestic Product, private sector employment, and other key measures. If today's leaders spent more time focusing on Hamilton and less time on Smith and Ricardo, I don't think we'd be facing the prospects of a jobless recovery.

The idea of a manufacturing strategy is also not a partisan one. President Reagan—spurred on by a Democratic Congress—adopted a flurry of measures to counter a grossly imbalanced trade relationship with Europe and Japan in the 1980s. The Plaza Accords, which raised the value of currencies in Japan and Europe relative to the dollar in a managed way, had a positive effect in lowering our trade deficit. Key government investments in the semiconductor industry and other technologies spurred their development and commercialization. President Reagan signed into law enhanced Buy America requirements for certain infrastructure projects to boost domestic employment. His Administration implemented the Market Oriented Sector Specific—or MOSS talks—with Japan that focused on market access with measurable results.

Yesterday, United States Trade Representative Ron Kirk delivered an address outlining the beginning of a new enforcement approach as part of our overall trade agenda. That comes as welcome news to those manufacturers and their employees who have seen a flood of imports flow into our market often benefiting from subsidies and other unfair practices by their governments. His speech comes as welcome news, but the success of his efforts are going to be measured on a daily basis.

Apply those principles to the economic challenges of today, and you have the foundation of a manufacturing strategy: raise the value of China's yuan to market-based levels, invest in value-added manufacturing such as clean energy and industries with strategic significance, and engage in serious bilateral talks with China to ensure that it honors the commitments it made upon entry into the WTO in 2001 to eliminate its myriad mercantilist and protectionist policies. Finally, keep Buy America requirements in place so that tax dollars are reinvested in our economy and the employment benefits of infrastructure spending accrue not only to the construction industry, but also to our manufacturers.

But a successful manufacturing strategy must go deeper than that. I join Leo Hindery, Mr. Chairman, in expressing support for your IMPACT legislation, which would provide access to much-needed capital for small- and mid-sized manufacturers to help capture new clean energy markets, both here and abroad. At a time when access to capital is still very tight, a public commitment like this is essential. Moreover, those who say the market alone should dictate winners and losers forget three important lessons. First, some of the greatest innovations since World War II—the semiconductor and the Internet—were developed with public assistance. Second, our policies already pick winners and losers, but we tend to pick the wrong winners—

those who profit through selling cheap, subsidized imports, or those companies heavily invested in fossil fuels. Let's pick winners in more productive, wealth-generating activities like domestic manufacturing for a change. Third, other nations are aggressively supporting emerging industries like clean energy. Unless we want green manufacturing jobs created in Shanghai instead of Cincinnati, or Dusseldorf instead of Denver, we must support domestic development of these industries.

A key component of any manufacturing strategy must be public investment, especially in infrastructure. The American Recovery and Reinvestment Act made a down payment on infrastructure investment, but our Nation will still be hampered by what the American Society of Civil Engineers estimates is a \$2.2 trillion deficit in infrastructure investment over the next 5 years. Improving our infrastructure provides a greater return on investment for taxpayers than tax cuts and virtually every other form of spending. In the process, it boosts construction jobs, stimulates demand for manufactured goods, and improves productivity and economic growth by making transportation more efficient. According to a recent study by economists at the University of Massachusetts at Amherst, ensuring that the materials purchased with tax dollars for infrastructure projects are sourced domestically creates 33 percent more manufacturing jobs, which is why we urge the Senate to continue its strong support for Buy America provisions.

The cost, supply and composition of energy resources consumed by our manufacturers must also be considered, especially in the context of Federal and international efforts to reduce greenhouse gas emissions. As the Senate begins its deliberations over a legislative solution to combating global climate change, it is essential that provisions be included to prevent the shifting of manufacturing jobs to countries with less regulation. A poorly designed approach to this issue will result in a net increase in global emissions and will put millions of energy-intensive manufacturing jobs here in the United States at risk.

Specifically, it is essential for any climate change bill to include a fair and equitable allocation of allowances to rebate the full cost of complying with new legislation. Sufficient allowances from the total pool should be devoted to energy and trade intensive industries; the allowances should be available for as long as practicable to bring other nations into compliance with a global regime and to develop new technologies to improve energy efficiency and reduce carbon use. Second, the legislation must include a mechanism to impose a "border adjustment" on goods imported from countries that do not have comparable limits on carbon emissions. Such a mechanism would impose a fee on the carbon content of goods imported from these countries and should be bypassed only with Congressional approval. And, the border adjustment must be rebatable to our exporters so that action—or inaction—on climate change is not used as a competitive tool by our trading partners to limit trade flows.

It is important to note that such a provision would be permissible under our international obligations. A June 26, 2009, report released by the WTO and the United Nations Environment Programme said: "Rules permit, under certain conditions, the use of border tax adjustments on imported and exported products The objective of a border tax adjustment is to level the playing field between taxed domestic industries and untaxed foreign competition by ensuring that internal taxes on products are trade neutral."

These provisions are essential to preventing a shift of our domestic manufacturing base in energy-intensive industries to industrialized nations such as China, the world's largest emitter of carbon dioxide, and India, which has publicly rejected efforts to control emissions.^u

To illustrate this point, in March, we released a study outlining the competitive advantage already enjoyed by Chinese steelmakers, who operate under less stringent environmental standards than most developed countries. Levels of pollution are 3 to 20 times higher per ton of steel produced in China than in the U.S., depending on the specific pollutant and industrial process analyzed. China is the world's leading industrial carbon dioxide emitter. Meanwhile, our domestic steel producers are the most efficient in the world, with the lowest energy consumption and lowest emissions per ton of production.

It would be a grave mistake to put our energy intensive industries (including chemicals, paper, iron and steel, aluminum, rubber, cement, and glass) at a competitive disadvantage as an unintended consequence of seeking to control greenhouse gas emissions. We look forward to working with you to ensure the Senate legislation includes these important measures.

Mr. Chairman, I want to close by framing the broad goal of an American manufacturing strategy, as outlined by President Obama in April. The President, appearing at a Group of 20 Summit in London, said:

. . . in some ways the world has become accustomed to the United States being a voracious consumer market and the engine that drives a lot of economic growth worldwide . . . We're going to have to take into account a whole host of factors that can increase our savings rate and start dealing with our long-term fiscal position, as well as our current account deficits. Those are all issues that we have to deal with internally, which means that if there's going to be renewed growth, it can't just be the United States as the engine. Everybody is going to have to pick up the pace . . . I should add, by the way, that to the extent that all countries are participating in promoting growth, that also strengthens the arguments that we can make in our respective countries about the importance of world trade—the sense that this isn't a situation where each country is only exporting and never importing, but rather that there's a balance in how we approach these issues.

Balance is the key. And if balance is the goal, the surest path forward is to invest more in domestic manufacturing and reform our trade policies. Such actions will create more exports, more jobs, more innovation, and more growth. Mr. Chairman, we look forward to working with you and Members of the Subcommittee on strategies to revitalize this important sector of our economy.