



# The Manufacturing Council

WASHINGTON, D.C. 20230

**December 12, 2008**

Dear Mr. Secretary:

In our capacity as your appointed advisors to counsel you regarding U.S. manufacturing policy, we are writing to communicate our recommendations to both you and Commerce Secretary-designate Bill Richardson. The urgency of the nation's manufacturing situation prompts us to communicate at this time rather than waiting until the new Secretary is confirmed.

The country is facing the most serious economic crisis of the last half century. We are in this situation in part because we have made bets on speculative financial schemes (the tech bubble of 2000-2002 and today's real estate bubble, among others) instead of investing in the proven wealth-creation machine of the manufacturing sector.

The United States needs bold new national economic strategies to harness the power of domestic manufacturing for economic revitalization. The Council's top two priorities are:<sup>1</sup>

- **Commit to Energy Independence.** We must commit our country to an Apollo-like effort to achieve energy independence and reduce our dependence on imported fossil fuels. This will require simultaneously increasing domestic supply; creating new alternative energy sources; transforming our US transportation vehicle fleet to run on alternative fuels, and radically increasing the energy efficiency of our economy, particularly the manufacturing sector, which accounts for one-third of national energy consumption.
- **Correct Trade Imbalances.** The failed trade policies of the last two decades must be reversed. They have produced record manufacturing trade deficits that are unsustainable and create dependence on foreign borrowing. Reversal will require renegotiation of key trade agreements; vigorous enforcement of trade standards and sanctions; and imposition of penalties for

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<sup>1</sup> We have provided some additional detail on each of these strategies in our attachments.

unfair trade practices such as currency manipulation and other export subsidies.

Two additional areas where we believe broad national initiatives are required include:

- **Build A Skilled Workforce.** A strong advanced manufacturing sector creates strong demand for skilled job growth. We need a robust national initiative to build a vast pool of proficient graduates in the engineering, math, sciences and skilled trades career tracks to meet these talent needs.
- **Eliminate Domestic Cost Disadvantages.** U.S. manufacturers face a 17% higher cost of doing business compared to our major trading partners. We need to level the playing field for American manufacturing firms through tax reform, health care reform and regulatory reform. And we need a tax structure that clearly rewards domestic manufacturing investment.

We are passionately committed to rebuilding the domestic manufacturing base as a core part of our national economic recovery strategy. The Council is eager to support the development of a comprehensive national manufacturing strategy. We are uniquely positioned to provide an independent source of outreach for the Department to multiple manufacturing stakeholders – helping to integrate and synthesize many points of view into a powerful and focused approach to domestic manufacturing revitalization.

We look forward to working with the new Secretary as the “voice of the customer” and in whatever way will be most productive.

Sincerely,

Members of the Council



**The Manufacturing Council**  
WASHINGTON, D.C. 20230

## **Background On Policy Recommendations:**

- **How We Got Here**
- **Energy Independence**
  - **Trade**
- **Workforce Competency**
- **Domestic Structural Costs**

**December 12, 2008**



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## The Nation's Current Circumstances and How We Got Here

Our country is at a critical phase in the development of its economy. Manufacturing has been the wealth-creating engine of the U.S. economy for most of the period since World War II. During this time, manufacturing has accounted for the majority of our exports; has been the highest contributor to economic growth of any sector; has accounted for the vast majority of private sector R&D; has fueled growth in services industries; and has generated good jobs with family-sustaining wages and benefits 25% higher than other sectors. And our expertise in making things drove innovation in product design and development, spawning new markets and industries. This wealth-producing machine worked, because it was based on the making of things that others valued and for which they were willing to pay money.

The last three decades have witnessed an unfortunate deviation from this proven economic success formula. Under misguided beliefs in a "post-industrial" economy, the U.S. made two dangerous national bets on "get rich quick" schemes that enticed investors and consumers with the promise of great wealth creation without producing sustainable value. They were both championed by Wall Street, and they both failed.

The first of these bets was the "dot.com" bubble that promised Internet riches based on now infamous "hockey stick" growth formulas. The resulting crash in 2000-2002 caused a 38% loss of value in the Dow Jones Industrial Average.<sup>2</sup>

The second bet was the recent speculative real estate bubble that promised riches based on the packaging and reselling of overvalued real estate assets. When the bubble inevitably popped this fall, the Dow Jones Industrial Average had declined by over 40%. In this bubble, American consumers were lured into using debt, rather than earnings, to fuel consumption. The ratio of debt to GDP more than doubled in two decades.<sup>3</sup> The resulting economic crash is devastating our national and international economies.

During these speculative binges, we also made two critical policy mistakes. First, domestic manufacturing was undermined by international trade policies. While the U.S. opened its markets to its trading partners, domestic companies were barred

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<sup>2</sup> A loss of this magnitude hadn't occurred since the stock market crash of 1973-1974, when the DJIA lost 45% of its value.

<sup>3</sup> Total credit market debt, which had been about 130% of GDP for over 35 years until the mid-1980s, reached over 340% of GDP by 2007. (Kevin Phillips, *Bad Money*, P. 46.)

from many foreign markets by a combination of currency manipulation; non-tariff barriers; and illegal subsidizing of export industries. As a result, our manufactured goods and services trade deficit has more than quadrupled since 1997, and now exceeds a half a trillion dollars a year.<sup>4</sup> The U.S. cannot innovate and export its way to economic strength while giving total market access to nations that disregard the rules of international free enterprise and use mercantilist and protectionist practices to distort markets to their advantage and unfairly lure manufacturing investment offshore.

Second, we totally failed to act on one of the most critical economic and national security challenges of our time – energy independence. We are more dependent now than we were 30 years ago on imported energy sources, which now account for one-third of total U.S. trade deficit. With **manufacturing being the largest energy consumer in the country**, our long-term success depends on reliable and stable sources of energy to run our factories and distribution systems. And we depend on fossil fuels such as natural gas for key raw material inputs such as plastic resins.

This mismanagement of our national economy has devastated the manufacturing base. Over 3.5 million jobs have been lost in manufacturing since 1997, and because of manufacturing's high employment multiplier, these job losses have had severe ramifications in the services sector. In the 1970's, manufacturing accounted for 24% of US GDP; today it is 12%. In the 1970's, the financial services sector accounted for 14% of US GDP; today it is 21%. By 2004, the financial services accounted for over 40% of total US business profits, compared to 10% from the manufacturing sector.

The impending collapse of the domestic automotive manufacturing sector will only add to this unfortunate trend, and could result in millions of additional jobs lost.

Let's be clear: the decline of manufacturing was not a "natural" or "inevitable" occurrence; it was the result of bad policy choices. And the lessons of the last several decades are quite clear:

1. Don't try to substitute speculative, debt-fueled economic stimulus for real wealth creation.
2. It's time to get "back to basics" and rebuild the manufacturing sector as our national wealth creation engine.

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<sup>4</sup> This does not include our energy trade deficit.



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## Energy Independence Recommendations

### Goal:

*Eliminate U.S. dependence on non-North American energy supplies and transition our energy sources from fossil fuels to renewable energy sources.*

### Background:

- U.S. manufacturers consume approximately one-third of all energy in the country.
- Foreign imports account for 60% of our petroleum use and 34% of total energy consumption. Much of this foreign energy comes from countries that are hostile to U.S. interests.
- The U.S. energy trade deficit accounts for more than 30% of our total balance of payments.<sup>5</sup>
- The US transportation industry consumes approximate 30% of all domestic energy and uses virtually 100% of our imported oil. Because the country's vehicle fleet runs predominantly on gasoline, the transformation of our motor vehicle fleet to run on domestically produced alternative fuels (hydrogen, electric batteries, etc) is essential to the reduction of our dependence on imported oil.
- Manufacturers have a heavy reliance on natural gas, both for energy, and for feedstock for products such as plastic resins. Natural gas prices in the US are significantly higher than natural gas prices in most countries.<sup>6</sup> Manufacturers need for increased availability of natural gas is approaching a critical stage and significantly affecting the viability of many kinds of manufacturing in the U.S.
- All energy prices have achieved record high levels in the last two years.
- U.S. industry has made good progress on reducing its energy use. Energy consumption per dollar of GDP had dropped by almost 50% since 1975.<sup>7</sup> The emerging "sustainable manufacturing" movement is accelerating this trend, as

<sup>5</sup> "The Energy-Competitiveness Relationship", Council on Competitiveness, September, 2007, P. 10.

<sup>6</sup> "Energy Policy and US Industrial Competitiveness", USDOC, ITA, 2007

<sup>7</sup> "Energy Policy and US Industrial Competitiveness", USDOC, ITA, 2007

companies apply lean manufacturing approaches to the elimination of energy and resource waste.

- “Clean technologies” and alternative energy have become one of the largest attractors of venture capital in the United States, signaling the emergence of a new growth sector.<sup>8</sup>
- Achieving climate change mitigation goals over the next 30 years will require shifting a significant percentage of our energy uses to clean energy sources.

### **Council Strategy Recommendations:**

Both the short term problem of providing adequate supplies of liquid fuels at reasonable prices, and the longer term problems of transitioning to permanent alternative energy sources, must be addressed in a single comprehensive energy policy which includes transforming our motor vehicle fleet to run on domestically produced renewable energy. We recognize there must be a transition period to move to significantly greater use of renewables to carry our energy load and that in this interim period we must maximize our domestic output of conventional sources of energy by dramatically increasing our exploration and drilling for natural gas and oil and by accelerating the development of nuclear power plants. We support that this be accomplished in an environmentally responsible way.

Our specific recommendations include the following:

- **Energy Independence.** Commit our country to an Apollo-like effort to achieve energy independence and reduce our dependence on imported fossil fuels.
- **New Traditional Sources.** Increase domestic energy supplies through new exploration in the Outer Continental Shelf; investment in advanced coal; and accelerated development of new nuclear power plants.
- **New Alternative Sources.** Support the growth of alternative energy supplies (wind, solar, biomass, micro-grids, nuclear) through a permanent Production Tax Credit; commercialization support; federal job training; and investments in national lab research.
- **Transportation Industry.** Support the transition of the US vehicle fleet from oil based fuels to domestically produced and renewable energy sources (hydrogen, electricity, etc).
- **Energy Infrastructure.** Invest in the upgrading of the national electrical distribution grid, and systems for developing and distributing transportable fuels for vehicles (such as gas; hydrogen; and other non oil-based fuels).

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<sup>8</sup> In 2006, almost \$5 billion was invested in the US in clean energy companies and products.

- **Energy Efficiency.** Help manufacturers reduce and conserve energy through support of DOE and DOC programs; tax incentives and low cost loans; and incentives to use alternative energy sources.
- **Sustainable Manufacturing.** Champion “sustainable manufacturing” practices for US companies, and support globally standardized ways of measuring sustainable manufacturing performance by industry type.



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## Trade Recommendations

### Goals:

*Remove inequitable barriers to free trade, such as tariffs, subsidies and currency manipulation, which have caused our unsustainable trade deficit.*

### Background:

- The U.S. manufacturing trade deficit has ballooned since 1990 and now exceeds a half a trillion dollars a year. These ballooning deficits have occurred during the introduction of multiple Free Trade Agreements (FTAs), many of which have not had their intended effect of stimulating multi-lateral trade between us and our trading partners.
- The trade deficit with one country – China – accounts for almost 50% of the total U.S. trade deficit.
- The escalating trade deficit creates dangerous levels of U.S. dependence on foreign capital to finance our debt.
- As a result of our trade deficits, an increasing amount of domestic consumption is being satisfied with imports, not domestic production. In 1990, domestic manufacturing met 93% of domestic demand; by 2006 that figure had dropped to 74%.
- The cause of our trade deficits has not been uncompetitive goods and services – but rather imbalanced trade agreements. Many of our trading partners still engage in essentially “mercantilist” trade practices that create artificial barriers to imports and heavy subsidies for exports. As stated by a former Clinton Administration trade negotiator: “The U.S. has been eliminating regulations and restrictions since the Reagan era started while other countries have been maintaining theirs as a barrier against the United States. Well, now they’ve won.”<sup>9</sup>

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<sup>9</sup> Robert Cassidy, former assistant U.S. Trade Representative for China, quoted in Manufacturing News, October 31, 2008.

- U.S. strategy on trade agreements and their enforcement has been heavily influenced by foreign policy goals, effectively leading to trade policy being run by the U.S. Department of State rather than the Department of Commerce.

### **Council Strategy Recommendations:**

We believe that the U.S. has entered into its international trade agreements in good faith. However: 1) many of our partners have not made good on their promises to create access to their markets; and 2) we have failed to aggressively enforce the terms of our agreements. The chief U.S. trade negotiator who paved the way under the Clinton Administration for China's entry into the WTO put it bluntly: "The premise on which our trade agreements are negotiated is at best flawed, if not broken."<sup>10</sup> Rebuilding the strength of our domestic manufacturing economy will require correcting these mistakes.

It is important to note that there are some significant differences of interests within the broad U.S. manufacturing community on this issue. Some trade associations are dominated by the larger multi-national companies who have developed business models based more on the importation of cheap foreign goods than on domestic production. These companies have been strong advocates of the current trade regime. Companies that are more focused on domestic production – like many of the members of the Council – instead favor a different trade regime that more clearly protects domestic producers from unfair foreign competition.

Our specific recommendations include the following:

- **Free Trade.** Pursue aggressive reductions in tariff and non-tariff barriers with key trading partners, especially East Asian exporters, and vigorously enforce existing trade agreements.
- **Currency Manipulation.** Advocate control of currency manipulation by all trading partners, and impose import duties in proportion to the level of cost advantage that currency manipulation (the difference between the current currency value and its value if it were allowed to float against international currency) provides to importers.
- **Intellectual Property.** Improve Intellectual Property Rights (IPR) enforcement and in particular enhance law enforcement cooperation with China on IPR violations.
- **FSC/EI.** Bring US Foreign Sales Corporation/Extraterritorial Income trade law into WTO compliance and use new revenues to provide tax relief to the manufacturing sector.

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<sup>10</sup> Robert Cassidy, former assistant U.S. Trade Representative for China, in an article published online at Foreign Policy in Focus, June 10, 2008.



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November 26, 2008

## Workforce Recommendations

### Goal:

*Build a skilled talent pool of proficient graduates in the engineering, math, sciences and skilled trades career tracks to meet the talent needs of an advanced manufacturing sector.*

### Background:

- The workforce in manufacturing has a tradition of being considered the most powerful, talented, and creative workforce in the world.
- In a recent survey by the National Association of Manufacturers, 81% of respondents stated that they could not find enough skilled production workers, and 65% said they could not find enough scientists and engineers.
- The skilled worker shortage is the result of a combination of factors, including the retirement of baby boomers; the need for higher skill levels; and difficulty attracting skilled talent to the manufacturing sector.
- The skill requirements of the sector have been increasing rapidly. Today's highly technical jobs require more U.S. students with the science, technology, engineering and mathematics skills necessary to drive innovation. Yet the number of individuals graduating from college with engineering degrees has declined by 20% from its peak in 1985.
- Technical skills need to be balanced with social skills. Manufacturing environments thrive best when cohesive teams work together to accomplish their objectives and solve problems. These "soft" skills are as important as "hard" skills and are increasingly the difference between success and failure in the manufacturing sector.
- No longer is the concept of basic education enough for the skills required and no longer is one education cycle enough. Continuous education is the norm as educational facilities of all types provide for the continuing education of the workforce.

## **Council Strategy Recommendations:**

To support the development and continuous learning of a skilled workforce, the workforce development system must be adaptable, innovative and well connected to the manufacturing world.

Our specific recommendations for education and workforce development include the following:

- **Worker Training Programs.** Enhance and expand worker training and retraining initiatives through public-private and federal, state and local partnerships. This should focus on a sector-specific strategy that builds an integrated “talent supply chain” for the manufacturing sector, from K-12 through graduate school levels.
- **Displaced Workers.** Improve and increase funding for displaced workers.
- **Local Grants.** Provide federal and state redevelopment grants to help communities maintain their manufacturing base and overall economic health in the event of a plant and industry closing.
- **Education Initiatives.** Build on education initiatives to ensure successful preparation for placement in the high tech manufacturing workforce of today. This should include reemphasizing technical schools focused on skilled trades career paths.
- **STEM.** Prioritize STEM (Science, Technology, Engineering & Math) initiatives (K-12; university; internships).
- **Workplace Skills Readiness.** Implement the National Career Readiness Certificate on a national basis as a baseline measure of workplace readiness.



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## Domestic Structural Cost Recommendations

### Goal:

*Eliminate the 17%+ domestic cost disadvantage that American manufacturers have compared to our major trading partners.*

### Background:

- Structural costs for U.S. manufacturers have improved in the last several years, with the cost disadvantage with major trading partners having dropped from over 30% to 17%.<sup>11</sup> Primary improvements have come from a combination of improved U.S. productivity; favorable US. policy changes (specifically in torts, health care insurance, and pension costs); and rising costs abroad..
- Manufacturing, more than other business sectors, faces a cost-price squeeze due to intense global competition. Nearly half (45 percent) of all U.S. manufacturing output is traded internationally, compared to just three percent for other sectors.
- The single most important structure cost difference – the high corporate tax burden – has not improved. U.S. manufacturers pay higher corporate tax rates (40%) than all but one (Japan) of our major trading partners.
- Rather than encourage manufacturing investment, the U.S. tax structure (federal and state), contributes to uncertainty and increases manufacturing’s cost burden through capital restructurings and arbitrary restrictions on the use of legitimate losses, deductions and credits.
- High health care costs continue to impose an unfair competitive disadvantage on U.S. manufacturers.
- Other key cost components include regulatory compliance costs; higher natural gas costs than trading partners; and historically high U.S. tort costs.

<sup>11</sup> “The Tide is Turning – An Update on Structural Cost Pressures Facing US Manufacturers”, The Manufacturing Institute and MAPI, November 2008

## **Council Strategy Recommendations:**

The Council advocates a tax and regulatory infrastructure that does not put U.S. manufacturers at a competitive disadvantage with major trading partners.

- **Restructure Taxes to U.S Taxes More Competitive:**
  - Restructure the Alternative Minimum Tax (AMT) to allow for accelerated depreciation; use of R&D tax credits to offset liability; and allow deductions for state taxes.
  - Make the capital gains tax rate permanent and eliminate the inheritance tax.
  - Make permanent the federal R&D tax credit.
  - Provide enhanced incentives for new and ongoing investment in advanced technologies.
  - Make the Subpart F active financing exception permanent.
  
- **Family and Medical Leave Act.** Advocate the release of revised Family and Medical Leave Act (FMLA) regulations.
  
- **Harmonization.** Implement a senior-level regulatory forum to take international harmonization into account when promulgating or making changes to regulations.
  
- **Health Care.** Implement comprehensive health care reform.