What Manufacturing Crisis?

America for Sale

by David A. Hartman

The recent U.S. recession, if judged by its effect on total employment, was the shortest and mildest of the post-World War II period. In the six months from the peak of July 1998 to the low of January 1999, employment declined by only 1.43 million workers, and, by May 2004, 7.5 million additional workers were employed.

For American manufacturing, however, the employment recession has been the longest and most severe since the Great Depression. During the same six-month period (July 1998-January 1999), 3.5 million workers lost their jobs—a decline of 19.7 percent. As of May 2004, only 187,000 were reemployed, just one out of every 19 laid-off employees.

Since the 1950's, manufacturing's share of the U.S. economy has been in a relentless decline, and its current share of GDP is less than half of what it was in the 50's. Employment in manufacturing, as a share of total U.S. employment, has fallen proportionately. (See Exhibit I.)

The origin of this downward trend can be explained partly by manufacturing's relatively greater productivity and partly by the rapid growth of government and the "service" economy. Since the 1970's, however, this trend has been exacerbated by the growing competitive advantage enjoyed by foreign competitors. In a follow-up article in the December issue, I will show that this advantage is largely the result of a system of border-adjusted taxation that is not available to U.S. manufacturers. As a consequence, the trade deficit in goods, which began in 1971, has increased ever since. To put the deficit in simple terms: U.S. companies today are only producing the equivalent of 4 dollars worth of every 5 dollars of manufactured goods consumed in the U.S. The U.S. trade deficit in goods for 2003 was more than $500 billion, the bulk of which was in manufacturing.

The United States has a sizable negative trade balance in goods with every principal nation and region. Although the negative balance in goods has been somewhat offset by exports of U.S. services, this positive balance has leveled off. The merchandise deficit is predicted to continue to grow through at least 2005, despite the recent devaluation of the dollar (which, according to conventional wisdom, makes U.S. goods more attractive to foreign customers). The trade deficit is currently more than five percent of GDP, and the net amount of U.S. assets now owned by foreigners is currently estimated at four trillion dollars. This figure is roughly comparable in scale to the total privately owned portion of the U.S. federal debt. The United States, which was the world's largest creditor in 1982, has since become the world's largest debtor—a consequence of the relentless growth of the trade deficit.

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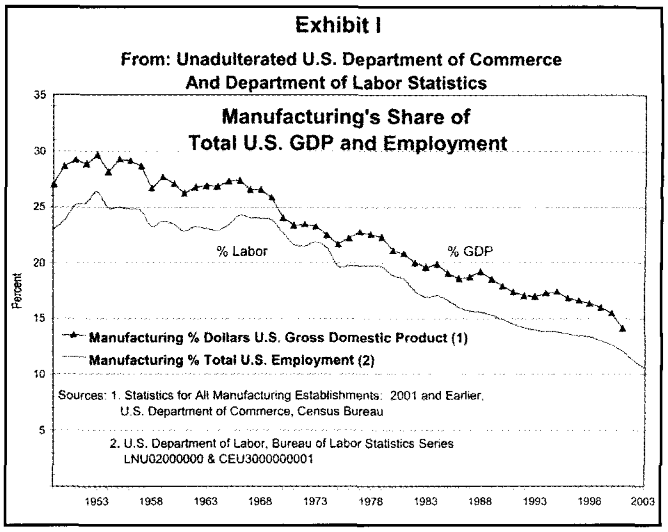
The National Association of Manufacturers (NAM) warned earlier this year that "the country may be dropping below critical mass in manufacturing." This is not hard to believe, as depressed manufacturing centers lose vital supporting services and as traditional industries provide neither the volume nor the financing required for the new factories and equipment that employ the newest and most productive technology. The United States is the leader in high-tech product innovation, yet current exports are only one third of the value of imports in electronic data processing and office products.



One crucial element in the trade deficit is American industry's higher manufacturing costs. According to a study prepared by the Manufacturing Alliance/MAPI for NAM (December 2003), the U.S. cost of $24.30 per labor hour exceeds the $19.30 average of nine principal trade partners by $5 per hour. The study goes further to show that other disadvantages saddle U.S. manufacturers with added costs of regulation, energy, employee benefits (particularly health insurance), and a significant difference in corporate-income-tax rates that total an additional $4.45 per labor hour. This adds up to a $9.45 disadvantage.

What is *not* considered by the MAPI/NAM study is the effect of border-adjusted value-added taxes (VAT) imposed by U.S. competitors on imports from the United States and rebated on exports to the United States, which exceed the total of the average U.S. disadvantage in labor and burden costs identified by MAPI. The average VAT imposed on U.S. exports by the Organisation for Economic Co-operation and Development (OECD) trade competitors is 17.7 percent *ad valorem*, which, expressed as MAPI's labor "raw cost" index, is the equivalent of

$14.76 per hour, over *half again more* than the $9.45 total burden calculated in the study. A conservative estimate of average VAT rebated on OECD exports to the United States is $13.04 per hour, nearly 40 percent more than the total of all adverse cost factors identified by MAPI. This important advantage enjoyed by our competitors is the source of much of our misery, but it also points the way to the solution.

Many optimists look to our strong improvement in manufacturing productivity as the source for a restoration of U.S. competitiveness. However, a recent *BusinessWeek* article, "U.S. Factories Falling Behind," showed that our principal trading partners are increasing their productivity at higher rates than the United States. The other straw the optimists grasp at is the devaluation of the dollar, which will supposedly right the trade balance, but such predictions have not proved reliable in past.

In an open world economy, in which neither commodity pricing nor capital is limited by borders, the parity achieved by devaluation is temporary. What devaluation *does* achieve is recurrent bargain-basement prices for the most strategic and productive American economic assets. In other words, "America is for sale and for a low, low price." Once markets have adjusted to the new exchange rates, the principal burden of lower real prices is forced upon labor. In the area of corporate taxation, Arnold Harberger arrives at the same conclusion: The wedge of corporate taxation primarily impacts labor. When governments at the federal, state, and local levels raise taxes (unless they are border adjusted) to augment depressed revenues and pay for rising welfare costs, they only pour fuel on the fire. After World War II, the United Kingdom opted for the quick fix of devaluation. The effect was to prolong rather than to remedy the problems caused by their uncompetitive manufacturing sector. It was only by adopting competitive VAT policies and supply-side income-tax reductions that Britain became productive.

There are many experts who actually deny that a trade imbalance is a problem, since foreigners must reinvest their dollars in the United States if they do not buy our merchandise. However, those dollars invested in U.S. debt and equity securities or productive assets by foreigners have a price tag—the interest, dividends, and rentals that will leave the United States increasingly indebted.

Most neoconservative and libertarian economists think that the problems in manufacturing can be resolved by tax reforms that will provide greater saving for investment and lower composite marginal rates of taxation. But greater investment in manufacturing productivity in the 1990's and lower marginal rates in the 1980's did not reverse the downslide.

The crisis in manufacturing is being obfuscated by internationalists who are indifferent to American concerns and by those who profit from the trade advantage of foreign-produced goods in competition with U.S. manufacturers. The federal government has negotiated bilateral trade agreements that have exposed U.S. manufacturers and their workers while granting them no commensurate concessions in return. This is not in our national interest. Yet all who have profited from or gave their blessings to this folly are joined in a chorus of denying reality.

The deterioration of the U.S. manufacturing sector threatens the progress and prosperity of the American economy. It also poses a risk to our military security. Manufacturing has traditionally provided the technological advances that drive productivity across all sectors of the economy, and America's military capability has been strengthened by the industrial development of new technology.

Industrial decline also threatens social stability. The declining employment and earnings in U.S. manufacturing are a principal cause of the declining incomes of blue-collar workers. The average factory wage per hour in real dollars declined 11.3 percent from 1978 to 2001, despite an increase of productivity by one half in the business sector and a *doubling* of productivity in manufacturing. The laid-off workers from manufacturing seeking re-employment in highly price-elastic service markets have brought further pressure to bear on blue-collar workers. The increasing share of income enjoyed by the top ten percent of wage earners is *not* the result of, as leftists would have us believe, excessive returns on physical and intellectual capital; it is the result of the stagnation of labor income, itself the result of the stagnant demand for manufacturing employment, which is exacerbated by the excessive immigration. It may be true that, in the years following World War II, labor (especially organized labor) was overpaid. Today, the opposite is the case: It often takes two workers to provide a family with a living income. The United States, which adopted the 40-hour work week in the 20th century, enters the 21st century with many families working an 80 hour week, often of necessity.

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Many of the proposed remedies will do some good without actually solving the basic problem. Supply-side economic prescriptions—lower government spending, lower marginal-income-tax rates, and deferred taxation of saving for investment—though helpful, will not be sufficient to overcome the VAT advantages enjoyed by our competitors. Internationalists sometimes forget that we are not the only country in the world. Foreign competitors can also lower their own corporate income taxes relative to U.S. levels, and some of them are already undertaking fundamental tax reform. The Netherlands has adopted a system for expensing fixed investment, and Russia has adopted the flat tax.

As David Enger and Kevin A. Hassett of the American Enterprise Institute observed in their recent review of international corporate taxation, "[I]f current EU trends continue, the corporate income tax may virtually disappear and be replaced by revenue from the VAT in just a few decades." And, if the United States fails to adopt border-adjusted taxation, the U.S. corporate income tax may all but disappear for a different reason—the loss of manufacturing corporations. c

REVIEWS

Ditching the Cadaver

by Samuel Francis

"Republics exist only on tenure of being agitated."

—Wendell Phillips

Where the Right Went Wrong: How Neoconservatives Subverted the Reagan Revolution and Hijacked the Bush Presidency
by Patrick J. Buchanan
New York: St. Martin's Press;
264 pp., $24.95

If anything might have transformed the presidential election of 2004 from a dull ritual of mass democracy into an interesting and perhaps even meaningful act of civic decision, it would have been the presence of Patrick J. Buchanan, whose wit and sharp conservative intelligence enlivened the elections of 1992, 1996, and 2000. Despite his absence as a candidate this year, Mr. Buchanan rides again in his most recent book, *Where the Right Went Wrong*, a work obviously crafted for the current election and—supposedly—for future ones as well.

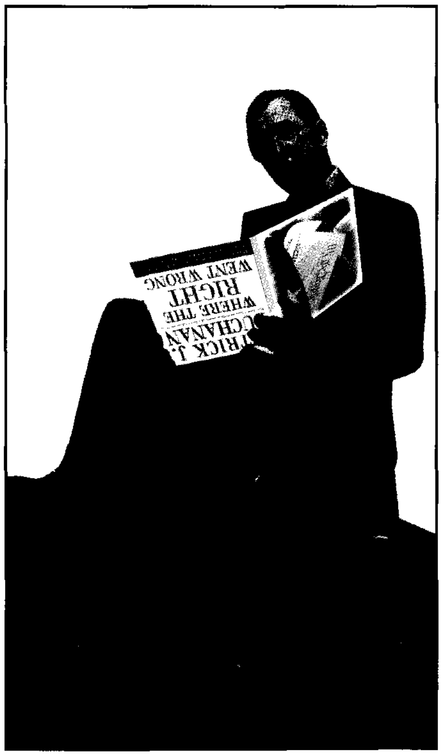
"Supposedly" is appropriate because the book's real message is directed at the conservative base of the Republican Party and what it can and should do to recover the party and its cause after this election. Toward the end of his book, Buchanan tells us, after recounting and analyzing what is wrong with the Bush administration,

> A crunch is coming, and a civil war is going to break out inside the Republican Party along the old trench lines of the Goldwater-Rockefeller wars of the 1960s, a war for the heart and soul and future of the party for the new century.

There is no indication that Mr. Buchanan intends to be a contestant in that battle, but, if there is a flaw in his book, it is his belief that there will be such a battle at all.

What is wrong with the right is a question that he answers fairly simply—neoconservatism—and there is little reason to doubt that he is largely correct. The Old Right, he tells us in the beginning of his book, is defunct. "Conservatism, as taught by twentieth-century leaders like Robert Taft, Barry Goldwater, Ronald Reagan, and Jesse Helms[,] is dead," and its death was not a natural one. The neocons murdered it.

Buchanan's documentation of this argument is ample. He describes in some detail how what representative neoconservatives—Norman Podhoretz, Irving Kristol, Bill Kristol, Richard Perle—say and write blatantly contradicts Old Right conservatism, and why most of what they say is simply bunk. Buchanan generally avoids the easier neoconservative targets such as David Frum and John Podhoretz (though he is probably the only writer anywhere who has ever quoted Tod Lindberg) and, instead, confronts what pass for neoconservatism's heavy lifters. Thus, the senior Kristol, who is as heavy a lifter as the neocons possess, wrote in 2003 that "the United States will always feel obliged to defend, if possible, a democratic nation under attack from nondemocratic forces, external or internal," and that this is why "it was in our national interest to come to the defense of France and Britain in World War II" and why we should "defend Israel today." Buchanan's deconstruction of this tissue of inanities is savage:



Melanie Anderson

> Not until eighteen months after the fall of France did we declare war on Hitler and not until after Hitler had declared war on us. America did not go to war to defend democracy. We went to war to exact retribution from a Japanese empire that had attacked us in our sleep at Pearl Harbor. Kristol is parroting liberal myths.
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> In the Cold War we welcomed as allies Chiang Kai-shek, President Diem, Salazar, Franco, Somoza, the shah, Suharto, Sygman Rhee, Park Chung Hee and the Korean generals, Greek colonels, militarists in Brazil, Argentina, and Turkey, President Marcos, and General Pinochet—because these autocrats proved more reliable friends and allies than democratists like Neh-

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