



Facing Up To The Challenge: Trade, Energy and The Economy

2008 NAM Labor Day Report



NAM National Association
of Manufacturers

Facing Up to the Challenge: Trade, Energy and the Economy

The American worker is currently going through a difficult time. Skyrocketing energy prices have eclipsed wage growth, the economy is not creating new jobs and the housing sector is in the deepest decline in the post World War II era. Amid these significant problems, the one bright spot on the economic landscape is exports. In a review of the current state of the American worker, it is important for the public and policy makers alike to recognize the benefits of engagement in the global economy, the futility of ignoring the competition, and the challenges from the lack of a comprehensive national energy strategy.

The housing recession has been ongoing for two and a half years, and rising energy prices have eaten into workers' paychecks. Together, these forces have slowed economic growth considerably:

- After averaging 3 percent growth in the 2004-2006 period, the economy has grown by 2.2 percent over the past year;
- Employment has declined every month so far in 2008 and has fallen by 174,000 over the past 12 months;
- The unemployment rate has risen a full percentage point, from 4.7 percent last July to 5.7 percent in July 2008.

With the housing recession being the most significant nationwide economic problem, it is not a surprise that the construction sector has experienced the largest employment decline. Over the past year, construction employment has fallen by 482,000 jobs. The manufacturing sector has experienced the second-largest job loss, with production employment falling by 264,000. Outside of construction and manufacturing, the economy created just 702,000 jobs during the past year, the slowest 12 month pace in more than four years.

Private sector compensation and wage growth have been eclipsed by inflation over the past year, primarily due to the surge in energy prices that started in the second half of last year. With real wage growth in decline and job losses piling up month after month, it is no surprise that consumer confidence has eroded by 46 percent over the past 12 months.

The Benefits of Exports. In addition to well-timed monetary and fiscal policies, the main reason why

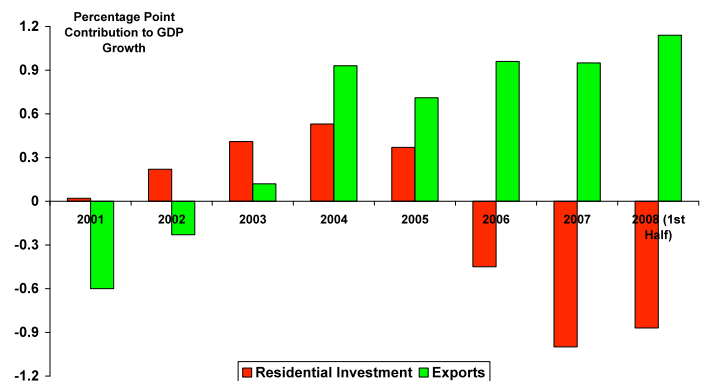
these headwinds have not driven the economy into recession has been a significant improvement in U.S. trade flows led by impressive gains in exports, which have been a positive offset for manufacturers in the face of a weak domestic economy.

Over the past year, exports have increased by 11 percent and have been the primary driver of the economy, accounted for nearly two-thirds (61 percent) of total GDP growth.

U.S. manufacturers are benefiting from a more-competitive value of the dollar, which makes U.S. products more attractive in foreign markets. The dollar has declined by 22 percent since it reached a 16-year high in February of 2002 and is back to the level of the mid-1990s, when exports also did well. At the same time, global demand remains solid. In contrast to the 2001-2002 period, when an overvalued dollar and sluggish growth abroad proved to be a toxic combination for U.S. manufactures, a lower dollar and positive growth in export markets are now a timely cocktail for growth.

In fact, since 2005 exports have added more to GDP growth than residential investment has taken away (See Chart 1.)

Chart 1. Exports Counter Decline in Housing



Source: NAM Analysis from Commerce Department data

Some have claimed that the United States no longer has a manufacturing base large enough to take advantage of the current favorable trade environment. These claims are patently false.

According to the Bureau of Economic Analysis, manufacturing products currently account for 93 percent of total goods exports, with agricultural products accounting for 5 percent, and mining products making up 2 percent.

The United States remains the largest and most productive¹ manufacturing economy in the world, accounting for more than a fifth of global manufacturing output.²

Nevertheless, from the fourth quarter of 2005 to the second quarter of this year, manufacturing production employment declined by 324,000. The bulk of this decline has taken place in motor vehicles (where output has declined by 19 percent and employment losses have totaled 166,000) as well as manufacturing industries that are *domestically focused* (primarily wood products, furniture and nonmetallic minerals which have been hard hit by the housing downturn), where exports are less than 10 percent of domestic output. In these industries, output has stagnated and employment losses have totaled 189,000 (See Table 1.)

Table 1: Manufacturing Employment and Production

4th Quarter 2005 to 2nd Quarter 2008

	Change in Production Employment (thousands)	% Change in Production
Most Export Oriented (Exports at Least 20% of Output)	119	17%
Moderately Export Oriented (Exports 10-20% of Output)	-89	2%
Motor Vehicles (Exports 17% of Output)	-166	-19%
Least Export Oriented (Exports Under 10% of Output)	-189	0%
Total Manufacturing	-324	2.7%
Total Manufacturing (2nd Quarter '00 to 4th Quarter '02)	-1,946	-3.6%

Source: NAM Analysis from Federal Reserve, Commerce Department and Labor Department data

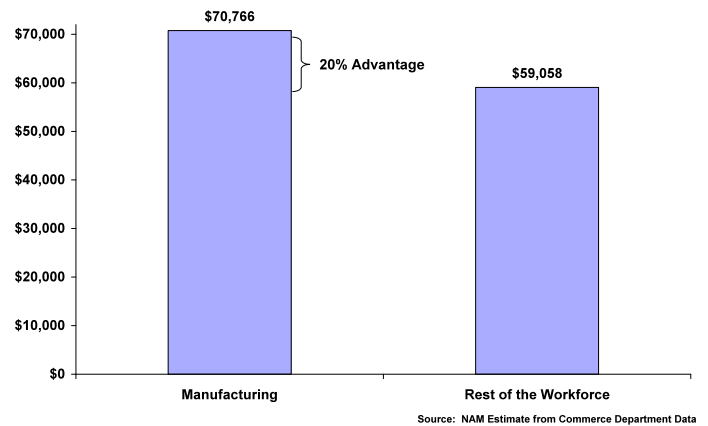
By contrast, manufacturing industries that are *export-intensive* (where exports are at least 20 percent of output: aerospace and other transportation equipment, machinery, computers and electronics, and electrical equipment) have experienced a 17 percent rise in production in the past two and a half years and have expanded production employment by 119,000 jobs.

The current export boom that has cushioned the manufacturing sector during the current domestic slowdown stands in sharp contrast to the last manufacturing downturn: From the second quarter of 2000 through the end of 2002, exports fell by 7 percent and manufacturing production employment declined by nearly 2 million (See Table 1.)

Increasing export opportunities for U.S. manufacturers boosts domestic manufacturing output and creates good paying jobs: Total compensation averaged \$71,000 for a full-time worker in manufacturing last

year, 20 percent higher than the average in the rest of the workforce (See Chart 2.)

Chart 2. Manufacturing Compensation Premium



With the Doha round of the WTO (World Trade Organization) stalled, the most immediate way to lower barriers for U.S. manufactured exports is for Congress to approve the three Free Trade Agreements (FTAs) that have already been successfully negotiated between the United States and Colombia, Panama, and South Korea.

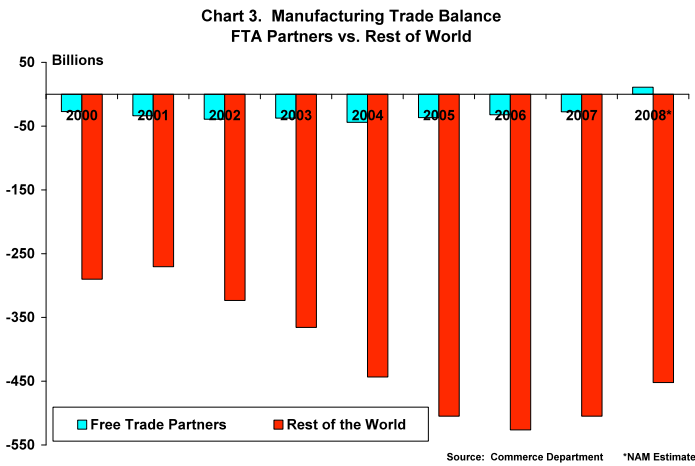
While special interest groups, including organized labor, have historically opposed FTAs, claiming that they have exacerbated the U.S. trade deficit and have been responsible for employment losses in manufacturing, the facts prove otherwise.

Outside of our FTA partners, U.S. manufacturers face high trade barriers in most other countries, where tariffs are typically 10-15 percent and sometimes much higher.

By contrast, the United States does not even charge any duties on 70 percent of imports coming into our country. And for the rest, tariff rates average less than four percent. In other words, our country is already open. FTAs work to level the playing field and make U.S. manufacturers more competitive. Recent history shows the benefits of FTAs to America's manufacturing base (See Chart 3.)

¹ NAM analysis

² World Bank.

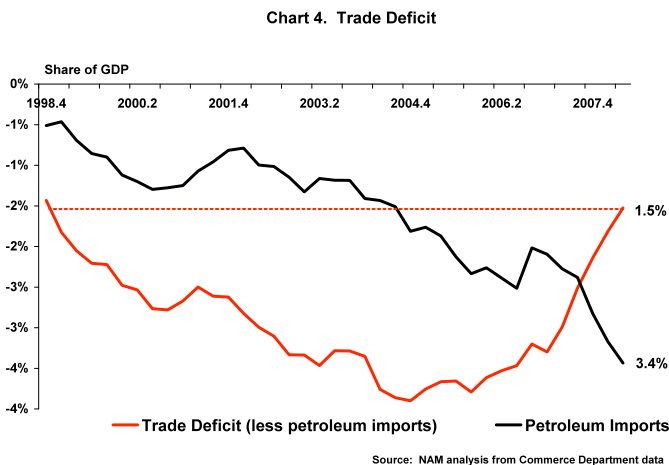


During the 2000-2002 period, the trade deficit with our FTA partners accounted for just 10 percent of the entire U.S. trade deficit in manufactured goods. By 2007, that share was cut in half to just 5 percent. More recently, through the first six months of 2008, U.S. manufacturers enjoyed a trade surplus with our FTA partners.

Organized labor's claim that current U.S. trade policy, such as engaging in FTAs with other countries, is a principal cause of job losses in manufacturing is a baseless assertion.

The usual foundation of this argument is that the decline of 3.8 million manufacturing jobs over the past 8 years has coincided with a 38 percent rise in the U.S. trade deficit.

This premise ignores the fact that the rising trade deficit has been principally driven by imports of petroleum, which have more than doubled from 32 percent of the trade deficit in 2000 to 69 percent by the second quarter of this year (see Chart 4.)



Outside of petroleum imports, the trade deficit has already narrowed by 58 percent over the past three years, and now stands at its lowest level (1.5 percent of GDP) in nearly a decade.

It is surging imports of petroleum -- not manufactured products -- that is the driving force behind the U.S. trade deficit.

The Need for a Comprehensive Energy Strategy.

Along with the housing downturn, high energy prices are the most significant challenge facing the economy and the American worker. The fact that real wage growth has turned negative over the past 12 months is solely due to the rise in energy prices, which have been responsible for 84 percent of the doubling of the pace of inflation over the past year.

Energy production and use are essential to the U.S. economy and to the health and well-being of American workers and America's manufacturing base. As the largest user of energy, manufacturers depend on affordable energy for the low-cost production of chemicals, plastics, fertilizer, paper, forest products, glass, metals, and food products.

During roughly the last three decades, the U.S. population grew by 40 percent; energy demand has increased by 30 percent, while domestic production has edged up just 16 percent.³ Without corrective policies, this trend will continue. Over the course of the next 25 years, our country's energy consumption is forecasted to grow by 34 percent, while production will only increase by 27 percent. At the same time, growing demand for energy resources in China and India will continue to stress global energy supplies.

A comprehensive energy plan is needed to enhance our nation's competitiveness and increase workers' living standards. While it is true that we can't drill our way to energy security, it is likewise true that we can't conserve our way there either. A robust, comprehensive and forward-looking energy policy must consist of five crucial elements:

1. A national commitment to further reducing the energy intensity of the U.S. economy;
2. Strengthening and focusing public-private research and development efforts;
3. Rationalizing existing statutes and regulations;
4. Increasing domestic baseload power generation; and,

³ Department of Energy

5. Increasing domestic energy supplies.

A comprehensive and forward looking energy policy can reduce our country's dependence on foreign sources of energy, lower energy prices, and improve the state of the American worker.

Conclusion. America's manufacturing base continues to face significant challenges, both domestic (a shortage of skilled workers, high taxes, excessive litigation and regulatory costs, unmet infrastructure needs) and foreign (barriers to U.S. exports, government intervention in currency markets, making trade rules work for U.S. manufacturers).

Today's challenges should be a wake up call to both Congress as well as the incoming Administration. Lowering foreign barriers faced by U.S. manufacturers and embracing a comprehensive national energy policy that promotes both efficiency and production are in the strong interest of America's manufacturing base and its workforce. Successfully addressing these challenges is vital if the United States is to maintain its position as the global leader in manufacturing.

The National Association of Manufacturers is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. Headquartered in Washington, D.C., the NAM has 10 additional offices across the country.

Visit the NAM's award-winning web site at www.nam.org for more information about manufacturing and the economy.

