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Introduction

Good Morning, Mr. Chairman, Ranking Member and Members of the Subcommittee. My name is Al Frink, Assistant Secretary for Manufacturing and Services in the International Trade Administration of the Department of Commerce. Thank you for inviting me to appear today to discuss the current state of manufacturing and solutions to strengthen manufacturing. I look forward to working closely with you and the other members in the months ahead.

Let me begin by reviewing the state of our very vital manufacturing sector.

Current State of Manufacturing

American manufacturers are a cornerstone of the American economy and embody the best in American values. They enhance U.S. competitiveness while improving lives domestically and internationally.

Manufacturers are full partners in the effort to build the future of the country in the marketplace for new products and ideas. Simply put, a healthy manufacturing sector is key to better jobs, fostering innovation, rising productivity, and higher standards of living in the United States.

The United States is the world's leading producer of manufactured goods. Standing alone, the U.S. manufacturing sector would represent the seventh-largest economy in the world - nearly equal to China's economy as a whole. The U.S. manufacturing sector also leads in innovation, accounting for more than 90 percent of all U.S. patents registered annually. Investments in technology create new industries and careers in manufacturing as U.S. firms introduce products and cutting-edge techniques. Perhaps most importantly, productivity in manufacturing has continued to rise significantly.

Strengthening American Manufacturing

Strengthening American manufacturing is a top priority for President Bush, Secretary Gutierrez, and myself. We are taking definitive steps to ensure that U.S. manufacturers remain competitive in the global marketplace. Manufacturing is an integral part of the U.S. and global economies. It is part of the network of inter-industry relationships that creates a stronger economy and the

conditions for growth. The sector currently accounts for roughly 13 percent of GDP[1] and employs over 14 million workers[2]. The United States is the world's largest economy and has the world's largest manufacturing sector.

That being said, the challenges facing U.S. manufacturers raise important questions for both industry and government. For industry, the question is how best to reinforce the sector's strengths and maintain its competitive edge in an increasingly competitive global economy. The competitive pressure on U.S. manufacturers has forced them to cut costs, to adopt lean manufacturing techniques, and to implement quality assurance programs that guarantee zero defects in production. Innovation in products, processes, and services has become a key determinant for success. The right policies in Washington, D.C.-and across the nation-can unleash the great potential of the U.S. economy and create the conditions for growth, prosperity, and job creation.

The President recognized this and responded quickly with an economic program of tax cuts and other initiatives soon after taking office. These initiatives are continuing to help revive the general economy, with expansion in the manufacturing sector beginning in mid 2003. Let me give you a few economic indicators to describe the current state of play in manufacturing:

- **Manufacturing output** in April 2005 was 10 percent above the levels in the fourth quarter of 2001.
- **Manufacturing exports** totaled $726 billion in 2004, which represents 63 percent of all U.S. exports of goods and services, and grew by 9.3 percent from a year ago.
- **Manufacturing profits** have continued their upward trend since the recession low and rose by more than 57 percent in 2004 compared to 2003.
- **Manufacturing wages and benefits** have increased since the fourth quarter 2001. Average hourly wages in manufacturing rose in May 2005 to $16.52, up 2.7 percent from a year ago. Benefits have increased 6.3 percent in the 12 months ending March 2005.
- **Manufacturing productivity** has increased 83 percent over the past 15 years, while productivity in the total non-farm economy has risen only 45 percent.
- **Institute for Supply Management (ISM)** – data indicates that manufacturing has had 24 consecutive months of growth.

At the Department of Commerce, we are confident that the outlook for manufacturing is good, but we cannot be complacent. The domestic and global economies are fiercely competitive and we will need to work very hard to stay on top. The Administration is committed to furthering conditions for economic growth and improving the overall competitive environment for U.S. manufacturers.

[1] Bureau of Economic Analysis, Department of Commerce
[2] Bureau of Labor Statistics, Department of Labor

The President's Plan
President Bush is committed to policies that create the business environment that encourages innovation, lowers the cost of doing business, makes our economy more flexible and promotes economic growth. For example, the President's plan:

- Allows families to plan for the future by making tax relief permanent.
- Encourages investment and expansion by restraining Federal spending and reducing regulation.
- Makes our country less dependent on foreign sources of energy through a comprehensive national energy policy.
- Expands trade and levels the playing field to sell American goods and services across the globe.
- Protects small business owners and workers from frivolous lawsuits that threaten jobs across America.
- Lowers the cost of health care for small businesses and working families through Association Health Plans, tax-free Health Savings Accounts, and tax credits for employer contributions to Health Savings Accounts, Medical Liability Reform, and health information technology.
- Prepares workers for jobs of the 21st century by improving school standards, reforming workforce training and increasing the number of people served.

Implementing recommendations from the *Manufacturing in America* report
Mr. Chairman, in order to advocate more strongly for the interests of U.S. manufacturers, my first priority was to learn what was most important to them. As such, since taking office in September 2004, I have:

- Visited more than 71 manufacturing facilities;
- Chaired 53 roundtable discussions;
- Addressed 33 industry association groups;
- Participated in five President's Export Council meetings;
- Presided over three Manufacturing Council meetings;
- Attended 11 Chamber of Commerce meetings;
- Led an eight-day trade policy mission to China; and,
- Met with senior officials in Japan.

In total, I have addressed over 14,000 manufacturers.

I am pleased to report that there is a renewed optimism in the manufacturing sector as the majority has plans to increase investments and hire more workers.

We are making great strides in supporting the President's plan through implementing the recommendations of the *Manufacturing in America* report released by Secretary Evans in January 2004. With over 21 recommendations implemented thus far, the Department of Commerce will continue making progress to ensure the competitiveness of all U.S. industry. The recommendations are grouped in the following categories:

1. Enhance Government's Focus on Manufacturing Competitiveness

2. Invest in Innovation
3. Create the Conditions for Economic Growth and Manufacturing Investment
4. Lower the Cost of Manufacturing in the United States
5. Strengthen Education, Retraining, and Economic Diversification
6. Promote Open Markets and a Level Playing Field

I would now like to discuss with you our progress in each of these areas.

1. Enhance Government's Focus on Manufacturing Competitiveness

Establishment of the Manufacturing Council
Secretary Evans established the Manufacturing Council to provide oversight and advice on the implementation of the President's Manufacturing Initiative. Secretary Gutierrez is working with the Council and values its input. In fact, his first domestic trip as Secretary was to the Manufacturing Council's February 2005 meeting in Dearborn, Michigan. In addition, most recently, he hosted a Council meeting in Washington attended by members of Congress.

The Manufacturing Council plays an integral role in identifying priority manufacturing issues and advising the Secretary. We will continue to work very closely with the Council, which has prepared reports on workforce issues, tort reform and market access. These on-going dialogues provide sound information regarding needs of U.S. manufacturing and the impact of federal government efforts.

Establishment of the Interagency Working Group on Manufacturing
Because manufacturing issues cut across numerous federal agencies, Secretary Gutierrez has asked fellow cabinet secretaries to name a manufacturing liaison to serve on an Interagency Working Group on Manufacturing. This Working Group will facilitate a coordinated Federal approach to the challenges facing this sector both domestically and internationally.

Establishment of the Office of Industry Analysis
In January of 2004 the Administration launched the Office of Industry Analysis, which is responsible for assessing the cost competitiveness of American industry and evaluating the impact of domestic and international economic policy on U.S. competitiveness, particularly in the manufacturing sector.

2. Invest in Innovation

Introduction to Innovation Challenges
The rapid advancement in technology has presented challenges and opportunities to U.S. industry. The United States must have a policy environment that promotes innovation, and allows industry to grow and prosper. Success or failure will depend on our ability to support technology investment, research and development, and create new industries, new processes, and important services, —setting the stage for advancing innovation. A partnership between the Federal Government, industry, and academia can accomplish this through strong support of research and development (R&D).

Federal Research & Development

President Bush's FY 2006 Budget request includes a record $132 billion for Federal research and development.

- This represents a 45 percent increase compared to 2001's $91.3 billion.
- President Bush's 2006 budget allocates 13.6 percent of total discretionary outlays to the conduct of R&D—the highest level in 37 years. Not since 1968 and the Apollo program have we seen an investment in R&D of this magnitude.
- In FY 2006, the Networking and Information Technology Research and Development (NITRD) program is budgeted for $2.2 billion, including research directly related to broadband technology.
- Since 2001, funding for nanotechnology R&D under the President's National Nanotechnology Initiative has more than doubled to $1.1 billion.

These investments are a reflection of the importance that President Bush assigns to science and technology to enhance U.S. competitiveness and our ability to solve challenges we face in health, defense, energy, and the environment.

Even in an environment of tight budgets, President Bush recognizes that one of the best tools we have for ensuring that the United States remains the world's innovation headquarters is to lead the world in cutting-edge fundamental research that industry can apply to its processes.

The Administration also recognizes that federal R&D is just one part of the investment that keeps our nation at the forefront of so many fields. Business and industry invests another $200 billion in research – the largest source of R&D funding in the U.S., providing 63 percent of total 2003 R&D funding. State governments, universities and colleges, and nonprofit institutions invest an additional $27 billion.

Interagency Working Group on Manufacturing R&D

The Interagency Working Group on Manufacturing Research and Development was established as a result of the President's Manufacturing Initiative in 2004. Participating agencies include Commerce, Agriculture, Defense, Education, Energy, Health and Human Services, Homeland Security, Labor, National Aeronautics and Space Administration, National Science Foundation, the Office of Management and Budget, the Office of Science and Technology Policy, Transportation, and the Small Business Administration.

The goal of this multi-agency focus is to lead the development and promote the implementation of advanced manufacturing technologies for the benefit of the U.S. economy and the U.S. manufacturing sector, in particular. The Group will also improve planning, coordination, and collaboration among Federal agencies in these key technology areas and to increase the effectiveness and the visibility of the overall Federal manufacturing effort. The working group's objectives are to:

- Identify and integrate requirements;
- Conduct joint program planning; and,
- Develop strategies for the Federal Government's manufacturing R&D programs.

Its functions are to:

- Engage in interagency manufacturing R&D program planning and budgeting;
- Identify opportunities for collaboration, coordination, and leverage among agencies in specific technical areas related to manufacturing R&D; and,
- Identify agency priorities within these areas and gaps among them.

Protection of Intellectual Property

In such an age where competitiveness is increasingly determined by access to new ideas, rather than ownership of physical materials or fixed assets, an innovative society must have sound intellectual property rights (IPR) protection. This includes strong global enforcement, with faster processing of patents. This is of even greater importance today due to the convergence of nanotechnology, biotechnology, information technology, and cognitive technology that will create new industries and new jobs now and in the future.

The Commerce Department, through the US Patent and Trademark Office, has placed an expert IPR Attaché in China to deal specifically with intellectual property rights abuses in that country. We have increased our intellectual property enforcement and compliance staff by 25 percent since 2001.

Secretary Gutierrez is committed to IPR protection and enforcement. He highlighted this commitment on his recent trips to Russia and China, where he sent a clear message that the gap between IPR laws and enforcement needs to be closed. He stated, "Violators need to face prohibitive financial penalties and real jail time, and it's time to do away with small, insignificant slap-on-the-wrist suspended sentences that allow IPR violators to go back into business."

To meet these challenges, the Administration is committed to upgrading the U.S. Patent and Trademark Office. Policies underway will allow the hiring of several hundred new patent examiners. This, in turn, will help ensure that the intellectual property rights of U.S. companies and innovators are upheld across the globe.

Strategy Targeting Organized Piracy (STOP!) Initiative

Commerce is a key member of the STOP! Initiative, which was announced in October 2004. The STOP! Initiative was created to coordinate government-wide activities to confront global piracy and counterfeiting. It seeks to:

- Secure and enforce intellectual property rights in overseas markets;
- Stop fakes at U.S. borders;
- Keep global supply chains free of infringing goods;
- Dismantle criminal enterprises that steal America's intellectual property; and
- Reach out to like-minded trading partners and build an international coalition to stop piracy and counterfeiting worldwide.

In order to provide a one-stop shop, we have established a hotline – (866) 999-HALT – which has received 300 calls since its inception in October of 2004, and set up a website, www.StopFakes.gov.

With this initiative, federal agencies work with America's trading partners to crack down on global piracy and counterfeiting.

3. Create the Conditions for Economic Growth and Manufacturing Investment

If we wish to remain a nation of innovators, we do not want to over-tax industry and commerce and dampen the entrepreneurial spirit. There are key elements of the tax relief passed by Congress and signed into law by President Bush that will expire in a few years.

The Administration has urged Congress to make these vital tax reductions permanent so American families and businesses can make better decisions for their financial futures.

The President has proposed to make the Research and Experimentation (R&E) Tax Credit permanent. The R&E tax credit promotes private sector investment in research and the development of new advanced technologies.

4. Lower the Cost of Manufacturing in the United States

The National Association of Manufacturers has claimed that United States manufacturers faced a 22.4% overall cost disadvantage relative to our chief foreign manufacturing competitors as of 2002.

The cost disadvantage comes from:

- Higher corporate taxes;
- Frivolous law suits;
- Energy costs;
- Unreasonable and excessive regulatory burden, and
- Health care costs.

This burden has had the highest impact on small to medium-size manufacturers – which represent 98% of all manufacturing firms, half of all the manufacturing jobs, and 70% of all new manufacturing jobs.

Cost of Regulations

High regulatory costs have a negative impact on job creation. As mentioned previously, the U.S. manufacturing sector currently accounts for roughly 13 percent of U.S. GDP, employs over 14 million workers, and accounts for over 60 percent of U.S. exports. It is also still the largest in the world. However, the regulatory regime is substantial and compliance costs are rising.

The Office of Management and Budget (OMB) estimated that that the cost of regulations imposed over the last 10 years by the U.S. Government is $35 to $39 billion per year[3]. A 2001

[3] Draft 2005 Report to Congress on the Costs and Benefits of Federal Regulation, available at: http://www.whitehouse.gov/omb/inforeg/regpol-reports_congress.html.

study by Crain and Hopkins found that manufacturing firms face a regulatory burden approximately six times greater than the average firm, and when adjusted for the number of employees, manufacturing firms face a regulatory burden per employee approximately two times greater than the average firm[4]. In addition, technology advances at times outpace the legal and regulatory system. Regulators must support innovators by incorporating private sector input in rule making.

Government-mandated regulations are designed to influence business behavior in favor of the public interest and focus on areas such as environmental protection, health and worker safety, national security, individual privacy, and commercial competition. However, contributions to the public good must be balanced against especially unnecessarily burdensome regulations that increase business costs, reduce productivity, and hinder job creation.

In addition, cost estimates often address only the direct expense of regulation compliance, such as reporting requirements and factory retrofitting, but these rules can also lead to increased prices, lower product quality, and other intangible costs like loss of business freedom. Most importantly, from a global competitiveness and economic growth standpoint, regulations can reduce innovation by inhibiting new ideas, constraining product development, restricting production process design, or encumbering marketing strategies.

Streamlining regulation is an important component in the President's economic agenda. The Administration has taken several positive steps toward targeting burdensome regulations for reform. The Office of Management and Budget's Final 2004 Report to Congress on the Costs and Benefits of Federal Regulations outlined 189 regulations nominated for reform through private sector input.

After a federal agency review, including the Office of Manufacturing and Services, OMB published a list of 76 priority nominations. Manufacturing and Services (MAS) is now working with OMB to assess these regulations to find how any proposed changes might affect manufacturers. In MAS, we are focused on enhancing our regulatory expertise and will continue to work with OMB and other agencies.

Tort Reform

We must also be mindful of the effect that higher levels of expected liability costs have on innovation. Due to the higher level of expected costs, firms often have to limit innovation, withhold a product from the market, or forgo hiring. If we are going to have an innovative society, we have to have a strong legal policy that supports innovation, entrepreneurship, and allows business to allocate risk in a transparent manner.

The President has proposed measures that would support this goal. We took an important step when Congress passed and the President signed legislation aimed at bringing back fairness to our federal class-action lawsuits. We need to keep working to address other important related issues such as asbestos reform and medical liability.

[4] Crain, W.M. and T.D. Hopkins 2001. "The Impact of Regulatory Costs on Small Firms." Report prepared for the Office of Advocacy, U.S. Small Business Administration. Available at http://www.sba.gov.

Health Care Costs

Another aspect of competitiveness is health care costs. Healthcare costs represent the largest and fastest rising cost faced by U.S. businesses. In order to maintain a competitive and innovative environment where business and job-creation can flourish, we need to make health care more affordable and predictable.

In response, the President has proposed Association Health Plans that would afford small businesses greater leverage in negotiating the cost of health insurance with providers. This proposal allows small businesses to pool together to purchase health coverage for workers at lower rates. The Administration also worked to establish health savings accounts to give workers more control over their health insurance and costs. The Administration believes it is important to also reduce frivolous lawsuits against doctors and hospitals that drive up insurance costs for workers and businesses. In addition, the President's Health IT Initiative is designed to reduce errors, cut waste, and lower costs. The President's goal is to make electronic medical records universally available for most Americans in the next ten years.

National Energy Policy

Energy costs are a major concern for manufacturers. Manufacturers consume about one-third of the U.S. energy supply –including 40% of the natural gas and 30% of the electricity. That is why the President's energy policy is really a manufacturing jobs plan.

President Bush believes the growing U.S. economy requires affordable, reliable, and secure supplies of energy. The President has outlined his broad vision to move America toward less energy dependence and urged Congress to enact a national energy policy.

5. Strengthen Education, Retraining, and Economic Diversification

Increasingly, sophisticated education and training systems are essential to ensuring that our workforce is fully equipped to compete in a truly global marketplace. A talented and skilled workforce allows manufacturing companies to succeed and drive innovation. Innovation increases the role of high value-added work to sustain our economic prosperity.

In order to stay competitive in the face of rapid technological change, we need to build the best skills and attract the best minds. Securing a high quality labor force requires an education system that is second-to-none and an effective worker training infrastructure that includes vocational training as well as worker retraining programs.

To address these issues, the President has a number of initiatives that would support U.S. manufacturers' education and workforce needs.

For example:

- The President has announced a new High School Initiative that will allocate $1.5 billion in his Fiscal Year 2006 Budget to ensure that every high school student graduates with the skills needed to succeed in college and in a globally competitive workforce.

- In the area of training, the President has provided $250 million in new competitive community-based grants under the Jobs for the 21st Century Initiative to strengthen worker training in technical and community colleges.
- He has also called for the creation of Innovation Training Accounts under which workers would have more choices about their training through increasing the use of personal job training accounts focused on instruction in high-growth job fields.
- Under the President's High Growth Job Training Initiative for Advanced Manufacturing, we have invested more than $60 million to develop model partnerships between employers, training providers, and the workforce investment system, in order to identify and replicate best practices in workforce development that help U.S. manufacturers retain and increase their competitiveness in the global economy.

6. Promote Open Markets and a Level Playing Field

Opening export markets and removing trade barriers are the key to U.S. manufacturing competitiveness. Free and fair trade provides U.S. companies with new markets and opportunities for our products and services.

Free Trade Agreements

As an example of our approach to opening markets, the President has signed into law several new Free Trade Agreements (FTAs) that will enable U.S. manufacturers to compete on a level playing field in these markets for the first time.

The Chile FTA, which became effective on January 1, 2004, boosted U.S. exports to Chile by almost a billion dollars, and increased U.S. market share of Chilean imports for the first time since 1995.

Looking at another example – the U.S. - Australia FTA – more than 99 percent of U.S. manufactured goods exports to Australia have immediately become duty free. Manufactured goods account for 93 percent of U.S. exports to Australia

CAFTA-DR is another vital instrument for leveling the playing field. Eighty percent of all exports from the CAFTA region enter the United States duty-free. U.S. manufacturers do not currently share in these benefits. However, they will under CAFTA. With this agreement, remaining tariffs will be phased out over the next 10 years.

Bilateral and regional FTAs help us encourage integration to meet some of U.S. industry's most important goals – a level playing field for exports, intellectual property protection, and a single set of standards leading to a more cohesive, integrated trading environment for our exporters and investors in that region.

The United States has concluded a total of ten FTAs – opening up the export markets of these countries to American industry and its workers. Of the ten agreements, the Bush Administration has entered into force FTAs with five countries -- Jordan, Chile, Singapore, Australia, and Morocco (Morocco FTA in force as of July 1, 2005). New and pending FTA partners, taken together, would constitute America's third largest export market and the sixth largest economy in the world.

These agreements are meaningful for the United States. They are comprehensive and in many cases carry immediate benefits. They contain broad commitments that provide a predictable environment for our exporters and investors.

Standards

The Department of Commerce Standards Initiative launched by Secretary Evans in March 2003 underscores the need to have consistent technical standards worldwide. The initiative responds to strong U.S. industry concerns that barriers associated with implementation of foreign standards and technical regulations are now one of the greatest challenges to expanding exports.

Increasingly, technical standards are being mandated around the world through government laws and regulations. This is becoming a critical issue for global competitiveness, since they can either facilitate or impede international trade. In the United States, technical standards are largely voluntary and market-driven, although with strong government participation and support.

Many U.S. companies view discriminatory or unnecessarily trade restrictive standards as the primary trade barrier today, and it is estimated that standards issues impact 80 percent of world commodity trade. Major impediments to free trade include the establishment of standards specific to a nation or region, redundant testing and compliance procedures, and unilateral and non-transparent standard setting processes.

Open and transparent standards adoption generally has a positive effect on fostering innovation. Vendors that adopt the standard determined by the marketplace are rewarded by greater sales and production efficiencies. This, in turn, provides additional funding for new rounds of research and innovation.

The Department of Commerce supports the adoption of voluntary standards, whenever possible and the development of standards in an open and transparent manner with industry input. The Department also supports a policy of technology neutrality in government procurement and other public actions. Technology neutrality allows the market to decide which products are best and stimulates technology advancement.

Conclusion

Prior to this job, I have spent my entire career in the business sector building a manufacturing company. One of the lessons I have learned is that business continually needs to innovate to grow, produce new and better products, and remain competitive. Many manufacturers are implementing lean production procedures to remain competitive. While improved means of production is important, I continue to convey that without innovation there is no life after lean. American leadership in innovation and the development of new ideas and technologies holds great promise for our generation and the next.

There are no magic formulas. We realize there are many challenges facing U.S. manufacturing, and while we are making progress, there is much more to do. A strong and vibrant manufacturing sector is critical to providing jobs and maintaining a growing healthy economy.

Like the President and the Secretary, I am an optimist. I know that when we lift the burdens from our manufacturers, their creativity, their innovation, and their work ethic will continue to make our economy the marvel of the world.

I look forward to working with this Subcommittee to meet the challenges facing U.S. manufacturing and welcome any questions you may have. I am also very interested to listen to the views of the Subcommittee on how we at the Department of Commerce might best advance these efforts. Together we can work to ensure that the U.S. continues to remain the technological and economic power that it is well into the 21st century.

Thank you.