UNITED STATES BUSINESS AND INDUSTRY COUNCIL

FIGHTING FOR AMERICAN COMPANIES AND AMERICAN JOBS SINCE 1933

Testimony of Alan Tonelson
Research Fellow
U.S. Business and Industry Council Educational Foundation
before the
Subcommittee on Terrorism, Nonproliferation, and Trade
Committee on Foreign Affairs
U.S. House of Representatives
July 17, 2008

Good morning, Mr. Chairman, Mr. Ranking Minority Member, and Members of the Subcommittee. I am very grateful for the opportunity to testify today on behalf of the U.S. Business and Industry Council and the more than 1,500 member companies it represents on the effectiveness of government action to help U.S. companies and investors do business abroad.

USBIC has been advocating for family-owned and other privately held companies – mainly small and medium-sized manufacturers – since 1933. The organization has been especially concerned about U.S. trade policy for the last two and a half decades. Our members overwhelmingly are capital- and knowledge-intensive companies. Typically, they supply precision components for large, extremely advanced machinery systems ranging from motor vehicles to aircraft to machine tools to medical devices to telecommunications networks. As such, they generate the types of technological progress, productivity gains, and living-wage jobs central to America's economic success so far and its economic prospects. In addition, the advanced production and innovation capability they embody, and the workforce skill levels they foster are critical for maintaining the world-leading defense manufacturing base on which our national security rests.

Our companies have been so competitive that they have survived literally decades of major U.S. trade policy failures – from Washington's unwillingness to respond effectively to predatory Japanese and European practices to its fateful, disastrous decision in the late 1980s to transform U.S. trade policy largely into an exercise in promoting the offshoring of production and jobs. Increasingly, however, the cumulative effects of these failures have been grinding these companies down, and convincing their owners that they should get out while the getting's still reasonably good. They believe – and the record makes clear – that foreign government support for their competitors will continue to intensify, while their own government remains generally asleep at the switch

Smaller and medium-sized domestic manufacturers generally rely heavily on domestic sales. Lack of

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(202) 728-1980 • (202) 728-1981 FAX • COUNCIL@USBUSINESS.ORG • WWW.AMERICANECONOMICALERT.ORG

resources, experience, and international contacts tends to make investing in foreign countries or even exporting directly to them prohibitively expensive. They are simply not in a position to absorb the kinds of front-end costs and take the risks required to set up foreign sales networks and support them over the long-haul – an indispensable ingredient of overseas success. The prospect of dealing with regulatory difficulties, intellectual property theft, and outright corruption is also extremely intimidating – especially in countries with little or no tradition of rule of law.

Moreover, these companies rightly believe that the U.S. market in its own right is by far their most promising in economic terms due to high incomes. Numerous foreign enterprises and governments, they constantly observe, have keyed their business and economic development strategies toward selling to the United States. The case for American companies being similarly focused is that much stronger.

Yet no business owner worth their salt is going to overlook a financially sensible revenue possibility, and many smaller domestic manufacturers export robustly and work hard to increase their foreign sales. The dollar's recent weakness against the Euro and many other major currencies clearly have opened opportunities – and produced results – that would have been inconceivable just a few short years ago.

To be sure, few small and medium-sized manufacturers I speak with – whether members of USBIC or prospects – are looking at the weak dollar as a cure-all. They know that currency manipulation is only one of many types of predatory trade practices in which foreign governments engage. Moreover, the revaluations in China and to a lesser extent Japan have unfolded much more slowly – and are likely to fall short of the mark needed to restore their price competitiveness vis-a-vis these two enormous trading partners.

These manufacturers also are starting to recognize a major downside to the weak dollar – exploding prices for the fuels, metals, and other commodities they require, which have hammered at their margins. And they realize that once started, a weak-currency policy can be very difficult to stop, especially for a country with enormous external debts like the United States.

Yet export markets continue to be of significant interest to many of these businesses. In addition, developments in foreign markets can decisively affect them in another important way. Specifically, foreign government actions and policies – ranging from currency manipulation to discriminatory value-added tax systems to illegal subsidies to lax environmental and worker safety regulations – can have a make-or-break impact on their competitiveness in the U.S. market and in third-country markets. So, by extension, can the U.S. government's poor record of addressing them.

The damage done by these U.S. trade policy failures can be seen far beyond the ranks of the small and mediums-sized companies with which USBIC works most closely. As is well known, the U.S. manufacturing sector has suffered immense job loss and unprecedented wage stagnation, on top of running up enormous trade deficits over every significant recent time period one cares to examine. Less well known, however, are several measures of domestic manufacturing's competitiveness that carry an even more worrisome message.

For example, from 1997 through 2006 (the latest data available), the import share of the domestic manufacturing market jumped from 19.46 percent to 27.70 percent. For many advanced manufacturing sectors, like semiconductors, turbines, machine tools, and construction equipment, the levels of import penetration are much higher and their growth much faster. These data make clear that even many U.S. "industries of the future" are fighting a losing battle in their own home market, where they should enjoy enormous natural advantages. The data also indicate that the United States is becoming a much less competitive site for such advanced manufacturing.

Further, from 1997 to 2007, although overall U.S. economic growth totaled nearly 67 percent before adjusting for inflation, manufacturing output expanded only 26.25 percent, Measured as value-added, manufacturing's annual growth rate has been in steady decline since 1977. Excluding the tech bubble of the 1990s, the annual growth rate of manufacturing capacity shows similar feebleness, and since 2000, capacity expansion has virtually halted. In other words, U.S. manufacturing has a major output problem in addition to a major employment problem.

The recent weakness of output is all the more disturbing considering how accommodating the policy environment has been for the economy. Even before the Federal Reserve's radical interest-rate cutting and the tax rebate-induced rebound in the federal budget deficit since last summer, interest rates remained at multi-decade lows for years after the last recession ended, money supply growth exploded, the federal budget balance experienced a record swing from surplus to deficit, and the dollar weakened considerably. Yet despite the greatest injection of peacetime stimulus ever provided in U.S. history, industrial output lagged and overall growth remained subpar. Washington was flooring the accelerator, but the car was only chugging along. Clearly, something has gone terribly wrong with the nation's engines of growth.

Thus to remain strong in export markets, and to prevent predatory foreign practices or simple policy and regulatory arbitrage from disadvantaging American firms in markets around the world, U.S. officials need to be forceful advocates and crackerjack problem solvers. Yet in the experience of USBIC member companies, both descriptions are wide of the mark. Indeed, Washington's efforts on their behalf appear to be woefully inadequate, as the following two representative examples should make clear.

Kason Industries of Shenandoah, Ga., is the world's leading manufacturer of commercial refrigeration door hardware and employs some 250 workers. Since its founding in 1926, this privately held company has expanded into hardware and accessories for food service equipment, truck bodies, material handling, and industrial fabrication, among other markets.

The owner of about 50 U.S. patents, Kason is typical of the untold numbers of smaller manufacturers that rely heavily on continuous innovation. Although Kason believes that the domestic U.S. market will remain by far its most important, foreign sales represent about 15 percent of the company's total sales. In addition, Kason has been forced to start sourcing some component parts from China largely because of the PRC's predatory economic practices.

Kason has been encouraged by the U.S. government to take fuller advantage of high economic growth rates in China and other emerging market countries, but finds that federal officials lack a basic understanding of business realities on the ground. In particular, they appear to be ignorant of how

predatory foreign actions and policies can much more than offset whatever market research, networking, and regulatory compliance advice Washington can provide.

For example, Kason's experience with the China market and Chinese competitors includes patent infringement as well as Chinese policies that directly and significantly affect the company's bottom line – and thus its price competitiveness These include the effects of currency manipulation, subsidized steel costs for China-based rivals, and a 13 percent rebate of the country's value-added tax granted to fabricated steel products that are exported. (The full value-added tax, it must be noted, must be paid by Kason for all of its exports to China, thus artificially raising their prices in China.)

According to Kason executives, federal-level legislators they have met often sing the praises of emerging markets, but seemed completely unaware of the discriminatory effects produced by a combination of VAT systems in most of these markets combined with America's failure to reciprocate. In fact, Chinese competitors have told Kason that they could afford to offer their products to U.S.. customers at or below production costs because the VAT rebate provided their profit. Kason has also been courted by the U.S. Commercial Service, whose Atlanta, Ga. office has offered to help the company make business connections abroad, conduct surveys, and satisfy regulatory requirements. But Kason has yet to hear about a program that can help the company overcome the bottom line costs imposed by currency manipulation, VAT rebates, and other subsidies.

Incidentally, China is far from the only country presenting VAT-related problems to American industry. Kason reports losing almost all of its Italy business because of that country's 19 percent VAT, and that Spain's 16 percent VAT has been a major impediment to its potentially important appliance production market. Although VAT rebates do not appear to be a problem because neither country competes with Kason in the U.S. market, their VATs plus the freight and fees exporters like Kason need to pay to sell into their markets give Italian and Spanish producers a big edge in hanging on to their domestic customers.

Legislation to remedy the VAT situation – which could be responsible for as much as half the U.S. merchandise trade deficit – was introduced in the House in 2007. But the Border Tax Equity Act (H.R. 2600) has garnered only a handful of supporters.

The members of the Polyurethane Foam Association face somewhat different problems, but Washington's response has been just as ineffective. These companies produce flexible polyurethane foam that is used primarily in cushioning material in upholstered furniture and mattresses, and they employ more than 30,000 American workers.

As the Association's submission for the record makes clear, many of the most helpful measures Washington could take on their behalf would mainly affect the conditions of American production. For example, because the suppliers of their principal chemical raw materials have not adequately maintained their U.S. manufacturing base, the flexible foam makers must increasingly rely on imported ingredients. The United States maintains a 6.5 percent tariff on these imports, but not on the finished foam product.

The Association has investigated the possibilities of winning a tariff suspension for these chemicals, but has been told by the U.S. Trade Representative's office to get at the end of a long line of similar requests.

The Association has also sought to persuade Congress to pass the legislation ultimately needed for the suspension, but to date no progress has been made.

The Association has no way of knowing how import levels have changed in recent years as a result of their relatively high production costs. Flexible polyurethane foam products have not been granted their own category in official systems for classifying the economy, despite repeated requests to do so by the PFA. Yet the foam makers do know that between 2005 and 2007 alone, their domestic output has dropped from 1.7 billion pounds to 1.3 billion pounds. A major reason: Much of the production of foam-using furniture has shifted to locations such as China. Indeed, during the above two-year period, Commerce Department data show that annual imports of upholstered household furniture from the PRC jumped from $1.1 billion to $1.7 billion.

The relatively high cost of foam production in the United States, of course, has created big obstacles to efforts by the U.S. foam producers to take the obvious step of trying to supply the growing upholstered furniture production markets in China and other developing countries. But the foam-makers also face another substantial problem – these countries' failure to impose the same regulatory burdens on its own producers that are borne by producers in the United States and other high-income countries.

Thus, as the PFA's submission shows, evidence abounds that China and other developing country producers make much of their flexible polyurethane foam with Ozone Depleting Chemicals such as CFC-11, whose use has been subject to an excise tax in the United States since 1990. The tax is supposed to be imposed on importers of products using these materials as well, but little enforcement of this provision is evident.

Producers in China can realize another cost break by using suspected human carcinogens such as methylene chloride n their foam. This very low-cost substance has not been used in American flexible polyurethane foam production for nearly two decades. But what is known about Chinese production methods – as presented in the PFA submission – indicates that use of CFCs or methylene chloride is widespread. Moreover, adopting safer alternative production methods and purchasing the needed equipment would add another layer of cost to Chinese production, and reduce major inequities in the trade relationship.

Unfortunately, many of these are problems that the U.S. government is simply not structured to deal with effectively. The Internal Revenue Service can and should review its enforcement activities related to the ODC Excise Tax on both imports of flexible polyurethane foam itself and of finished goods containing such foam. Yet the cost of continuously inspecting the vast Chinese and other developing country production complexes alone clearly would be prohibitive.

All of which leads to a fundamental conclusion I hope that subcommittee members, their colleagues in the House and Senate, and Executive Branch officials will take seriously. The companies whose experiences I have described here clearly would welcome more effective assistance from Washington on various discrete, specific problems they encounter in overseas markets.

Yet as they also make clear, this piecemeal approach simply will not be enough. As one of them has put it, "The underlying problem is not lack of government help to overcome bad policy. The problem is the

policy, which has indiscriminately opened U.S. markets to countries that don't share our regulatory values and/or economic priorities, and whose governments protect and support their industrial bases far more than does America's.

So the companies USBIC represents – and doubtless many others – certainly appreciate the subcommittee's interest in improving the performance of government agencies tasked with advocacy and problem-solving for U.S. firms in foreign markets. But they are also fervently hoping for changes in America's broader international trade strategy.

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