

Will Obama's plan to boost manufacturing jobs work?

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By Pete Engardio

Is Washington finally getting serious about doing something to shore up America's flagging global competitiveness in manufacturing? There are certainly some signs in recent moves by President Obama.

The president has promised to listen to the needs of business more carefully and declared that America must "out-innovate, out-educate, and out-build the rest of the world." He has visited factories in the hard-hit Midwest and appointed General Electric CEO Jeffrey Immelt to head a new jobs panel. And Wednesday, President Obama unveiled an initiative to increase training of skilled manufacturing workers. But do these moves add up to a manufacturing policy? Yes and no.

On one hand, Obama's administration has been one of the most active in recent years when it comes to intervening to support industries seen as strategically important for America's industrial future.

The rescues of General Motors and Chrysler were the most prominent examples. The administration also pumped \$2.4 billion in loans and grants into dozens of factories involved in production of next-generation lithium-ion batteries for cars, an important new industry that once seemed destined to take place entirely in Asia. Washington gave similar subsidies to developers of innovative solar-power modules. And Congress has approved tax credits for building and modernizing factories.

Handing out those kinds of subsidies is controversial. Many economists and conservatives don't think the government should be in the business of picking and choosing industries to favor. Given the heavy subsidies that rivals such as China and Germany are willing to shell out to attract these kinds of factories, however, others argue that this kind of government intervention is necessary in today's global economy.

Yet even those who believe such investments are smart see problems with the current programs. Most of the loans and grants for new factories are part of one-off programs included in the American Recovery and Reinvestment Act of 2009, the Obama stimulus bill that Republicans revile. Convincing Congress to make them permanent fixtures of U. S. policy will be tough. What's more, they benefit only a handful of manufacturing industries that meet strategic goals, such as cutting greenhouse-gas emissions and promoting renewable energy.

The main thrust of the Obama plan to boost U.S. competitiveness so far has been to propose big funding increases for research and education. The idea is that will spur more American

innovation, which in turn will translate into new products, companies, industries, and ultimately high-paying manufacturing jobs.

No question, spending more on education and basic research could help spur innovation in the long run. But it will do little to create manufacturing jobs in the near future.

Even though other countries are catching up in science, the U.S. still far outspends any other nation on research and development. America generates the most patents, has the biggest concentration of top-notch universities, and remains the best place in the world to start up a new company. Whether the industry is renewable energy, micro-electronics, or new materials, the United States is at the technological vanguard

The problem is that once it comes time to make a high-tech product at any kind of scale, the manufacturing work and most of the jobs and supply industries that accompany it often head offshore, typically to Asia. Cheap Chinese labor has little to do with the problem, because most modern factories are highly automated. Besides, if wages were the only issue, how can one explain Germany's ability to keep running up huge trade surpluses in everything from vehicles and machinery to wind turbines? Factory wages and benefits now are much higher in Germany than in the United States.

American inventions are industrialized elsewhere because the United States is not a cost-competitive place to build modern production capacity. Former Intel CEO Andy Grove notes that thanks to differences in taxes and government incentives, building a state-of-the-art silicon wafer plant offshore rather than the U.S. can yield \$1 billion in additional profit.

While Asian nations waive taxes for 10 years to attract industries they covet, U.S. companies pay some of the highest corporate taxes in the industrialized world. Between state and federal levels, U.S. manufacturers are taxed at 39.3 percent, compared to a median rate of 33 percent for other industrialized nations, according to the Organization for Economic Co-operation and Development. The Manufacturing Institute estimates that non-production expenses such as taxes put U.S. factories at an 18 percent cost disadvantage compared to average offshore locations.

Moreover, the cost of capital in the U.S. is high, if it can be raised at all from banks or investors. In Germany, China, South Korea, and other nations, industry can tap government development banks for low-interest loans. In much of the U.S., the regulatory hurdles are also complex and too time-consuming to navigate. Nations such as Singapore have one-stop shops that take care of all the necessary permits within days.

Even if they are willing to shoulder these burdens, many U.S. companies that want to manufacture at home run into other more practical problems. Many high-tech manufacturing industries have been so hollowed out by years of offshore outsourcing that modern factory capacity, key suppliers, experienced managers, and engineers with up-to-date know-how are hard to find in America. Rebuilding this industrial base will take years.

Countries such as Germany, South Korea and Taiwan also have lost plenty of factories to lower-cost countries. But they remain export powers because they refused to let go of the parts of their

industrial bases that were necessary to sustain the next wave of more advanced industries. They shower domestic manufacturers with financial help and state-funded research institutes that employ armies of engineers who help local companies apply new technologies into innovative products. If a strategic industry is a little ahead of its time, such pro-manufacturing governments also help build a domestic market for cutting-edge products.

Take Germany. When the Great Recession hit in 2008 and forced companies to cut production, the government didn't just hand out unemployment benefits. It paid half of workers' wages so that companies could hold on to them until recovery came. Rather than focus only on basic research--the focus of most U.S. government research spending--Germany has the Fraunhofer Institutes, which have a \$2.2 billion annual budget and 17,000 technical staff that work hand-in-glove with German manufacturers big and small to develop new products. Germany also spends around six times more than the U.S. on research and development related to manufacturing.

China uses generous subsidies and its immense government purchasing power to build markets in next-generation industries it wants to dominate, such as wind turbines, electrified vehicles, and solid-state lighting devices. The caveat: The products must be built domestically.

The Obama Administration is getting the message about building domestic markets. It has announced a goal of putting 1 million advanced-technology vehicles on American roads by 2015. To help make that happen, it suggests giving U.S. consumers an instant \$7,500 rebate when they buy an electric vehicle. It also proposes that the federal government start converting much of its fleet of 700,000 vehicles to hybrids and electric cars and trucks.

Given the intense political pressure to slash government spending of any kind, however, there is little chance the U.S. can come close to matching many of the subsidies offered by other nations. Washington can, however, overhaul the U.S. corporate tax system to cut the cost of building capacity on U.S. soil. Congress could boost applied research aimed at helping companies turn discoveries into commercial products and manufacturing processes. The U.S. also could set up a development bank of sorts to lend to U.S. manufacturers who need to build or expand factories when money isn't available from private capital markets.

Such actions may have little political traction for now. But they lie at the heart of reviving U.S. competitiveness in manufacturing.

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