

MakingItInAmerica



Pittsburgh, G-20 and the New Economy



Lessons to Learn, Choices to Make

By Eric Lotke

America's economy is now struggling to recover from the Great Recession. But even when the economy was said to be humming, it did not work for most Americans. Wages were stagnant or declining and the costs of basics – health care, housing, college – were soaring. Growth was built on unsustainable debt, as the country borrowed \$2 billion a day from abroad and Americans spent more than they earned. Wall Street captured fully 40 percent of the country's profits.

President Obama has stated that we can't go back to the old economy, and shouldn't want to. We must make more, sell more and consume less. The question is: What is our economic strategy in a global economy?

"The fight for American manufacturing is the fight for America's future," Obama has declared. That fight will require a fundamentally different economic strategy, one that will ensure a sustained prosperity that is widely shared, one that will leave the American dream within reach of those who work hard.

Making It In America is a new project sponsored by the Institute for America's Future in conjunction with its sister organization, the Campaign for America's Future, to expand these discussions from small groups of experts into a broad public debate. Through conferences, papers and an aggressive effort to engage the press and the blogosphere, IAF and CAF will seek to further explore and debate America's global economic strategy, with an emphasis on reviving manufacturing as a key element in the new economy.

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By Eric Lotke

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America faces daunting challenges. Jobs are scarce, roads are crumbling and states are reducing vital services. We face staggering levels of public and private debt.

It is fitting that the G-20 meet in Pittsburgh at this time. As White House spokesman Robert Gibbs explained, “[Pittsburgh] has seen its share of economic woes in the past, but because of foresight and investment is now renewed, giving birth to renewed industries that are creating the jobs of the future.”¹

Gibbs is right, in part. Pittsburgh has come back from enormous setbacks in its dominant industry, steel. A combination of deliberate planning, public investment, and partnerships between government and private industry created a new, mixed economy better able to compete in challenging new conditions.

But optimism is only half the story. As we documented in our earlier report, *Pittsburgh, The Rest of The Story*,² Pittsburgh’s comeback reveals the limitations of local efforts. In the absence of a national industrial strategy and a different approach to trade, the U.S. will be lucky to end up where Pittsburgh is now. It’s not the cellar, but it isn’t the Super Bowl either. Pittsburgh’s population is declining and its young people are leaving. Many high-paying jobs in manufacturing were replaced with low-paying jobs as waiters or hotel clerks, and many were never replaced at all. Real attention is needed to address the unsolved half of the problem.

The Revenge of the Real Economy

America grew up as an industrial superpower, from mass-produced automobiles to the Arsenal

| Pittsburgh recent history: A glass half empty ¹ | | |
|--|-------------------------|---------------------|
| | Job change 2001-2008 | Avg. salary 2008 |
| Manufacturing | - 15,199 | \$57,335 |
| Leisure and Hospitality | + 3,459 | \$20,029 |
| Accommodation and Food Services | + 3,198 | \$14,938 |

of Democracy. But our once-robust system of economic production — the invention, design and manufacture of products — has been steadily eroded. In its place has come an economy based on asset bubbles and foreign borrowing. We’ve shifted from production

to consumption, from high wages to low wages, from creditor to debtor. Even when the economy was growing, we ran a current account deficit in excess of \$700 billion every year.³ We borrow \$2 billion every day to cover the difference.

That strategy was never sustainable and is no longer available. Now is the time for a new economic strategy, one based on balanced growth for the nation and living wages for the people. As President Barack Obama said in April, we need a larger vision of America's future:

“.... a future where sustained economic growth creates good jobs and rising incomes; a future where prosperity is fueled not by excessive debt, or reckless speculation, or fleeting profits, but is instead built by skilled, productive workers, by sound investments that will spread opportunity at home and allow this nation to lead the world in the technologies and the innovation and discoveries that will shape the 21st century.”⁴

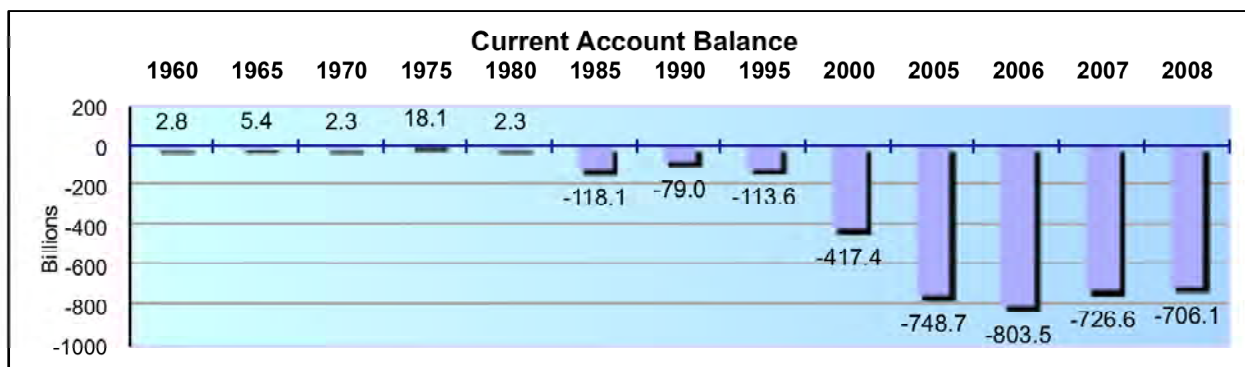
The Goods on Goods

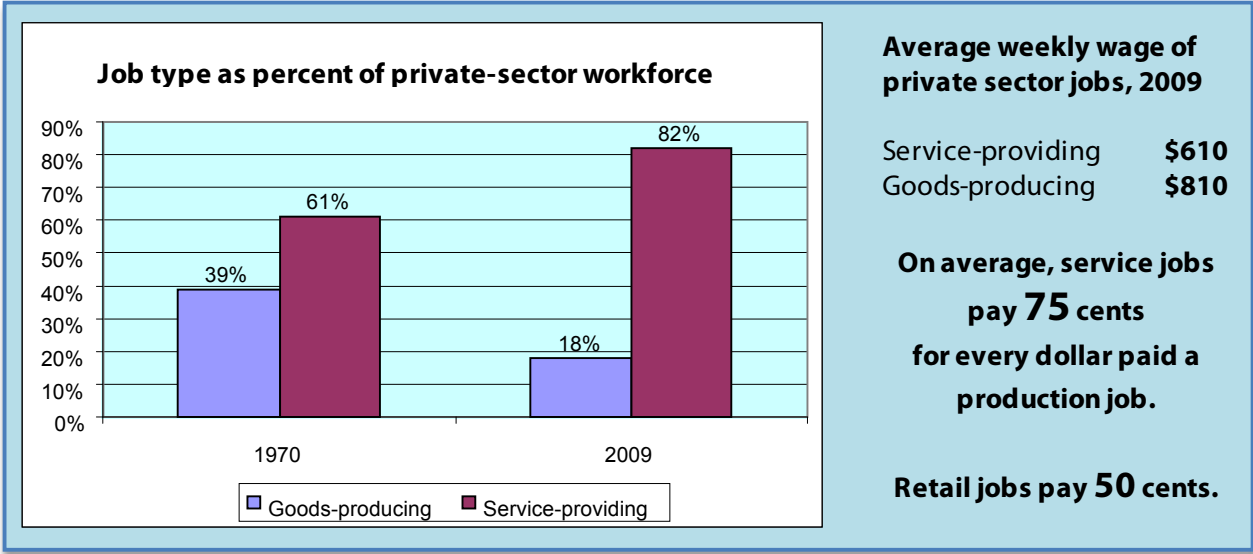
A key component of economic power is the production of goods. Too often, modern Americans associate manufacturing with horse carts and buggy whips. We think of dirty old industries that economic evolution will naturally replace with high-end services in America and low-wage workers in other countries. We don't appreciate that manufacturing still constitutes 12 percent of U.S. gross domestic product, 60 percent of U.S. exports and 70 percent of private sector research and development.⁵ If we hope to move beyond the production of goods, we need to think what would replace it.

Services alone are no path to prosperity. Recent history makes that clear. Between 1970 and 2009, goods-producing jobs shrank from 39 percent of the private sector workforce to 18 percent (a decline of 54 percent). At the same time, service jobs increased from 61 percent to 82 percent (an increase of 34 percent).⁶ But service jobs don't pay as well. Even in the broad category of “services” — which includes high-end professionals such as doctors, lawyers, and investment brokers — service-providing jobs have an average weekly wage of \$610 compared with \$810 in the goods-producing sector. The average weekly wage in retail trade is just \$400.⁷

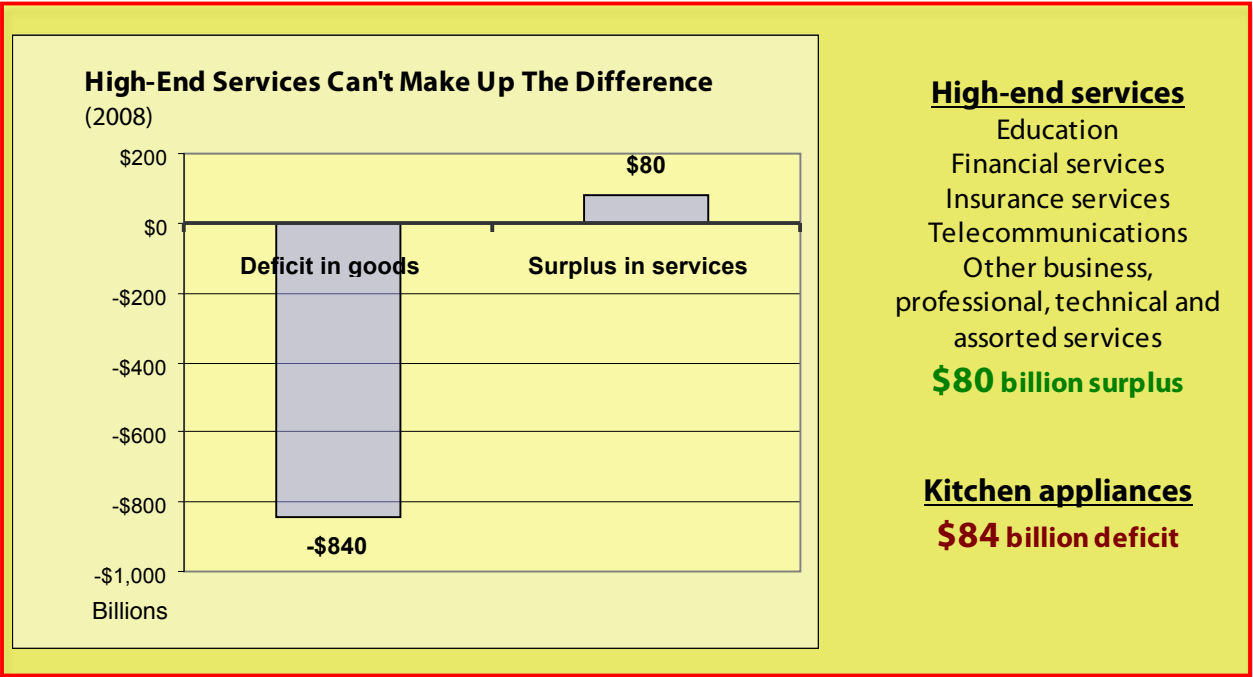
Even if the U.S. service sector were to specialize in fields in which it has a “comparative advantage” — high-end services, financial trade, telecommunications — it's not enough to power the economy. Ralph Gomory, formerly the senior vice president for science and technology at IBM, puts the theory of comparative advantage in perspective:⁸

“Ignored in all these discussions is the obvious fact that when you don't make for yourself the things you need, you will have to trade for them. If you have to import cars and all sorts of manufactured goods, you will be importing on a large scale; to trade for them you will need to create additional goods or services that you can export on an equally large scale.”

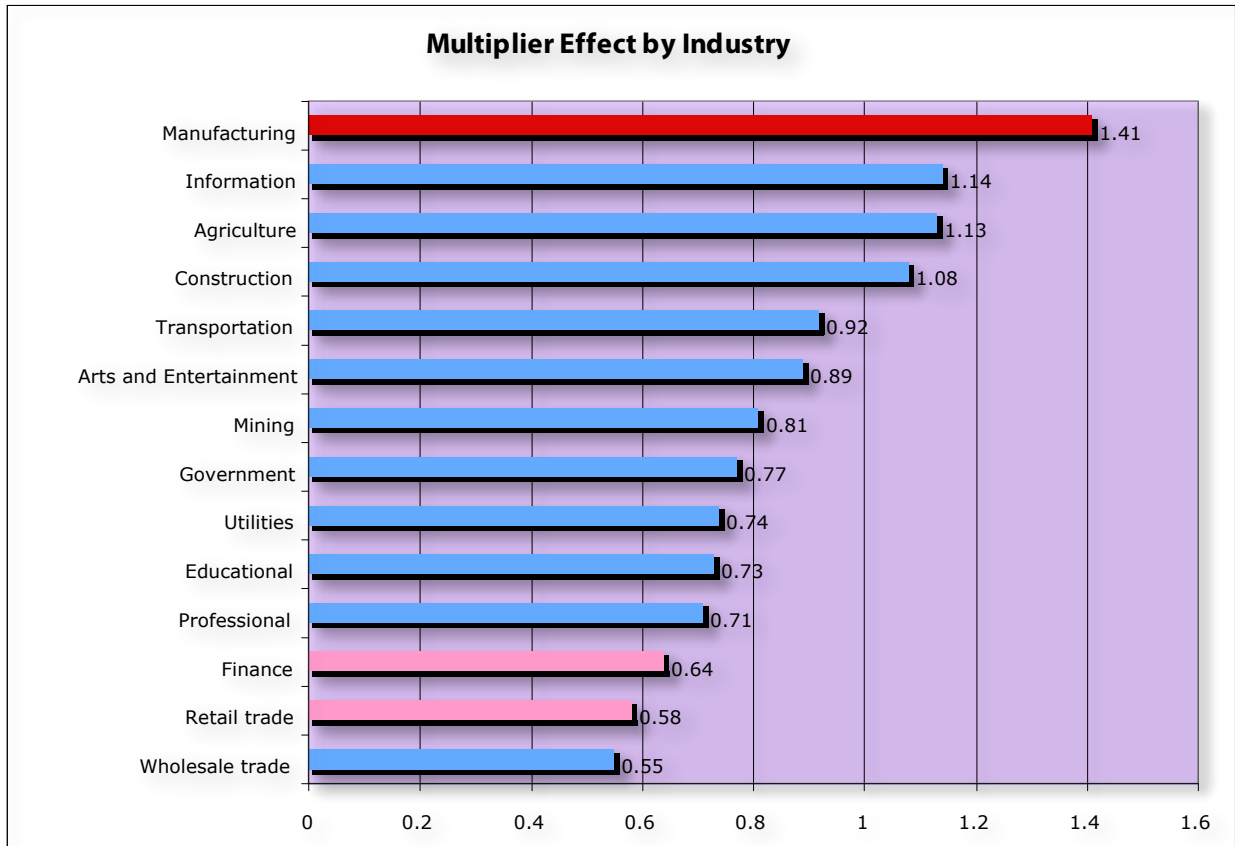




The United States imported \$840 billion more goods than it exported in 2008. We can't make up a deficit that large with specialty items. Indeed, the bulk of our high-end service exports — education, financial and insurance services, telecommunications, and all other business, professional, technical and assorted services⁹ — totaled \$233 billion in 2008. And we imported \$153 billion of such services, generating a surplus of only \$80 billion. That \$80 billion surplus in high-end services isn't big enough to offset the \$840 billion deficit in goods. We have a deficit of \$84 billion just in kitchen appliances.¹⁰



What’s more, many of those high-end services are related to the production of goods. Fully 70 percent of U. S. research and development relates to manufacturing.¹¹ The next generation of thin, low-cost solar cells will be developed by companies planning to manufacture them, as will the batteries for hybrid motor vehicles and the computers and software used to design them. The innovative edge of manufacturing is why developing nations are so keen to move production inside their borders, and they provide subsidies to make it happen.



Finally, manufacturing has a greater “multiplier effect” than other industries.¹² Manufacturing adds value to the economy by enabling production workers to buy housing, sandwiches, and financial advice from other sectors of the economy, and the impact multiplies as those workers buy goods or services from other sectors. The relationship can track “backwards” from manufacture (such as mining or plant construction) or “forwards” (such as transportation and trade of the finished product). Manufacturing has twice the multiplier effect of financial services or retail trade.

Turning Around: Two Lessons from Pittsburgh

Pittsburgh’s fall, renaissance and continuing troubles, contain lessons for the entire nation. Two lessons stand out: the need for industrial policy and the high cost of so-called “free” trade.

Industrial Policy. When steel started to decline in the 1970s, Pittsburgh didn’t just mourn its losses and wait for an invisible hand to lift it up. It designed a solution. Public and private interests came together to form the Regional Economic Revitalization Initiative and revitalize the Allegheny Conference. Members included the Pittsburgh mayor, the Allegheny county

commissioner and the Greater Pittsburgh Chamber of Commerce. Labor unions, nonprofits, and other community leaders were essential partners. Together they created and executed a strategy to build on local strengths and advance innovative industries of the future.

The public sector played a vital role by investing in local infrastructure and mass transit. Governor Ed Rendell steered public money toward research, economic development, and health care. The new Gold LEED-certified convention center, site of the G-20 summit, is a joint venture between government, philanthropic, and corporate groups in the region.

Manufacturing remains important. The manufacture of steel grew and transitioned into the manufacture of specialty metals and sophisticated alloys. Over 300 metals technology firms provide production equipment, engineering services, parts, and supplies.¹³ Allegheny Technologies manufactures titanium, hafnium and cobalt, and forges custom fittings for the aerospace and nuclear energy industries.¹⁴ Aerotech manufactures motion-control products to nanometer accuracy, and Dawar Technologies creates transparent membrane sensors for touch-screen technologies. More than 30 robotics companies make Pittsburgh one of America's major centers for robotic innovation.¹⁵ Carnegie Mellon's Robotics Institute hosts the world's only Ph.D. program in robotics.¹⁶

But local efforts can go only so far. Pittsburgh's lesson for America is the need to create the national equivalent of what the Regional Economic Revitalization Initiative created in the city and what Governor Rendell created in the state: *an industrial policy to retain and support high-paying jobs that add value to the economy*. States and cities all over the country engage in such partnerships and planning, working to entice business to relocate or build upon local strengths. But such local efforts, if poorly designed, can produce a "race to the bottom" or destructive competition between adjacent towns. National efforts to coordinate or set standards, visions or goals are often decried as socialism, communism, fascism or worse. Efforts to create a national industrial policy have never gotten off the ground.

Trade. Pittsburgh also shows the consequences of feckless trade policies. Other countries enact protectionist and mercantilist policies to their individual advantage. The U.S. sees itself as the champion of global trade, and scorns many such efforts as "protectionist."

As a result, steel manufactured in Pittsburgh is competing against steel manufactured in China with devalued currency, government subsidies, deeply suppressed labor rights, and lower environmental and safety standards. American workers are many times more productive, but Chinese steel produces three times more carbon emissions than American steel.¹⁷ Poor

Manufacturing in America Lost Opportunity, Lost Advantage¹

- The U.S. closed 40,000 factories and lost a third of its manufacturing jobs between 2001 and 2008.
- The U.S. printed circuit board industry shrank from \$11 billion to \$4 billion between 2000 and 2007, while our global market share dropped from 26 percent to 8 percent.
- Worldwide, 1.2 billion cell phones were sold in 2008. None were made in America.
- The U.S. invented solar cells. But 90 percent of solar cells used in America are imported from China.¹
- Only two American companies rank among the top 20 producers of solar technology worldwide. Only one U.S. company ranks among the top 10 for wind energy production.
- In 2007, only two percent of new semiconductor fabrication plants under construction in the world were located in America. Thirty percent were in China, 25 percent in Taiwan and 22 percent in Korea.

ventilation, inadequate fire control and other shortcuts kill thousands of people in Chinese coal mines every year — but lower the cost of making steel.¹⁸

Similarly, many toys imported into America violate safety standards that U.S. manufacturers are required to obey, like the plastic Frankenstein drinking cups with 65 times the maximum allowable level of lead.¹⁹ Many foods imported into America were produced with fertilizers, pesticides, and storage systems with lower — and cheaper — standards of safety and quality.²⁰ American producers bear the cost of higher standards for the benefit of American citizens. Other countries avoid these costs with minimal consequences in the U.S. market.

At the same time, other countries craft policies to keep the production of goods at home, to employ their own citizens and to keep their techniques on the cutting edge. But the U.S. is much more passive about nominally American companies moving production overseas. The interest of those companies and that of the American people are not necessarily in alignment. The government sometimes needs to choose a side. For example, in recent assistance to major automobile manufacturers,

- The Italian government bailed out Fiat during the global economic downturn on the condition that manufacturing remain in Italy.²¹
- The U.S. government supported GM on the basis of plans to outsource more production to China and Mexico.²²

American policymakers seem trained to respond to code words that other country's leaders ignore. Modest “Buy American” provisions in the U.S. stimulus bill in early 2009 led to cries of “protectionism” and domestic and international protest.²³ Meanwhile:

- China requires that at least 80 percent of the equipment in its own solar power plant be made in China and 70 percent of domestic content for wind turbines installed in China. China exports over 95 percent of its solar energy products to the United States and Europe.²⁴
- Canada negotiated exceptions to WTO agreements for government procurement of steel, coal and motor vehicle production for all provinces and sectors.²⁵
- The European Union negotiated WTO exclusions for drinking water, energy, transportation, and communications.²⁶

John Meier, CEO of Libbey Glass in Toledo, Ohio, says such policies create “an eight lane highway coming into” America, but a “dirt road back.”²⁷

The G-20 in Pittsburgh: Why It Matters, What to Ask

Pittsburgh's success shows that the U.S. remains an adaptive, innovative nation. But Pittsburgh's limitations show why the U.S. needs a new industrial policy and a different strategy in global trade. As people consider the G-20 in Pittsburgh, they can look out for these mistaken assumptions:

- **The attitude that manufacturing is a thing of the past**
We need things. From cars to shoes, computers to refrigerators, a country needs *things*. If we don't make those things here, then someone else gets our money and we have to borrow to be able to buy the things we need.

- **The abuse of “comparative advantage”**
Be sure that the industries of comparative advantage operate on the same scale as the industries being replaced. An \$80 billion surplus in services can’t cover an \$840 billion deficit in goods. Check the math for today; check the prospects for growth in the future.
- **The double standard on “protectionism”**
See if the U.S. is being criticized for actions that other countries take. Question whether other countries should be more like us (and how to make them so), or if we should be more like them (and how we can do it).
- **The details behind low costs overseas**
Question the truism that high paid U.S. workers can’t compete with lower wage workers in other countries. While other countries often do have a wage advantage, that is often only a small part of cost savings compared with safety standards, environmental standards and quality controls. Producers who want access to American markets must be held to American standards.
- **The fantasy that Pittsburgh did it alone**
First, Pittsburgh is only halfway to a success story. Wages are lower, many people have left, and good jobs are elusive. Second, to the degree Pittsburgh has succeeded, it is a success story of industrial strategy and government involvement. The “invisible hand” didn’t save Pittsburgh. Planning did.

In the old days, the interests of the American people and American business lined up. What was good for General Motors really was good for the country. But in an era of multinational corporations, global financial markets and portable production, the interests of people and business aren’t necessarily in alignment.²⁸ Rising GDP and rising stock values can be consistent with declining wages and lower standards of living. America needs a strategy to bring these interests back into alignment. America needs an industrial policy designed to advance industries that add value, train a workforce suited to the task and make certain that the profits are widely shared.

These changes in America will affect other countries as well. No longer can the U.S. be counted on as the world’s consumer — spending more than we earn, and paying for it with personal and national debt. As America adjusts, other countries may need to adjust as well.

That’s the background question for the full G-20. It is not simply how countries coordinate to generate recovery from the global downturn, nor how countries cooperate to meet the challenge of global warming. The G-20 must also chart the process by which the global economy that emerges out of the crisis is more balanced, and no longer dependent on U.S. citizens spending more than they earn. That means the U.S. must invest more and consume less, make more and import less. And the surplus nations must do the reverse: consume more and buy more from abroad. This will require wrenching changes in policy and in attitudes. But if we are to move to growth that is sustainable in Pittsburgh as well as Beijing, we have little choice.

ENDNOTES

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