

# PROTECTING OUR OWN



I recently spoke with a gear manufacturer whose primary business is supplying gears to U.S. Department of Defense contractors. Things aren't going so well for his company these days.

Despite the fact that business is booming at the factories of most of the gear manufacturers I talk to, this particular gear manufacturer is struggling. In 2010, his shop just laid off 40 people.

The reason for the layoffs, he said, is that he'd lost a big chunk of his business to overseas competitors. His customer, a major U.S. government contractor, was able to save \$10 per part by outsourcing to an Asian supplier.

So our government is saving \$10 a part, but at the same time, indirectly, it's allowing 40 U.S. citizens to go unemployed. That's 40 people who would otherwise be paying Social Security, federal taxes, state taxes, and so forth, not to mention that they would be earning money and spending it in the U.S. economy instead of the government paying them unemployment.

Is it just me, or is there something wrong with this picture? Does saving \$10 on a part that may be vital to our nation's defense seem rather shortsighted? As a nation, we need to be more cognizant of what provides those jobs and keeps our factories and people working.

I know what you're thinking. Protectionism is the dirty word of economics. Tariffs and quotas inevitably do more harm than good—to both trading partners. But something should be done. We need to be more vigilant in looking out for our own economic well being.

The fact is, many countries employ protectionist measures. The United States is no exception. The "Buy American" clause in the recent American Recovery and Reinvestment Act is just one example. Brazil's restrictions on the import of machinery and China's currency exchange rate manipulation are two well-publicized examples.

When I visited China several years ago, I learned quite a bit about the Three Gorges Project, a massive undertaking to build the world's largest hydroelectric power station on the Yangtze River. As part of the project, the Chinese required their foreign joint-venture partners—including ABB, Alstom, General Electric, Kvaerner, Siemens and Voith—to sign technology transfer agreements with their Chinese joint-venture partners. By the end of the second phase of the project, eight of 26 generators had been built almost entirely by the Chinese.

Other nations seem to have a far better understanding than we do of the value of a healthy manufacturing economy, and they take steps to protect their own.

In their book, *A Nation on Borrowed Time*, Joe Arvin of Arrow Gear and Scott Newton describe what they call



"the brighter side of protectionism." In the book, they suggest that the way to help U.S. manufacturing is to remove barriers to investment. The primary tool they recommend is tax incentives. Unlike tariffs and quotas, which restrict trade, these measures—if used properly—can encourage growth and investment, particularly in key industries like manufacturing.

Arvin and Newton give an extreme example of possible tax incentives that would help U.S. manufacturers: "For all U.S. based manufacturing companies that produce products, and do so without relying on foreign labor or suppliers, the profits of all shareholders will be 100 percent tax free. In addition, all employees of these companies will be exempt from paying Federal income taxes."

Although the authors themselves admit that this idea is "rather outlandish," they do a good job of arguing for its merits. Instead of restricting trade, like many protectionist measures, their tax incentives would encourage growth and investment in vital industries. If such a law were enacted, they argue, investors—both American and foreign—would rush to find ways to build manufacturing plants in America, and workers would line up to find employment at these facilities.

Undoubtedly, there are other options besides Arvin and Newton's radical approach. In their book, they admit that tax incentives have to be carefully constructed and well targeted, or they may do more harm than good.

But whatever the solution, I'm certain that something must be done. There are only three ways for a nation to create wealth. You can dig it out of the ground in the form of raw materials. You can grow it in the form of agriculture. Or you can manufacture it. It's foolish of us as a nation to continue to be the world's only champion of free trade while our ability to create wealth is being slowly bled away.

If we can find solutions like Arvin and Newton's, which encourage growth and investment, as opposed to restricting imports or artificially adjusting the prices of our competitors, I'm confident that our nation's defense contractors won't have to search overseas to save \$10 a part.

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P.S. If you're concerned about America's future, you should read *A Nation on Borrowed Time*. You can order your copy by visiting the authors' website at [www.anationonborrowedtime.com](http://www.anationonborrowedtime.com).