

# IS AMERICA THE SICK MAN OF THE GLOBE?

As manufacturing dies, the U.S. faces the prospect of structural unemployment. Germany shows a way out, but the U.S. political cycle may work against change.



Restaurant waitress Tammy Maynard. REUTERS/REBECCA COOK

BY NICK CAREY  
SAGINAW, MICH., DEC 16

**N**OT LONG AGO, if you wanted steak for lunch at the Texan Restaurant, less than two minutes drive from the Nexteer Automotive assembly plant, you had to be in the door by 11 o'clock in the morning. If

you arrived any later, you joined a long line with other laggards and waited for a table to open up.

With noon fast approaching on a recent day, however, only a handful of customers sat in one of the restaurant's two sections and the other was closed.

Asked how the decline in the U.S. auto

industry has affected the local economy, Tammy Maynard, a waitress here since 1988, waved a hand around at the empty tables and said: "You're looking at it, sugar."

Regulars and retirees keep the restaurant in business, while workers at the nearby auto supplier plant buy steak at the beginning of the month when they get paid -- if they

*"I JUST KEEP PRAYING EVERY DAY THAT WE'VE HIT THE BOTTOM AND THAT THINGS ARE GOING TO GET BETTER."*



**GETTING BY:** Auto parts manufacturing plant Nexteer Automotive, formerly the steering unit of General Motors, is seen in the Buena Vista township of Saginaw, Michigan November 18, 2010. REUTERS/REBECCA COOK

come at all -- and then dine on specials over the next four weeks.

"I just keep praying every day that we've hit the bottom and that things are going to get better," Maynard said, "because it doesn't seem like it could get any worse."

The U.S. government may have bailed out General Motors, the country's largest

automaker, but it hasn't begun to tackle the broader problems that led to the city's implosion. Doing so, experts say, would require the kind of political will that has not been in great evidence in the country recently.

To the few remaining auto workers left in a city half the size it was in 1960, the America they knew growing up is long gone and things can only get worse.

"We have made concession after concession on wages and benefits and there is no end in sight," said Dean Parm, a worker and union committeeman at Nexteer Automotive, whose hourly wages have been cut to around \$17 an hour from \$28. "It feels like we're dinosaurs. And we're on the verge of extinction."

This is the point of the story where many Americans typically glaze over because they see Michigan as a long-standing financial basket case of a state thanks to the shrinking U.S. auto industry. But the problem is that the broad decline of the manufacturing sector that has been underway in this country for decades now may threaten not just the long-term health of the economy but also the living standards of all but the wealthiest

Americans.

"The whole country is now seeing the story that Michigan has been living with for a long time," said Diane Swonk, chief economist at Mesirow Financial. "We have kicked the can so far down the road that now all we have is a cliff to fall off."

"The recession merely revealed a reality that has been with us for a long time. We faced a growing gap in education and skills that we tried to fill with debt and credit, which gave us the illusion of growth."

After World War Two, unskilled blue-collar jobs in manufacturing -- typified and in many ways defined by the auto sector -- became America's easy path to the middle class. As U.S. manufacturing declined, starting in the 1980s Congress and successive administrations focused instead on the financial sector and relied on debt -- its own and that of the U.S. consumer -- to foster economic growth.

At the same time, U.S. companies faced a growing competitive challenge, largely from Asia -- both in terms of manufacturing prowess and lower wages and legacy costs -- that hastened the nation's exodus from the



**SIGN OF THE TIMES:** The 'Texan Restaurant' in Saginaw, Michigan November 18, 2010. REUTERS/REBECCA COOK

ALL ABOUT JOBS: A United Auto Workers union member wears a 'Good Jobs Now' union t-shirt as he marches in the 2010 annual Labor Day parade in Detroit, Michigan August 6, 2010. REUTERS/REBECCA COOK



sector.

That in turn created lop-sided trade imbalances, with the U.S. invariably in the red. The U.S. trade deficit with China, for instance -- a nation that tightly controls its imports -- hit a record of \$268 billion in 2008 and could reach \$270 billion this year.

At the other end of the spectrum, deregulation and a laissez-faire attitude toward financial institutions culminated in the housing "boom" that former Ohio Attorney General Richard Cordray (who failed to win reelection in November) has aptly described as a "Roman orgy" of debt.

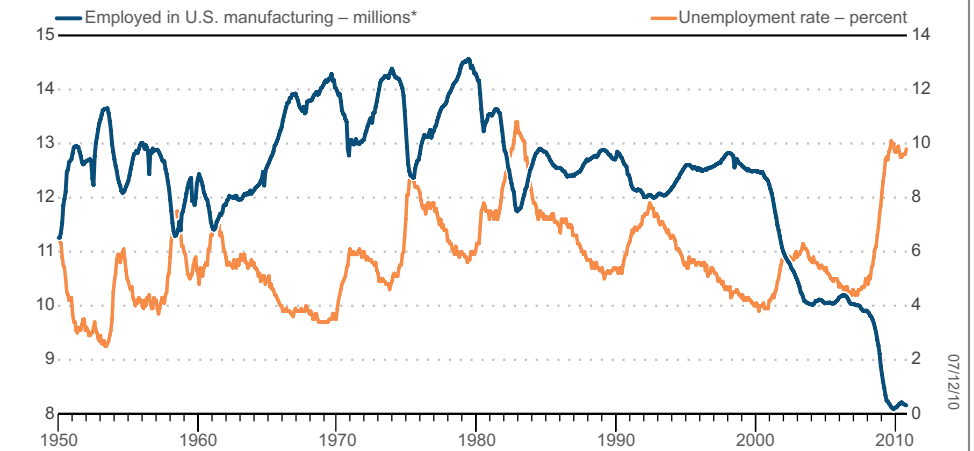
The subsequent downturn, the deepest and longest since the 1930s, merely exposed the extent of the hollowing out of America's manufacturing sector. By one estimate, since 2003 up to 20,000 manufacturing plants have shut down. The trend is leaving the country with a legion of unskilled workers stuck on long-term unemployment benefits.

"Over the past 20 years we have simply borrowed more money in order to prosper," said Bill Gross, co-chief investment officer of the world's biggest bond fund manager PIMCO. "We forgot that the more stable and safe way to go is to make things."

"Now we're paying the price."

## U.S. manufacturing jobs, 1950-2010

Over the past 60 years, U.S. unemployment has mirrored manufacturing sector's ups and downs.



\* Production and non-supervisory jobs  
Source: U.S. Bureau of Labor Statistics



Reuters graphic/Stephen Culp

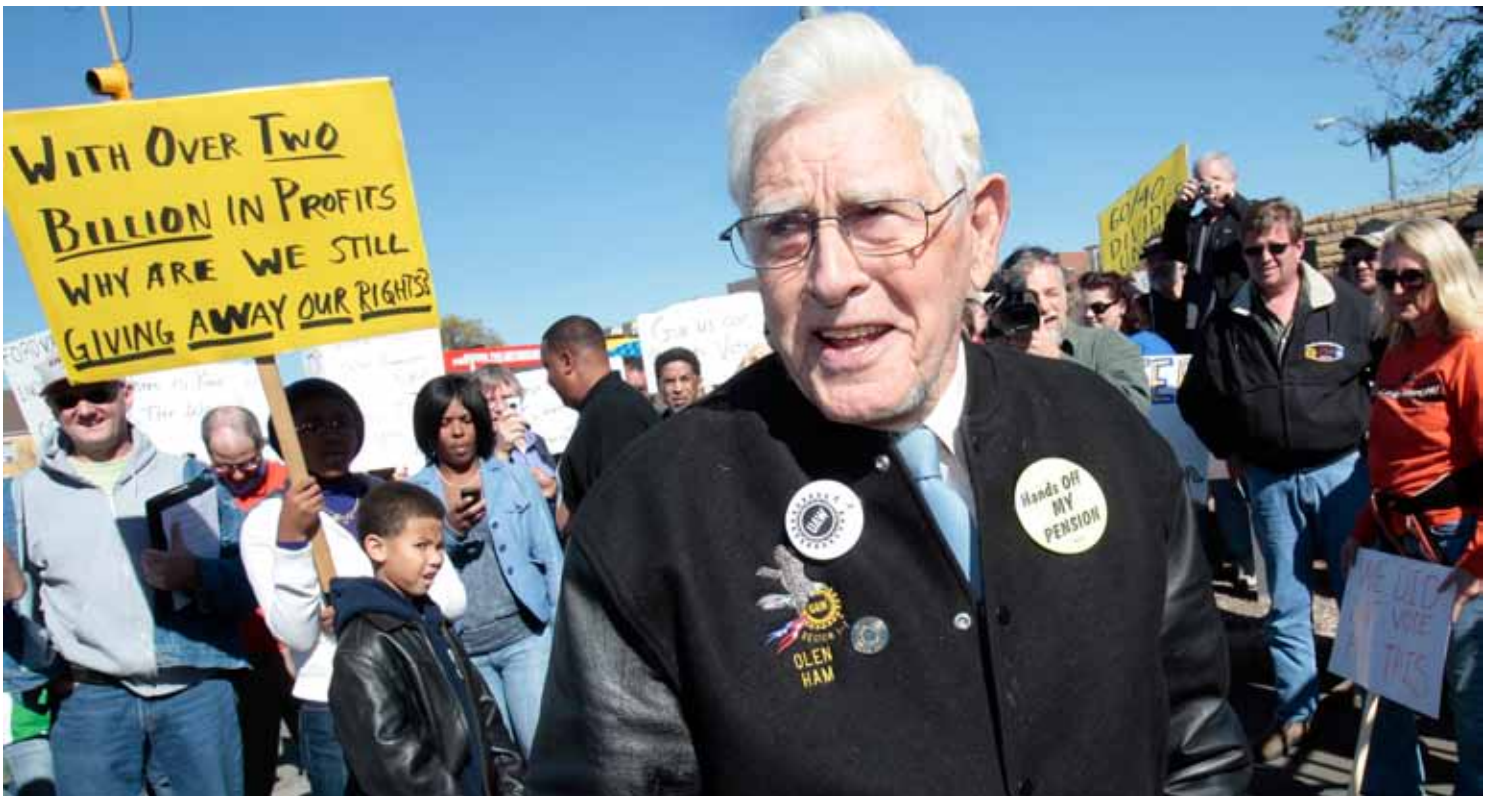
### TURNING A BIG SHIP

AMERICA NOW faces "structural" unemployment. Which means unless the world's largest economy changes in a fundamental way, millions of unskilled workers will remain jobless and economic growth will be sluggish, at best

"The financial sector and America's wealthiest classes can help grow the

economy, but not enough to bring down unemployment," said Harm Bandholz, chief U.S. economist at UniCredit Research in New York.

None of this means a death spiral is inevitable. A growing number of economists and investors like PIMCO's Gross say a fix exists: a comprehensive overhaul of America's education system and retraining



**VETERAN:** Olen Ham, 93 years-old, wears a 'Hands off my Pension' button as he joins workers and their supporters to protest against two-tier wages outside the United Auto Workers union Solidarity House in Detroit, Michigan October 16, 2010. **REUTERS/REBECCA COOK**

**VIDEO**

Video story featuring Olen Ham:  
<http://link.reuters.com/zyz32r>

programs for the unskilled.

Some point to the example of how Germany's manufacturing has rebounded a decade after the country was derided as the "sick man of Europe," though they add the German experience shows reform is a long, hard road.

America is now the "sick man of the globe," says John Silvia, chief economist at Wells Fargo. "The good news is the illness is not terminal."

But fixing America's education system for jobs of the future plus retraining unskilled workers would require bipartisan consensus, a long-term commitment by America's political class and funding to make it happen. In today's bitterly divided Washington, that is a tough sell.

In the recent midterm elections Democrats were pummeled less than two years after President Barack Obama's triumphal arrival in Washington and American voters remain in a volatile mood. Steven Schier, a politics professor at Carleton College in Minnesota, said unless the job mess is repaired more

wild swings lie ahead.

"It's entirely possible we're going to see voters flip the switch every two years until both Republicans and Democrats get the message," he said.

Besides ensuring national paralysis, such swings would be bad for investors and financial markets, which abhor political risk. Peter Schiff of Euro Pacific Capital, who predicted the housing-fueled crash (and made an unsuccessful bid for the U.S. Senate this year), is among the skeptics who fear that Washington isn't owning up to the problem.

Schiff said he favors ending long-term unemployment benefits because he says they prevent Americans from taking low-paid jobs. "Nobody wants to tell the truth and say that lower paying jobs are here to stay," he said. "One way or another, America is going to be poorer. Basically, we're doomed."

**"WE BUILT THE MIDDLE CLASS"**

OLEN HAM LIVED through the rise of organized labor alongside American manufacturing and has witnessed its painful decline. Born in rural Arkansas in 1917, his family moved to Michigan, where the auto industry beckoned.

"They were hiring every hick and hillbilly they could find, so off we went," said Ham,



**FIGHTING FOR MORE:** United Auto Worker union members and their supporters protest over two-tier wages for auto workers outside the UAW Solidarity House in Detroit, Michigan October 16, 2010. **REUTERS/REBECCA COOK**

now 93 and living at his daughter's house in Grand Blanc, Michigan.

In 1914 Ford Motor Co founder Henry Ford had instituted a daily wage of \$5 for workers -- more than doubling their wages -- to reduce turnover and enable workers to afford the cars they made.

In his 1922 book "My Life and Work" Ford, who was staunchly anti-union, dismissed the notion this was an act of charity. "We wanted to pay these wages so that the business would be on a lasting foundation," he wrote. "A low wage business is always insecure."

In 1936 Ham found work at a General Motors plant in Flint straight out of high school, where he started out "pushing a broom" in the foundry at 52 cents an hour. "It was hotter than Hades with no ventilation," Ham said. "You had to use the bathroom quick because if you were away from your spot too long you'd be fired."

Paid holidays, pensions, healthcare and other benefits were nonexistent. Amid the Great Depression's high unemployment and declining standards of living, the National Labor Relations Act of 1935 made it easier for private sector unions to exist.

Founded in 1935, the United Auto Workers union targeted GM first, arguing that if the biggest automaker had to accept a union, the others would follow suit.

In December 1936 the "sitdown" strike began in two plants in Flint then spread to others. The strike got its name because workers occupying the plants sat on seats destined for the cars they made. Ham is one of the last surviving "sitdowners."

Events took a violent turn when the police attempted to storm one plant with tear gas and guns. Eventually Michigan Governor Frank Murphy called in the National Guard to keep the peace. He ordered GM and the UAW to negotiate and the strike ended in February 1937, resulting in the union's first, one-page contract with GM.

Within weeks, Olen Ham's hourly wage doubled to \$1.04.

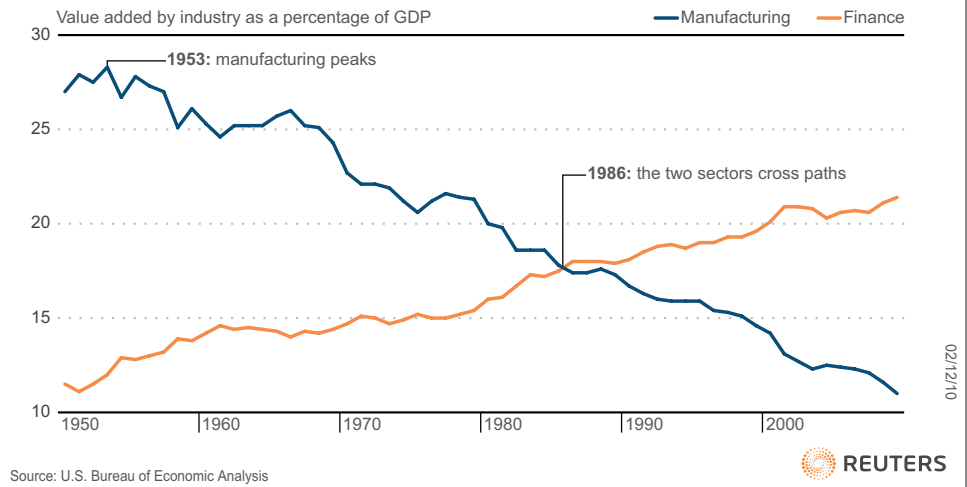
"The other automakers were forced to follow suit on pay and benefits, as was the rest of the manufacturing sector," he said. "We built the middle class in this country."

Ham retired more than 30 years ago and in his lifetime has owned more than 25 GM cars (the latest is a 2008 Chevy HHR). He looks hurt when asked if he ever bought a used car, responding "I only buy new cars."

He owns an RV, which he still drives, and he and one of his sons (who retired from Boeing) bought a small airplane between them. Like

## U.S. manufacturing vs. finance

Finance has taken over as once powerful manufacturers have faded.



*"THE OTHER AUTOMAKERS WERE FORCED TO FOLLOW SUIT ON PAY AND BENEFITS, AS WAS THE REST OF THE MANUFACTURING SECTOR."*

millions of other Americans, Ham made it into the middle class with a high school education and few skills.

### DECLINE AND FREEFALL

MANUFACTURING AS A percentage of U.S. gross domestic product (GDP) peaked in 1953 at 28.3 percent. By 2009 it was 11 percent. Employment in manufacturing continued a roller coaster ride for a couple more decades, peaking in 1979 at just over 14.5 million workers. But by 1979 the oil shocks began to threaten the middle-class status of manufacturing workers.

The 1970s stand as a "bookend to the New Deal era: that which was built in the thirties and forties -- politically, economically and culturally -- was beginning to crumble," writes Jefferson Cowie in his book "Stayin' Alive: The 1970s and the Last Days of the Working Class."

From the 1980s onward, manufacturing jobs and the sector's contribution to U.S. GDP declined, a process accelerated by productivity enhancements and increasing

competition from lower-cost markets. Now there are just over 8 million manufacturing workers in a population of 300 million.

"The post-World War Two paradigm that allowed unskilled workers to go straight from high school into the middle class died in the 1980s," Mesirow's Swonk said.

Instead of seeking a solution to the sector's woes America's political class sought a different way out, she added. "We decided as a nation to issue debt and focus on the financial sector to counter what was becoming a major structural issue in the 1980s," Swonk said.

That decision would have far-reaching implications for the structure of the U.S. economy.

While manufacturing's contribution to U.S. GDP had declined since 1953, the financial sector's steadily increased. The two sectors crossed paths but once -- in 1986 during President Ronald Reagan's second term in office -- with finance on its way up and American manufacturing on history's down escalator.

"This mess has been a long, long time coming," PIMCO's Bill Gross said. "We should have been getting people out of the unemployment line, re-educating and retraining them for the future. We failed to do that."

### WHILE CONSUMERS FIDDED

THE CONSEQUENCES of what happened when, as Swonk says, credit in America went "from being a privilege to a right" are well documented.

Thanks to low interest rates and the

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spurious promise that property prices could only go up, U.S. consumers in the first decade of the 21st century bought into the property market hook, line and sinker in order to profit and afford a better lifestyle.

They also drew down home equity in order to fund that lifestyle, spending money they did not have.

This is a phenomenon John Hoffecker of restructuring advisory firm AlixPartners LP refers to as “pulling forward” purchases. In just one example, Hoffecker said his firm estimated that U.S. consumers pulled forward 17 million car purchases from 2001 to 2007.

Based on average vehicle transaction prices over the past year provided by automotive information web site Edmunds.com, that gives a ballpark figure of around half a trillion dollars (\$504 billion).

When the real estate boom began to show signs of unraveling in 2006, lenders used ever more exotic products to get people into homes they could not afford, such as stated-income or “liar” loans where the borrower merely stated how much they earned without

verification.

It is interesting to note that on the U.S. Securities and Exchange Commission’s web site the definition of a Ponzi scheme (a type of fraud also known as a pyramid scheme) includes the following line: “Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk.”

“With little or no legitimate earnings, the schemes require a consistent flow of money from new investors to continue,” the web site says. “Ponzi schemes tend to collapse when it becomes difficult to recruit new investors or when a large number of investors ask to cash out.”

The crumbling housing market brought the U.S. financial system to the brink of collapse in 2008, requiring an unpopular bailout by the government and emergency action by the U.S. Federal Reserve to prop it up.

“Obviously the last two years have made it clear that finance has its limits,” PIMCO’s Gross said. “We have seen the end of the magic era of finance as opposed to making things.”

#### ROME WAS BURNING

FOR MORE THAN TWO decades, Jon Clark has been buying and selling machinery, primarily generators, from defunct American manufacturing plants.

When a manufacturing plant dies, for a while it becomes a hive of activity as a

“multibillion dollar industry” strips it of equipment to be “rebuilt, recycle and reused elsewhere.”

Based in Texas, the 63-year-old originally hails from Liberal, Kansas (“I’m the most conservative thing ever to come out of Liberal”) and says after years of seeing a consistent number of plants shutting down, he was urged in 2003 to open a bimonthly publication that would document those closures in the United States and Canada.

“We figured we could have maybe anywhere up to 25 plant closings around the country per issue,” Clark said. “It turns out we grossly underestimated the scale of the closures.”

Since then Plant Closing News (PCN), as the publication was named, has regularly featured 75 or more plant closings per issue, or 150 per month. Clark said PCN has seen around 10,000 plant closings since 2003, which is “probably not even half the real total.”

The machinery that comes out of those plants often ends up being shipped to developing countries, representing a gradual hollowing out of America’s manufacturing capacity.

“The only thing that doesn’t get recycled or reused is the people,” Clark said. “What do you do with someone who is 50 years old who has been doing the same thing for 30 years? We treat people now like disposable resources and just like that we throw them away.”

## BLOG

Find more Reuters special reports at our blog The Deep End here:

<http://link.reuters.com/heq72q>



**SHUTTERED:** The abandoned and decaying Packard Motor Car Manufacturing plant, built in 1907 and designed by Albert Kahn, is seen near downtown Detroit, Michigan June 21, 2009. REUTERS/REBECCA COOK

"All of a sudden we decided that it was more economically viable to shut all these plants down," he added. "I'm sorry, but I think we've taken this too far."

"The golden rule used to be do unto others as you would have them do unto you," said the born-again Christian. "Now the rule is he who has the gold, makes the rules."

**THE AFTERMATH**

IN DOWNTOWN SAGINAW, a few miles from the fading sign in the Texan Restaurant's parking lot there is a handful of architecturally impressive but mostly dead high-rise buildings, a reminder of the high tide of manufacturing-based prosperity that crested here in the 1960s and has receded ever since.

Spray-painted on one building are the words "All gone to look for America," a riff on Paul Simon's song "America": "Michigan seems like a dream to me now, it took me four days to hitchhike from Saginaw, I've gone to look for America."

The Great Recession took a chunk out of America that is unlikely to come back.

Manufacturing generates just over a tenth of America's economic output and employs less than 9 percent of the workforce. Yet it accounted for more than 26 percent of the 8.4 million layoffs in the downturn, according to the U.S. Department of Labor.

There are pockets of strength in the sector, including construction and mining equipment makers like Caterpillar Inc or the world's largest farm equipment maker Deere & Co.

But executives in those areas have been candid about the fact that fresh improvements in productivity during the downturn mean many of the 2.2 million manufacturing workers who lost their jobs will not be rehired. And much of the hiring they plan to do will be overseas to serve developing markets.

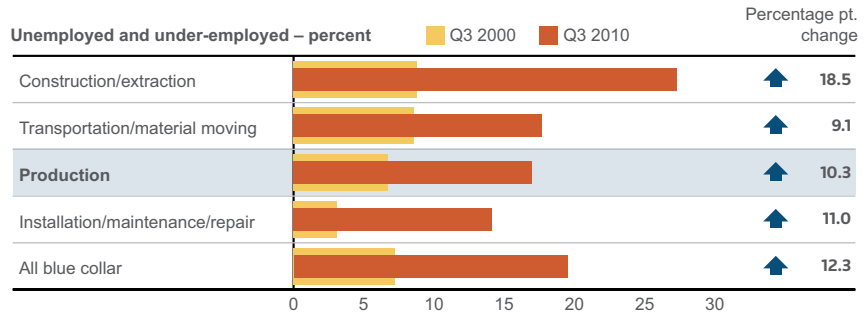
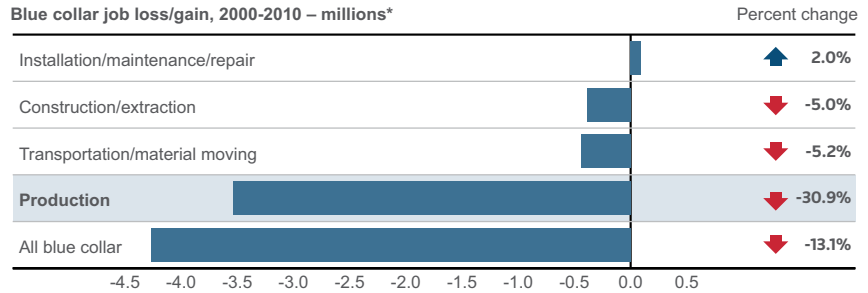
For instance, construction, quarrying and shipping machinery maker Terex Corp laid off 35 percent of its global workforce during the recession. Back in May Terex CEO Ron DeFeo said frankly, "we're trying not to hire anyone back."

During the real estate bonanza of the past decade construction, primarily residential, provided a temporary safe haven for unskilled workers as homebuilders fell over themselves to meet the demand for new housing stock.

The foreclosure mess brought most residential construction to a halt. Employment in the sector has fallen to 5.6 million from a high of 7.7 million in 2006.

# Blue collar blues: job loss and unemployment

Manufacturing has borne the brunt of blue collar job loss over the last decade.



\* Annual average for 2000, average of Jan. through Oct. for 2010. Source: Center for Labor Market Studies, Northeastern University, U.S. Bureau of Labor Statistics

Reuters graphic/Stephen Culp



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According to the U.S. Census Bureau, there are 6.3 million vacant homes on the market for sale or rent. David Crowe, chief economist at the National Association of Home Builders, said that the "more normal" level should be around 4 million.

Ken Simonson, chief economist at the Associated General Contractors of America, says apart from a few potential bright spots such as North Dakota and the Appalachians where natural resource stories may fuel residential housing projects, the housing glut means little job creation can be expected.

"It does seem like we have enough housing stock to last us quite a while," he said.

Incidentally, the housing mess also hurt labor mobility. According to real estate website Zillow.com, in the third quarter nearly 1 in 4 single-family homes in America had negative equity, with the home worth less than the mortgage.

"Labor mobility has always been a difference between America and Europe, and has worked in America's favor," said David Rosenberg, chief economist at Gluskin Sheff & Associates. "The housing market has now become a constraint on the labor market."

Despite government stimulus, the U.S. unemployment rate has not been below 9 percent since April 2009 and now stands at 9.8 percent. A review of U.S. Bureau of Labor Statistics conducted for Reuters by the Center for Labor Market Studies at

**"WE'RE TRYING NOT TO HIRE ANYONE BACK."**

Northeastern University found the rate of blue-collar workers who are unemployed or underemployed hit 19.5 percent in the third quarter (compared with 15.1 percent for all occupations), up from 7.2 percent in the same period in the year 2000.

"For blue collar workers it is a depression," said Andrew Sum, the center's director. "Why are people having such a hard time? The answer is their jobs don't exist any more, they have nowhere to go."

Though Wall Street has posted hefty profits this year and the economy officially grew at 2.5 percent in the third quarter, that has not created many jobs.

"We're not very far from the level where the economy is not self-sustaining," Federal Reserve Chairman Ben Bernanke said in a rare television interview on CBS's "60 Minutes" on Dec 5. "It's very close to the border. It takes about 2.5 percent growth just to keep unemployment stable and that's about what we're getting."

In November the long-term unemployed (jobless for 27 weeks or more) hit 6.3 million, or 41.9 percent of the total of 15.1 million. As part of a deal to extend tax cuts implemented by President George W. Bush, President Obama and the resurgent Republican



**LEFT BEHIND:** Auto parts assembly workers and UAW union members (L-R) Steve Deets, Jeannie Castell, Dean Parm and Bryan Bovee have seen their wages and benefits chipped away. (Picture taken in Saginaw, Michigan November 18, 2010.) **REUTERS/REBECCA COOK**

Party agreed on a 13-month extension of unemployment benefits. According to the U.S. Department of Labor, without that extension more than 6 million people would have lost their benefits by the end of 2011.

Gluskin Sheff's Rosenberg says the problem is extending unemployment benefits alone means in 13 months those same workers will merely need them extended again.

"The last thing America needs is a class of permanently unemployed people," he said. "They will lose their drive and lose their ability to gain and maintain future employment."

### "THEY'VE TAKEN US BACK 30 YEARS"

BRIAN BOVEE USED to make \$28 an hour back when auto steering supplier Nexteer Automotive was part of GM -- before it was spun off to Delphi Corp in 1999.

Bovee, 42, saw his wage cut to \$17.55 well before the company was returned to GM's ownership in 2009 as part of Delphi's restructuring. "I've looked back through old UAW contracts and I'm now making what I would have made in the 1980s," he said.

### "OVERTIME IS THE ONLY WAY TO GET BY."

"Once you give up pay or benefits, they never come back. They've sent us back 30 years."

Bovee is at Dean Parm's house in Saginaw along with co-workers Steven Deets and Jeannie Castell. They have agreed to talk despite expressing concerns about retribution by the UAW or Nexteer, which was recently sold to a Chinese investment group backed by Beijing's municipal government.

Prior to the sale, workers at the plant rejected a new contract that would have new workers starting at \$12 an hour, then approved it 10 days later under what workers describe as scare tactics by the UAW (a shareholder in GM since its bankruptcy) and Nexteer.

Deets makes \$16.28 an hour working by the plant's furnace which reaches temperatures of 1,600 degree Fahrenheit (870 degrees Celsius) and he takes as much overtime as he can.

"Overtime is the only way to get by," he said, with barely contained frustration. "But it gets very tiring very quickly."

A widely accepted definition holds that wages of about \$20 an hour -- \$41,600 a year -- is the minimum needed for a family of four to obtain middle-class rank in America.

UAW members have traditionally bought the cars they made thanks to their middle-class wages. Now there are many small, used Asian brand cars in the parking lot at Nexteer because they are more fuel efficient and low-paid workers can afford them.

Unlike during the Great Depression, the latest downturn has weakened America's manufacturing sector unions. A sign of that weakness has been the growth of the two-tier wage system, whereby newer workers make far less than their more senior co-workers.

That two-tier system is already firmly entrenched at manufacturers like Caterpillar and has recently been adopted at others such as Harley Davidson. It has also become part of the landscape at the Big Three automakers. The number of lower-wage workers has



*"ALL I HAVE LEFT IS MY PAY AND MY BENEFITS."*

**DISILLUSIONED:** Angela Turner and Rondo Jabbar (above), auto workers in Indianapolis, October 5, 2010. **REUTERS/NICK CAREY** Marc Amante, 61, (below) is a journeyman (machine repair man) at a General Motors plant in Grand Rapids, Michigan November 19, 2010. **REUTERS/NICK CAREY**

grown in the wake of the government-led bankruptcy and restructuring of GM and Chrysler during the downturn.

The UAW is down to about 400,000



members from its glory days of nearly 1.5 million workers in 1979. Despite the decline, union president Bob King insists the two-tier system had been necessary to help U.S. automakers survive and he was bullish ahead of contract talks with the automakers in 2011.

"We are obviously in a really positive environment," he said. "There is a lot more stability in the industry and... the relationships -- the UAW and the employers -- I think is excellent."

It is difficult to find rank-and-file UAW members who share King's enthusiasm.

Janet Townsend has worked at GM for 34 years and has been through 21 plant closings. Employees at the plant where she works in Indianapolis recently rejected a contract that they say the UAW negotiated without their consent which would have halved their wages to \$14 an hour as part of a deal to sell the facility to an investor. The plant will close in 2012.

"I am beginning to think I don't need a union," Townsend said. "Why do I need a union to get me a job paying \$14 an hour? I can find a job like that myself."

Her colleague Rondo Jabbar described the attempted deal as class warfare. "All I have left is my pay and my benefits," he said. "I'm the one who's worried about gas at \$3. Not

the rich executives at GM."

Up in Grand Rapids, Michigan, Marc Amante, 61, is just holding on for retirement. As a journeyman and machine repairman at GM Component Holdings LLC (like Nexteer, formerly part of Delphi), he is a skilled tradesman and still commands a wage of \$34 an hour.

He owns nine cars, has paid for his two children's university education and bought his daughter a house. But he says those days are over and he is glad he will retire before skilled trades workers have their wages slashed.

"I'm really happy I've made it to the end of my career and I feel really sorry for those behind me," he said. "Because I don't see any way for them to make it into the middle class."

Even more, he laments the fact that GM has apparently abandoned the old practice of attaching apprentices to old hands like him.

"They have never taken my skillset and transferred my 40 years of experience to the next generation," he said. "When I walk out the door all that experience goes with me."

Although Bob King says he hopes the UAW can address the two-tier wage system at contract talks in 2015, retired activist Gregg Shotwell describes it as a "prepaid funeral

arrangement" for the union because it has pitted workers against each other.

"To have solidarity and a functioning union everyone has to be in the same boat," he said. "But if one group has first-class tickets and the other is sitting in steerage, you're doomed."

Thomas Stallkamp, an industrial partner at private equity firm Ripplewood Holdings, says the two-tier system has enabled U.S. automakers to become globally competitive and is here to stay. But he frets about the long-term implications.

"If it benefits employment and manufacturing comes back, it's a very positive benefit," he said. "If it doesn't result in a resurgence in U.S. manufacturing that will be very bad because all we will have done is lowered the standard of living for lots of people."

"I don't see any other answer than wage reduction because we're in a global market," he added. "But I also feel very strongly that we need to make things in this country."

"We can't all flip hamburgers at McDonald's."

According to the Census Bureau, income inequality has reached the highest level since it began tracking household income in 1967.

"The aggregate (GDP) numbers are biased by a relatively small number of immensely wealthy people making unbelievable amounts of money," UniCredit's Bandholz said. "When you build a house if you don't place enough emphasis on solid foundations, the result is a structure that is unstable."

"Unless this structural problem is fixed we will continue to see sluggish economic growth of around 2 to 2.5 percent," he added.

## GERMAN LESSONS

ECONOMISTS LIKE Bandholz say America could learn from the experience of Germany over the past decade.

By the time Germany passed its Agenda 2010 reform package in 2003, the country had been suffering from double-digit unemployment and mostly anemic growth for a decade. The reforms included draconian cuts in pensions and unemployment benefits, increased labor flexibility and wage cuts.

Harm Bandholz's Munich-based colleague Andreas Rees is UniCredit's chief German economist and says that the country's road to recovery from being the "sick man of Europe" has been anything but easy.

"The road to higher GDP growth was long and hard," he said. "It involved cutting wage costs for about 10 years and consumer



**UNION KING:** United Auto Workers International President Bob King addresses the media and plant workers after General Motors announced it will build a new Cadillac small car at the Grand River Assembly plant and will add a second shift with 600 new workers in Lansing, Michigan October 28, 2010. **REUTERS/REBECCA COOK**

**"AMERICA CANNOT  
COMPETE WHEN IT  
COMES TO  
LOW-SKILLED,  
LOW-COST LABOR."**

expenditures have simply been a disaster."

"We've been through massive uncertainty and for many Germans it was a really painful period."

The reforms also resulted in the formation of the new Left socialist party, altering Germany's political landscape.

But thanks to the country's more flexible work force and "also partly good luck" in the form of demand from China for quality manufactured products, Rees said the "reforms have clearly paid off."

Driven by its manufacturing sector, the German economy is expected to grow by anywhere up to 3.7 percent in 2010, while unemployment fell to an 18-year low of 7.5 percent in October. Rees said he is upbeat about future consumer spending. But even seven years after reforms began, Rees said they are not over.

"The next step that the government was supposed to take was to improve the qualifications of the work force," he said. "We

have a serious lack of skilled workers, but now that things are looking alright German politicians do not appear to be in a hurry to follow through on this."

"This is not a positive development. But we have come a long way."

## "HEARTACHE AND HUNGER LIE AHEAD"

AMERICA IS NOW SEEN at a similar crossroads to Germany a decade ago.

Wells Fargo's Silvia said the first thing the country needs is an "honest conversation" about the fact that unskilled manufacturing work will be done wherever labor is cheapest.

"America cannot compete when it comes to low-skilled, low-cost labor," he said. "Those jobs are few and far between and the idea that we can bring back those American jobs that have gone is not realistic."

Silvia argues America needs to retrain and retool its unskilled, unemployed workers for jobs of the future.

"The type of workers that are needed in manufacturing has changed dramatically, where workers frequently operate laptops," he said. "The people who run American companies are smart. If we provide workers with skills, the jobs will come."

Gluskin Sheff's Rosenberg says that if he were in charge "I'd have a shovel in the hands of the long-term unemployed from 8am to



**CARS OF THE FUTURE:** General Motors assembly workers Monique Watson (L) and Evetta Osborne install an electric battery on the underside of a 2011 Chevrolet Volt electric vehicle at the Detroit-Hamtramck Assembly plant in Hamtramck, Michigan November 30, 2010. **REUTERS/REBECCA COOK**

noon and from 1pm to 5pm I'd have them studying algebra, physics and geometry."

In the Organization for Economic Cooperation and Development's latest Program for International Student Assessment (PISA) survey released Dec 7, American 15-year-olds performed below the OECD average in mathematics (Chinese students in Shanghai topped the rankings) and just average in science and reading.

One third of American college students require remedial mathematics classes because they have not taken those classes at the high school level. A sound knowledge of mathematics is apparently exactly what America's children need.

Achieve, a Washington-based bipartisan education reform organization, says math-intensive science and engineering jobs are growing three times faster than overall job growth. Through 2016, professional occupations will add more new jobs -- at least five million -- than any other sector, and within that category, computer and mathematical occupations will grow the fastest.

But education reform and retraining jobless workers for skilled jobs of the future will be painful, last many years and require long-term thinking that PIMCO's Bill Gross says is lacking thanks to America's unending election cycle.

"The problem we have is that our politicians are focused only on the next 12 to 24 months."

Another factor that does not favor reform is that it would cost money. Christopher Koch, state superintendent of Education at the Illinois Board of Education, says school districts are not keen on having the federal government leading the charge on education reform. But the government could play a supporting role by providing research into best practices and funding to help cash-strapped states overhaul their school districts systems.

"I confess I am not optimistic that funding will be forthcoming from Washington given the current political environment," he said.

America's fiscal mess was a major focus of conservatives during the midterm elections. Cutting the size of the government, reducing spending and lower taxes were rallying cries of the Tea Party movement, which helped Republicans win the House of Representatives.

The new conservative members of Congress rail against increases in spending of any variety and some even advocate defunding the Department of Education.

Mesirow's Swonk says rather than acknowledge the depths of the country's problems or the cost of fixing them, Democrats and Republicans have retreated into "faith-based ideological views of economics that do not reflect reality."

"We're still a nation in denial," she said. "If we had a 10-year deficit reduction plan we could include spending on necessary reforms. But America's political class is not willing to do that because the incoming Congress has decided gridlock is good and our politicians keep lying to us by telling us we can get out of this without pain."

"So we're going to get a double whammy of adding insult to injury by not focusing on a pro-growth fiscal policy and creating a very wealthy class of people," she added.

"What we've chosen as a country is the hard way, which means more heartache and hunger lie ahead."

### "I'LL BE STUCK MAKING \$14 AN HOUR FOREVER"

AFTER SERVING A tour in Iraq from 2004 to 2005, Nick Waun struggled to find work back home in Michigan, in part because he said many private firms are reluctant to hire Reservists who can be called up for duty.

But then an aunt who worked at the GM plant in Lake Orion managed to get him a job in the body shop there.

"I was extremely, ex-treme-ly lucky," he said, with heavy emphasis on every syllable, "to get hired at the plant."

Waun's luck continued when he was bumped up from a second-tier wage to \$28 an hour, enabling him to pay for part-time college tuition in combination with GI Bill funding (he is studying economics and pre-law).

His luck ran out when the plant closed down in 2009 during the recession. He managed to hold onto his small car, but "lost about everything else from a year of being unemployed" and had to move in with his father in Lapeer, Michigan, when he lost his apartment.

In October the UAW and GM negotiated a

deal whereby the automaker would make a small car, the Chevrolet Aveo, at the plant. But 40 percent of the workers would have to work for \$14 an hour, including Waun because he has no seniority, a plan that angered many workers because they did not get to vote on the new contract.

The only option for Waun to keep making \$28 an hour was to take a job at a GM plant in Lordstown, Ohio, a four-and-a-half hour drive away from home. At first he slept in his car there until he could get an apartment.

Speaking during a visit home to Lapeer, he said he hopes to study law and get out of the auto industry because he has no doubt the second-tier wage will continue to spread and

will catch up with him eventually if he does not.

"I'm just trying to stay one step ahead of the decline," he said. "I'll keep moving if it means I can hang onto a job paying \$28 an hour. It's the only way I'll be able to pay for a law degree and get out."

"If I end up being shoved down to a \$14 an hour job, I'll be stuck there for the rest of my life," he added.

(Additional reporting by David Bailey, James Kelleher, Ed Stoddard, Emily Kaiser and Rebecca Cook; Editing by Jim Impoco and Claudia Parsons)



**MAKING HIS OWN LUCK:** Nick Waun, UAW worker and former Iraq veteran, in Lapeer, Michigan, November 15, 2010. REUTERS/REBECCA COOK

**COVER PHOTO:** Restaurant waitress Tammy Maynard talks about the local economy and its effect on business at the 'Texan Restaurant' in Saginaw, Michigan November 18, 2010. REUTERS/REBECCA COOK

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