

# **Toward a New Political Economy for the U.S.**

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## Abstract

The U.S. economy faces a fundamental structural and institutional crises that requires major changes in economic policy and far reaching programs including: A) A federally funded *permanent living wage jobs program* mostly funded through transactions taxes on finance, B) Emergency measures to cap and gradually *reduce the U.S. trade deficit*, C) A transparent and coherent “*industrial policy*” to increase high value added, competitive manufacturing exports. The goal should be to support “non-predatory” trade and industrial policies that move the U.S. and world economies toward sustainable and balanced trade and development.

**Key Words:** Jobs Program, Full Employment, Trade Policy, Industrial Policy, Living Wage, U.S. Manufacturing

**JEL Classifications:** E - Macroeconomics and Monetary Economics, L - Industrial Organization, H - Public Economics, F - International Economics, P - Economic Systems.

## Introduction

For at least three decades, the U.S. economy has failed to produce an adequate number of well-paid jobs (CPEG, 2009). Current efforts to “jolt” or “stimulate” the economy, while laudable, are inadequate to the task of creating an economy that works for the vast majority of Americans. As of October 2009 the U.S. economy faced a gap of 10.9 million jobs to make up for job losses and new labor force entrants since the start of the Great Recession in December 2007.<sup>1</sup> Just filling this gap will require the creation of 583,000 jobs every month continuously for two years. Addressing the economy’s longer term failure will require the creation of many more jobs.

In manufacturing the situation is even more dire. Since the 2001 recession the U.S. has lost 42,400 factories including 36% of plants employing more than 1000 workers (which declined from 1,479 to 947) and 38% of factories employing between 500 and 999 workers which declined from 3,198 to 1,972. An additional 90,000 factories are now at risk of going out of business (McCormick, 2010). Manufacturing full-time equivalent employment (FTE) has declined from 18.6 million in 1987 (19.1% of all FTE) to 13.2 million in 2008 (10.3% of all FTE).<sup>2</sup> Moreover, this is not just a result of productivity improvements as manufacturing value-added as a percentage of GDP has declined from about 17% to 12% over the 1987 to 2007 period.<sup>3</sup> Particularly in the last 10 years, the U.S. economy has lost critical capacity and technological leadership in key high-tech and emerging green technology sectors (McCormick, 2010).

Economics students know that there are four major categories of national expenditure that make up GDP: a) consumption, b) investment, c) government spending, and d) exports minus imports.

Aggregate consumption in the U.S. is not likely to grow quickly unless employment and incomes

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<sup>1</sup> AFL-CIO 2010 Jobs Initiative. See: <http://www.aflcio.org/issues/jobseconomy/jobs/jobsinitiative.cfm#gap>

<sup>2</sup> BEA data on full-time equivalent employment by sector. 1-2 million of this decline may be attributable to the shift from SIC to NAICS codes over this period but the decline is still very large.

<sup>3</sup> Federal Reserve Bank of St. Louis data cited in (McCormick, 2010, p. A4).

increase. Adequate employment generating private domestic investment was not occurring before 2007 and is even less likely now. The U.S. has been running a trade deficit for decades and, as will be documented below, this is unlikely to change soon without a revival of U.S. manufacturing. The only feasible way to restructure and revive the U.S. economy for long term and sustainable job growth at this point is through a massive publicly funded *permanent high quality* jobs program accompanied by far reaching trade and industrial policies. Given continued rapid productivity advances in manufacturing, and in some but not all service sectors, many of these jobs will be in the service sector.

Across advanced mixed economies, we find that the level and conditions of employment in the service sector are dependent on the kinds of services that are dominant and how they are funded and provided. In more “liberal” (in the classic sense) economies like those of the U.S. and U.K., industrial policy and service sector growth has been oriented toward for-profit services, propelling massive private investment and employment in retail and financial services.<sup>4</sup> In social democratic economies service sector growth and industrial policy has been focused on public, non-profit, and highly regulated private, provision of health care, education, and human services based on generous public funding that in some cases approaches 50% of GDP – see Figure 1 below.

Figure 1: Tax Revenue as a Percent of GDP

	2006
<b>US</b>	<b>28.00%</b>
<b>Australia</b>	<b>30.60%</b>
<b>Canada</b>	<b>33.30%</b>
<b>UK</b>	<b>37.10%</b>
<b>Italy</b>	<b>42.10%</b>
<b>France</b>	<b>44.20%</b>
<b>Denmark</b>	<b>49.10%</b>
<b>Sweden</b>	<b>49.10%</b>

Source: OECD Revenue Statistics, 1965-2007, 2008 Edition.

<sup>4</sup> This has increasingly dominated a long-standing “implicit” and unacknowledged Pentagon based industrial policy in the U.S. – see (Pollin and Baker, 2009) (Ruttan, 2006). In the U.K. large scale deindustrialization and macro policy benefiting the “City” at the expense of the larger economy began under Margaret Thatcher - see (Harvey, 2005).

Since the beginning of the current “Great Recession” the Chicago Political Economy Group (CPEG) has been calling for the U.S. to vastly expand, publicly provided, well paid and professionalized “human” service employment and provision, and eliminate and reduce economic incentives that lead to financial and low-end (non “human”) service sector job growth. This goal, shared by other commentators such as Kuttner in *Obama’s Challenge* (2008), is at the core of our independently arrived at proposal: “A Permanent Jobs Program for the U.S.: Economic Restructuring to Meet Human Needs” ( CPEG, 2009 ), see: [www.cpegonline.org](http://www.cpegonline.org).

This program is based on the following premises:

- 1) The U.S. economy has not been generating an adequate number of well paid jobs for many decades.
- 2) As manufacturing employment declines due to productivity increases and globalization of production, productive work will increasingly be in the service sector.
- 3) Moreover, as for-profit service sector work, for example: in retail, and warehousing and distribution, also becomes more efficient, productive service sector work will increasingly be in largely publicly funded non-commodifiable areas like health care, education and human services, that are best provided through direct state provision or through non-profit providers funded directly or indirectly by the state.
- 4) This inevitable “socialization” of the economy requires a fundamental and long-term restructuring effort that must be led by major increases in progressive public taxing and spending that move the U.S. closer to a social democratic configuration like that of the most successful northern and western European advanced economies which typically have a much larger share of their economies tied to public funding.

- 5) In order to support a high quality education, health care, and human service, sector, these jobs must be professionalized and well paid. As these jobs will inevitably make up an increasing share of all jobs they need to be good jobs if we are to sustain an equitable and vibrant economy.
- 6) The growth of a large and productive public services economy must be complemented by an internationally competitive export sector that will allow the U.S. to finance necessary imports. Without a viable export sector, public service sector growth will lead to a large increase in the already unsustainable trade deficit that the U.S. has been running since the 1970's.
- 7) In the foreseeable future a large share of exports will be tradable goods (as opposed to services), i.e. manufacturing exports. Thus, in order to sustain an advanced public sector service economy, we will need to be able to produce an adequate output of high-valued added and competitive manufactured tradable goods, as countries like Denmark or Sweden are able to do, so as to support our imports.
- 8) We need to reinvigorate the U.S. manufacturing sector so that it regains the ability to sustain necessary imports for an advanced economy. This suggests that in the short-term we need to increase manufacturing employment that as noted above has dropped by almost 50% in the last two decades.
- 9) None of this necessary long-term restructuring can occur without large scale, and radical, public policy efforts. In the following we outline a proposed set of public policies that would begin to move the U.S. economy toward a sustainable and prosperous future.

The U.S. economy thus needs both radical *restructuring* to increase publicly funded productive service employment, and *revitalization* to increase production of high value added internationally competitive tradable goods that can be exported to pay for necessary imports. As many of these exports will, for the foreseeable future, be manufactured *goods*, a core high-skilled high-value added manufacturing

capability must be maintained and/or recreated. These policies must both reverse the alarming growth of *inequality* in income and wealth that underlies the increasing corruption of democratic politics in the U.S., and the inability of the economy to sustainably increase overall prosperity.

Policies necessary to accomplish these goals are:

- A) A large scale and permanent federal *jobs program*
- B) A *trade policy* that openly breaks with the fundamentally misguided and historically and mathematically erroneous “free trade” doctrine of the last half century.
- C) A complementary *industrial policy* that recognizes the “Evolutionary Economics” or Schumpeterian imperative of continuously generating, and maintaining as long as possible, a sufficient number of “Retainable Industries” adequate to balance necessary imports to sustain an advanced economy.

#### **A) Permanent Jobs Program for the U.S.: Economic Restructuring to Meet Human Needs**

The following is an outline of a permanent federal jobs program that has been proposed by the Chicago Political Economy Group since the beginning of the current recession (CPEG, 2009). Details of the full program including funding and taxing estimates can be accessed at [www.cpegonline.org](http://www.cpegonline.org).

The program proposes that the federal government support the creation of 3.5 million new high quality jobs each year, or 17.5 million new jobs over five years in three broad areas:

- (1) Investment in *public infrastructure* such as transportation, educational and health care facilities, and parks;

- (2) Current *social services*, which will include a major upgrading of pay and working conditions of human service jobs such as those in child, elder and health care;
- (3) Industries of the future, particularly the areas of energy, agriculture, and other broadly defined “*green*” technologies.

The jobs that the program creates and supports are necessary jobs for economic and social development of the U.S. economy. These are not short term stop gap or make work jobs. They should pay good wages equal to the median wage today. In 2008Q3 this was according to the BLS \$18/hr or \$37,440 per year. Including various other items discussed in detail below, this implies a cost of \$173.5 billion for each cohort; so that by the fifth year of the program, assuming no further need for Keynesian stimulus through deficit financing, the cost would be \$867.5 billion. 35% more funding is built into the proposal for administrative costs and to account for the fact that some of the jobs created would be managerial and supervisory jobs paying more than \$ 18 hr (CPEG, 2009, p. 9). Workers in these jobs should have the same rights as others, including the right to assert increased control over their work place by associating together into unions, taking advantage of the opportunity offered by the Employee Free Choice Act. The CPEG proposal does not include social safety net spending, assistance for state and local governments, or “job creation tax credits”.

Moreover, just as the program implements a redistribution of access to good jobs, its funding mechanisms restructure the economy away from finance and financial schemes and towards productive activities. CPEG proposes to finance these jobs largely through *taxes on financial transactions*. In 1996 the World Bank estimated that world wide such a tax would raise \$3.25 billion/day or \$832 B annually. In the U.S. in 2008, using only stock transactions on registered exchanges, the tax would have generated (for one side only, if both buyer and seller pay the amount doubles) \$175.2 billion. When transactions in various derivative markets and the off-exchange bond



market are included, the revenues generated, even discounting for the likely reduction in trading, would be sufficient to finance most if not all of our jobs program. An estimate of \$600 billion does not seem unreasonable for a 0.25% tax on both buyers and sellers.<sup>5</sup> Many of these incomes and much of this wealth have come from employment in trading, regulatory arbitrage or other activities carried on within the finance industry. These taxes can be seen as a modest down payment on what the financial sector owes the rest of us in return for the decision to rescue companies and individuals who led the country into the great recession.

The Economic Policy Institute (EPI) has recently also proposed a jobs program funded largely through financial transactions taxes (EPI, 2009). However, the EPI proposal is significantly smaller and of shorter duration than the CPEG proposal. EPI proposes the creation of 4.6 to 6 million jobs over a three year period at a first year cost of \$ 400 B. The program would be funded through a financial transactions tax of 0.5% that would take affect three years after the implementation of jobs program and continue for 10 years. EPI estimates that this would raise \$113 – \$226 billion.

Roughly 2 million of the jobs created in the proposal would be tied to expanded safety net funding and federal assistance to state government (EPI, 2009, p. 22). These are both laudable and necessary goals but the jobs created would be temporary, as would be the 239,000 tied to school modernization. These leaves about 2.4 to 3.8 million direct public service jobs and jobs created by the “job creation tax credit” whose duration may, or may not be long-term. EPI does not address wages, benefits, or working conditions for these jobs.

Fundamentally, the EPI proposal appears to be premised on the notion that the U.S. economy is fundamentally sound, but needs a short-term boost to get it back on track to creating well-paid, mostly

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<sup>5</sup> For detailed documentation of our transactions tax estimates see (Barclay, 2010) available on: [www.cpegonline.org](http://www.cpegonline.org). Note that these CPEG estimates are considerably higher than the \$ 350 B (without repression) estimated by Baker, et. al. (2009). See Barclay (2010) for the detailed discussion of these differences.

private sector, jobs. The CPEG proposal is based on the premise that the U.S. economy has not created a sufficient number of well-paying jobs for many decades (well before the current crises) and is unlikely to do so in the future absent a permanent and large scale restructuring of the U.S. economy that has to be led by public sector jobs creation.

## **B) Rebalancing World Trade to Create a Sustainable U.S. and World Economy**

The myth that “free trade” is a sustainable world trade solution is as debilitating as the myth of a “private sector” job creation solution to the current crises. In fact the corner stone of the free trade doctrine, Ricardo’s theory of comparative advantage has been shown to be mathematically over-determined and infeasible (Baiman, 2010a). Comparative advantage demonstrates static gains from *managed trade*, not free trade. For Ricardo’s parable to work England must impose a tariff or quota on Portuguese wine. A similar demand side analysis of a general world trading model, that satisfies Marshall-Lerner and other assumptions, proves that even under the most idealized Neoclassical conditions, “free trade” is mathematically unstable and thus an economically infeasible outcome (Baiman, 2010b).

In a masterful new book Fletcher (2009) looks at the history, policy, and theory of U.S. and world free trade. Worldwide “free trade” tends to increase global inequality. Fletcher notes that according to the World Bank the entire net decline of the number of people living in poverty in the world since 1981 has been in China. Elsewhere their number increased (World Bank, 2008). The “unequal exchange” model used in Baiman (2006) demonstrates this. It has also produced an unsustainable U.S. trade deficit. Fletcher points out that over the last two decades the U.S. has bought over \$ 6 trillion more from the world than it has sold back to it; that this amounts to over \$20,000 per American; and that our annual trade deficit which (until the recession) was about 5% of the GDP was the largest of any

country since Italy in 1924. Moreover, even before the 2008 recession the U.S. had not generated any net new manufacturing or service jobs in internationally traded sectors (Fletcher, 2009, p. 2).

In 2007 (before the recession) the U.S. had a trade deficit in every single goods category, see Figure 2.

**Figure 2:**

Period	Total Census Basis (1)	End-Use Commodity Category (billions of 2005 dollars)						
		Foods, Feeds, & Beverages	Industrial Supplies (2)	Capital Goods	Automotive Vehicles, etc.	Consumer Goods	Other Goods	Residual (3)
2007	-\$734.7	-\$5.5	-\$239.8	-\$15.9	-\$136.7	-\$324.9	-\$16.0	\$4.0

(1) Detailed data are presented on a Census basis. The information needed to convert to a BOP basis is not available.  
(2) Includes petroleum and petroleum products.  
(3) The "residual" represents the difference between total Census Basis exports or imports and the sum of the components. For additional information, see [www.census.gov/foreign-trade/aip/priceadj.html](http://www.census.gov/foreign-trade/aip/priceadj.html).

Moreover, this deficit in goods exports is not made up by taking out Petroleum Products, see Figure 3.

**Figure 3:**

Trade Balance (Billions of 2000 dollars)				
Period	Total Census Basis (1)	Petroleum	Non-petroleum	Residual (2)
2007	-\$654.8	-\$121.1	-\$545.2	\$11.5

(1) Detailed data presented on a Census Basis. The information to convert to a BOP basis is not available.  
(2) The "residual" represents the difference between total exports or imports, and the sum of the components in the table.

In 2007 we had a \$ 129.6 M service, and \$90.8 M income receipts, surpluses, see Figure 4. This was hardly enough to make up for our deficit in current account.

**Figure 4: 2007 U.S. Current Account in Services (millions of current dollars)**

	Exports	Inports	Net
1 Exports of goods and services and income receipts	\$2,462,099	-\$3,072,675	-\$610,576
2 Exports of goods and services	\$1,643,168	-\$2,344,590	-\$701,422
3 <a href="#">Goods, balance of payments basis2</a>	\$1,138,384	-\$1,969,375	-\$830,991
4 <a href="#">Services3</a>	\$504,784	-\$375,215	\$129,569
5 <a href="#">Transfers under U.S. military agency sales contracts4</a>	\$25,436	-\$32,820	-\$7,384
6 Travel	\$97,050	-\$76,354	\$20,696
7 Passenger fares	\$25,636	-\$28,437	-\$2,801
8 Other transportation	\$51,550	-\$67,100	-\$15,550
9 <a href="#">Royalties and license fees5</a>	\$83,824	-\$24,656	\$59,168
10 <a href="#">Other private services5</a>	\$220,077	-\$141,664	\$78,413
11 U.S. government miscellaneous services	\$1,212	-\$4,184	-\$2,972
12 Income receipts	\$818,931	-\$728,085	\$90,846
13 Income receipts on U.S.-owned assets abroad	\$815,960	-\$718,019	\$97,941
14 Direct investment receipts	\$363,247	-\$126,532	\$236,715
15 Other private receipts	\$450,480	-\$427,159	\$23,321
16 U.S. government receipts	\$2,233	-\$164,328	-\$162,095
17 Compensation of employees	\$2,971	-\$10,066	-\$7,095

The U.S. has even been running a deficit in “high technology” since 2002. Chinese imports are half of our deficit in manufactured goods and over 100% of our deficit in technology (there is a U.S. surplus with the rest of the world in these goods). More generally, in 1989 only 30% of Chinese imports competed with high-wage industries in the U.S., but by 1999 that figure had risen to 50% (Fletcher, 2009, p. 70-1).

(McCormick, 2010) provides detailed documentation of the demise or drastic decline, particularly over the last decade, of U.S. capacity across high tech and emerging green technology sectors including: printed circuit boards, photovoltaic cells, wind-energy, cell phones, steel production, and machine tools. McCormick notes that in 2007 Georgia Tech’s bi-annual “High Tech Indicators” study found that the U.S. peaked in 1999 at 95.4 (on scale of 100) and had fallen to 76.1. China technological standing moved from 22.5 in 1996 to 82.7 in 2007 higher than the U.S. for the first time since the index was created two decades ago.<sup>6</sup>

Gomory and Baumol (2000) building on earlier work by Krugman and others, have simulated the impact of capturing path dependent, dynamic, “Retainable Industries” that enjoy oligopolistic rent or “unequal exchange” due to scale or other barriers to entry . Their work suggests that without an industrial policy to encourage the growth of these kinds of industries, U.S. trade deficits that are not fundamentally due to low wage competition will not be overcome. Moreover, without a trade policy a permanent jobs program will further increase these unsustainable trade deficits. We are not therefore likely to be able to sustain a jobs program without a trade policy.

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<sup>6</sup> Needless to say this finding sparked considerable debate. For a recent review see (Porter, et. al., 2009). The author’s conclude that while China’s precise current standing in high tech may be debatable: “If not yet, then within not too many years, the United States will likely be supplanted by China as the leading technology-based economy (p. 1).”

Greider (2009) and Gomory and Baumol (2000) point out that in social democratic countries labor, community, and other local stakeholders have institutional power that enables them to often block significant disinvestment or off-shoring of high-value added high-wage employment. In contrast U.S. based” multi-nationals are often driven by short-term returns with no concern for the long run impact of investment or out-sourcing decisions on their home country where many of them no longer produce or design the bulk of their products. The U.S. must thus rely on macro policy. Greider suggests using Article 12 of the WTO, under which countries that run persistent and unsustainable trade deficits may apply emergency tariffs as a remedy. Under this plan the U.S. would invoke this Article to cap and gradually reduce its trade deficits. Revenue from these tariffs would be used to support raising real wages and consumption in the poorest low-income developing countries. This strategy is similar to that advocated by (Schweickart, 2002) (Palley, ) and (Baiman, 2006) where it is called “Solidarity Trade Policy”. These payments might complement payments to developing countries to offset carbon emissions reductions under carbon cap and trade schemes.

An alternative or complementary “natural strategic tariff” or flat tariff approach with progressivity sustaining cuts in other taxes, is proposed by Fletcher (2009). This would avoid the political problems of trying to design industry specific tariffs but would have the affect of subsidizing emerging dynamic manufacturing sectors with rapidly declining cost curves that are more likely to turn into “retainable industries” without generating (at say a 30% level) comparable cost advantages for more mature “commodity” industries that are not in the U.S. interest to retain.

A composite solution might be a natural strategic tariff adequate to cap and gradually reduce U.S. deficits, invoked through WTO Article 12, the proceeds of which would be rebated for progressivity neutralization in the U.S. and to the poorest developing countries to support economic and

environmental upgrading. Warren Buffet has proposed that exporters be given a \$1 certificate for every dollar that they export and that importers be required to purchase these certificates for every dollar that they import (Fletcher, 2009). This would result in a flat tariff on importers and flat subsidy for exporters but no public revenue. Another alternative is to acknowledge that self regulating free trade is impossible and to use global diplomatic leverage and trade sanctions to force major surplus “trade predator” countries to appreciate their currencies and/or cut back on mercantilist policies until world trade comes into approximate balance.<sup>7</sup>

### **C) Industrial Policy to Maintain U.S. Prosperity**

Finally, as should be clear from the discussion above, it is likely to be difficult, if not impossible, to ultimately solve the U.S. trade problem through legislation alone. An industrial policy will be necessary. Such a policy needs to follow the historic pathways described by Norwegian economist Eric Reinert’s path breaking book on the neglected institutionalist “Other Canon” of economic thought and policy history (Reinert, 2007). We need to find a way to incubate “good industries” that can be retained and that function as dynamic drivers of further development. A simplified version of “developmental trade” with “unequal exchange” is also modeled in (Baiman, 2006).

Industrial policy suggestions include changing the federal corporate tax code to provide tax deductions for domestic value-added production and tax penalties for off-shore production. The tax can be implemented in a gradual fashion over some number of years to allow a transition to domestic production (Grieder, 2009, chap 7). However, such a change in tax code, including new transactions taxes as proposed in the jobs program, can only be the start of a comprehensive industrial policy for

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<sup>7</sup> The print edition of Kuttner (2010, p. A8) includes an informative table adopted from Peter Navarro that divides nationalist industrial and trade policies into “Predatory”, “Ambiguous”, and “Sensible”.

the U.S. Pollin and Baker (2009) offer some initial suggestions for a U.S. industrial policy centered on public and transportation infrastructure, and clean energy.

## **Conclusion**

The small bore “stimulus” or “jolt” rhetoric coming out of Washington needs to end. The U.S. economy faces a fundamental structural and institutional crises that requires major changes in economic policy and far reaching programs including: A) A federally funded *living wage jobs program* mostly funded through transactions taxes on finance, B) Emergency measures to cap and gradually *reduce the U.S. trade deficit*, C) A transparent and coherent “*industrial policy*” to increase high value added, competitive manufacturing exports.

The goal should be to support “non-predatory” trade and industrial policies that move the U.S. and world economies toward sustainable and balanced trade and development. This will require an explicit eschewal of the “Neo-liberal” or “Neoclassical” economic policies that have generated enormous concentrations of wealth, especially for Finance Capital, and economic growth in selected countries, but increased poverty and inequality for workers and the unemployed throughout most of the world.

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