

REVIVING CONFIDENCE IN THE AMERICAN ECONOMY CHINA, INVESTMENT AND THE DEFICIT HAWKS

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Since the early 1980s, rises in the living standard of middle class United States citizens have not kept up with the gains in labor productivity. Wages in the middle class have been close to flat. At the same time, consumer spending continued to grow abetted by innovations in consumer finance that supported ever-higher levels of consumption for any level of income. The credit crisis of 2008-9 has ended and unmasked the contradictions inherent in this unstable system and also in the international commercial system that has relied upon U.S. consumers as the buyers of last resort since the Second World War. American consumers cannot be both under downward pressure from outsourcing competition and relied upon to be the locomotive of worldwide economic growth.

The retrenchment of the American consumer, as housing wealth evaporates and unemployment rises, blows a chill wind over the sentiments of consumers and business investment. Only the Obama Administration's fiscal stimulus resists the decline of demand.

Declining fortunes associated the crisis are surely accelerating the retrenchment of American living standards. Yet the pain of adjustment is more easily borne if it is seen as transient rather than without end. The Obama Administration, despite the oratory brilliance of the President, has yet to articulate a credible vision and plan of how a broad base of Americans, and not just a few financiers, will recover and return to a vital medium term outlook. What challenges stand in the way of a credible plan that must hinge upon restoring sustainable living standards in this country? I see two. 1) Significantly lower costs of production in developing countries; 2) and deficit hawks.

The top management of American corporations has been able to see plainly for years that social costs of labor inputs and the costs of energy inputs (polluters do not pay) are much lower in the developing world than they are in the United States. Economists look at measure called relative unit labor cost of production and can see that China, and several other developing countries, have much lower labor costs per unit of output than in the United States.

Right now that gap is closing slowly. Investment is depressed in the United States and much more vibrant in China. Wage growth is higher in China than in the USA, albeit from a much lower level, but Chinese wage rises are somewhat dampened by the sheer scale of labor supply that can move from rural life to the factories. At the same time investment and productivity growth in China is also much higher than in the USA where investment is depressed. So the relative unit labor cost gap is not closing rapidly. In fact it may be decades before the relative unit labor cost gap ceases to be a major incentive to outsourcing, absent a large change in the exchange rate. The sheer size of China and India make this a major challenge to the United States and the industrial world.

This is not a static situation. The U.S. can regain competitiveness in several ways. First through an exchange rate appreciation of the currencies of China and the developing countries relative to the dollar will diminish the cost imbalance. That is a necessary change in the near to medium term. Secondly,

labor rights agreements and environmental standards in the developing world may also be helpful by raising the floor of costs rather than driving us to the lowest common denominator. Third, rising living standards in the developing world may increase demand for products made in the industrial world over time. Though these recommendations of a shift to environmentally sound consumer led growth in China often leaves Chinese officials confused. They hear U.S. corporate top management with substantial foreign direct investments in China resisting policies of wage growth or environmental cost increases while leading officials in Washington talk as though it is a necessary component of restoring macroeconomic balance.

Finally, rising productivity in the United States both in absolute and relative to productivity growth rates in the developing countries would improve the competitiveness of our workforce. What would that entail? Investment in the human capital of the American workforce, business fixed investment on the U.S. mainland, and infrastructure investment by the U.S. government to augment and complement, and therefore inspire, business investment in the USA.

Resistance to public spending along these lines may be formidable. In an era when money driven American politics has shown itself so much more responsive to special interests than to general interests it may be difficult if not impossible to create a consensus for efforts to enhance broad based productivity growth. Much of multinational corporate top management does not need a vital and healthy American workforce to thrive. Yet they do need a strong foreign military presence. Many high-income earners who finance politics see little benefit from paying more taxes to support public spending when they do not trust that their dollars will be efficiently used. As is evident in the news media today, the deficit hawks are on the warpath now when it comes to nonmilitary spending.

Despite their silence when tax cuts for the wealthy were enacted while we fought in Afghanistan and Iraq and despite their silence when losses from reckless financial institutions were transferred from the creditors of those Too Big to Fail firms to the public balance sheet, the deficit hawks will now vehemently resist efforts to rebuild the public infrastructure that would complement and augment the productivity of the productive plant of the mainland United States. That is the productivity that constitutes the promise to the American people that this crisis will be only transient.

Deficit hawks prefer, it appears, to rely upon private sector solutions. Yet business fixed investment in the U.S.A. is likely to be lackluster without a public jumpstart as consumption wanes and the temptation toward outsourcing continues. The Obama Administration is faced with an increasingly angry populist energy and 2010 is none too soon to implement a plan for the economic revitalization of the nonfinancial economy.