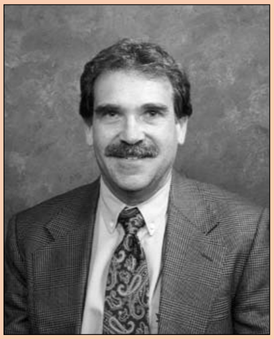
Pains of realignment

Americans are squeamish at best and fear the worst as the economy shows evidence of cracking under the weight of bad debt, overzealous risk taking, government and consumer indebtedness, and lower productivity. Cheap imports, especially from China, and easy credit have kept consumers happy and willing to spend beyond their means. US companies, for the most part, have strong cash positions, but are becoming wary about expansion and investment. This economic upheaval, added to world political uncertainty and global environmental degradation, makes Americans nervous about the future. What will be the cost and who will suffer from the USA's current state of economic misalignment? What will be needed to right the American economic ship?

"This economic upheaval, added to world political uncertainty and global environmental degradation, makes Americans nervous about the future."

The USA's economic malaise can be attributed to several factors. The most obvious is the volatility of the stock markets which is the result of investor greed finding vulnerable consumers who want to realize the "American dream" although they lack the resources in an overheated housing market. Policymakers should have been extremely nervous over the news that 40% of California homebuyers last year purchased their homes on interest-only loans, suggesting that they had no money for a down payment. Loans based on very little documentation to people with few or no assets ran to about half of all mortgages in 2006. The sellers of those loans made their money up front, packaged the loans to investors, and then covered their eyes to avoid seeing the ugly consequences. Who is to blame? That depends on whom you talk to. Your textbook capitalist will argue that bad economic decisions are penalized by the market, and the



market will self-correct. The opposing view is that trickery and misinformation duped the consumer and such behavior is morally and perhaps legally unacceptable. Regardless of one's position on the matter, in August 2007 the Federal Reserve Bank pumped in over US$60 billion and central banks around the world took similar actions to avert a global economic meltdown. The Federal Reserve Bank's infusion of money three times in one day was unprecedented in US economic history. As this article was being written the outcome was still uncertain.

One must wonder why the overly generous credit climate never rang the alarm bells among economists. Retail store offers of no money down and no payments for two years would seem to strike at least the more senior economists who once lived in a cash economy as extraordinary. What should really rattle economists are the negative savings rates for individuals and the government. Individual savings have declined into negative territory from about 7% 15 years ago. As mentioned above, businesses maintain a positive savings rate. Having no savings would seem to be a problem, but many economists believe that economic growth trumps indebtedness. Such faith in economic growth is not shared worldwide. The USA has the lowest individual savings rate among industrialized countries and many developing countries; a good example is Chinese peasants who reportedly save 20% of their income.

Alarms are being heard, however, over the US government's dependence on foreign investment to cover its debt. The government's operational shortfall of some US$800 billion a year has been made possible by some US$900 billion in foreign purchases of long-term US securities. Governments, however, are exhibiting reluctance to continue to depend on the US dollar and are diversifying away from dollar-denominated debt. Higher yields can be found elsewhere, although at greater risk. Perhaps it is hyperbole to suggest that the USA is intoxicated with what debt can buy, but certainly some lifestyle adjustments are in order for both the consumer and the government.

"The USA needs to resolve the healthcare crisis and revamp Social Security to ensure long-term viability."

Increasing productivity was the cornerstone of the US economy over the past decade. During that time, the economy benefited from over US$6 trillion in additional output due to improvement in productivity rates. From 1995 to 2005, the average productivity increase was 2.7% per year. This represents a one-point increase over the prior two decades and a 10% increase in economic output. The ensuing productivity bonanza allowed Americans to enjoy an unprecedented improvement in their standard of living and provided the courage to incur considerable debt. The ability to continue to depend on productivity is now being questioned with the latest revised figures for 2006 showing a low 1% productivity gain. (The preliminary estimate was 1.7%.) The first quarter of 2007 showed only a 0.7% increase in productivity. This compares with a 3% average annual rate from 2000 through 2005. At the same time, labor costs are increasing. Unit labor costs rose 2.9% in 2006 and 3% in the first quarter of 2007. The decline in productivity and increase in labor costs will erode the living standards of Americans, perhaps more dramatically than the current turmoil in the stock market.

Given the storm clouds on the horizon, what might be the face of a realigned economic landscape for the USA? It is hard to imagine that business as usual will suffice. A decline in US quality of life will be felt disproportionately by the middle and lower economic classes who will shoulder the brunt of the readjustment. Should the shock be severe, the next election will divert the USA away from President Bush's "ownership society" toward more government responsibility for righting the ship. Americans do not relish more government involvement, but will need to turn somewhere for relief. Americans will want to curtail military expenditures and put more money toward social improvement. This may or may not be possible, however, given the perceived threat of increased terrorism. The USA needs to resolve the healthcare crisis and revamp Social Security to ensure long-term viability. Job creation is key, which begs the question of immigration and job outsourcing. In an eye-opening article by Michael Mandel of *Business Week*, we learn that job creation in the US private sector, except for healthcare and construction, has been negative over the past five years. Job growth has been limited to healthcare (1.7 million jobs), construction (0.94 million), and the government (0.9 million). The remainder of the private sector lost 1.2 million jobs, with the highly touted information sector losing 800,000.

The US economy needs to reinvigorate itself beginning with some belt-tightening and a renewed sense of mission that has been derailed of late by investor greed, unrealistic consumer expectations, and government miscalculation of how best to lead the country and share world leadership.

Michael Manson had a long and close association with the APO when he was the Assistant Director of the East-West Center's Institute of Economic Development and Politics in Honolulu. He helped to initiate a number of collaboration programs between the APO and the East-West Center. Manson also served in the Asian Development Bank, and was Director of Communications with the State of Hawaii's Department of Business, Economic Development and Tourism. He is presently an educator.