FT.com FINANCIAL TIMES

Close

America needs a growth strategy

Print

By Michael Spence
Published: July 8 2010 21:53 | Last updated: July 8 2010 21:53

As the International Monetary Fund warned on Thursday, America's economy **shows worrying signs of weakness**. Worse, and in common with other developed countries, it also lacks a credible strategy for longer-term growth. Without such a strategy, a strong global recovery is unlikely.

The structural evolution of the US economy over the past 15 years has been driven by excess consumption, enabled by debt-fuelled asset inflation. The crisis put a stop to this, but structural deficiencies remain. America's export sector is too small and underdeveloped. The financial sector became outsized, and is down-sizing.

A pattern of underinvestment in infrastructure has left the economy less competitive than it should be. Energy pricing issues have been ignored, causing underinvestment in urban infrastructure and transport. The **education system** has widespread problems with efficiency and effectiveness. Elsewhere, state budgets are in distress as a result of insufficiently conservative budget policies.

Even with a fiscal strategy that balances short-term stimulus and longer- term stability, America must still address the composition and size of expenditures, investments and revenues. To finance growth-supporting long-term investments, domestic private consumption has to shrink. This means higher taxes. In addition, existing government expenditure must be shifted away from consumption and towards investment, meaning fewer government services. **Restoring fiscal balance** in a way that supports longer-term growth will therefore be painful.

But even that is not enough. The real issue is employment: not just stubbornly high unemployment, but a bigger problem described recently in a thoughtful article by Andy Grove, the long-time chief executive of Intel. He argued that **manufacturing is vanishing** in the US, a trend that must be reversed. The question is how.

There is little doubt that America's social contract is starting to break. It had on one side an open, flexible economy, and on the other the promise of employment and rising incomes for the motivated and diligent. It is the second part that is unravelling.

Incomes in the middle-income range for most Americans have stagnated for more than 20 years. Manufacturing jobs are moving offshore. Globally the set of goods and services that is tradable is expanding, but the US and other advanced countries are not competing successfully for an adequate share of the tradable sector.

The employment effects of these trends over the past 15 years have been masked by excess consumption and the overdevelopment of sectors such as finance and real estate. The latter are now set to shrink, as multinational companies grow where they have access to high-growth emerging markets in Asia and Latin America. Such companies will locate their operations where market and supply chain opportunities lie. In the tradable sector, in manufacturing and in a growing group of services, that means outside advanced countries.

The availability of low-cost, disciplined labour forces in developing countries reduces the incentive for these companies to invest in technologies that enhance labour productivity in the tradable sectors of the advanced economies. As a result, the evolving composition of advanced economies is increasingly weighted towards the non-tradable sector, combined with a set of high-end tradable services where both human capital and proximity matter. The rest of the tradable sector is shrinking.

The shrinkage creates problems. Over-specialisation could threaten independence and national security. Spillovers between R&D, product development and manufacturing will be lost if manufacturers leave. Employment will stagnate. Income distribution will move adversely and the social contract will erode further.

Solutions to these problems are not easy to find. The unequal distribution of income can be dealt with through the tax system, although this does not attack the underlying problem. Protectionism could alter the pattern of out-migration of manufacturing, but only by imposing costs on domestic consumers and risking the breakdown of the open global economy model.

To avoid an outbreak of protectionism, there has to be an alternative. President Barack Obama's **new export council**, announced on Wednesday, is a step in the right direction. But a bolder move is needed: a broad public-private partnership to invest in the development of technology in parts of the tradable sector where there are opportunities to make advanced countries competitive. The goal must be to create capital-intensive jobs that have labour productivity levels consistent with advanced country incomes.

Would this damage developing countries? Clearly not. The US (or even developed economies combined) does not have hundreds of millions to employ. A targeted programme would leave the vast majority of labour-intensive manufacturing right where it is now: in the developing world. With new credible growth strategies in America (and other advanced countries) developing countries may even be willing to play an important complementary role in restoring global demand through, for example, the reduction of excess savings.

We are already on a lengthy and bumpy road to a new normal. That is unavoidable. The risk is that without a new direction in American economic policy, the new normal may be as unpleasant as the journey.

The writer received the 2001 Nobel memorial prize in economics and chairs the Commission on Growth and Development