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REBUILDING AMERICAN INDUSTRY

[by Tom Larson]

All around us is evidence of decline in the American economic system: massive trade deficits, excessive federal budget deficits, high unemployment, rising structural unemployment and stagnant productivity. Our economic problems have already led to a declining standard of living for millions and may soon reduce the standard of living for the majority. For many union workers, evidence of decline is seen in falling employment and wages in basic industries. Economists are worried about massive federal deficits stretching "as far as the eye can see" -- that will not go away even at full-employment and will reduce needed capital investment by pushing up interest rates. Exploding trade deficits are leading to fears of a new trade war as we import about $165 billion of goods more than we export, each year.

These problems cannot be addressed by traditional "Keynesian" economic policies. Keynesian policies, which manage the demand for goods and services, may be well suited for short-run fluctuations in demand, using increased public expenditures, for instance, to counterbalance declines in private sector expenditures that lead towards a recession. However, these policies are simply not designed to combat long-term decline in productivity growth -- the source of past improvements in our standard of living. Despite the rhetoric of Reaganomics, no short-term supply-side solutions to the business cycle have been found and nothing has been done by the Reagan administration to promote long-term productivity growth.

Lester Thurow, the new dean of MIT's Sloan School of Management, argues that the government must aid in the development of industries with a strong core of middle-income and high-wage jobs that are at the forefront of technology and we must revive productivity growth in our older industries using innovative and less adversarial labor-management policies; for example, labor must be treated as a partner in production. We cannot compete with the rest of the world on the basis of lower-wages or a reduced living standard -- we should compete instead by raising our skill levels and improving our products.

The U.S. currently ranks about seventh among the world's nations in per capita output. Our low productivity growth guarantees that other nations will soon pass us and further reduce our ranking. (Productivity growth was 3.7% per year in the 1960s and fell to .2% in the 1970s, a barely discernible growth rate.)

Our Treasury Secretary's solution to the trade deficit, lowering the value of the dollar, means that we are supposed to become competitive with the rest of the world by reducing our standard of living. A lower value of the dollar in international trade means that imports are more expensive and exports are cheaper. So far this has only raised the cost of living as consumers pay more for imports and for import substitutes. Since imports are equal to 12% of our GNP, a 30% fall in the value of the dollar potentially means another 4% of inflation on top of the base rate. Our exports have failed to expand, so we have traded inflation for nothing. This is the free market solution!

The U.S. no longer enjoys clear technological advantages in international trade. Faced with stiff foreign competition for even our domestic markets, it is indeed difficult to find ways to become more competitive with foreign producers. In 1984, a trade deficit of $123 billion meant the loss of three million U.S. jobs and the devastation of many communities. Now the trade deficit is around $165 billion a year. We have to do something to generate new jobs and this means becoming more effective in international trade. The U.S. is no longer a leader in many important fields -- we cannot count on formerly strong export industries such as machine tools, pharmaceuticals and agriculture -- and foreign firms lead in important new industries such as fiber optics and robotics.

The current emphasis by the Administration and business community on cutting wages and the standard of living is the wrong approach, one that is not only unfair to wage workers but that wi. come back to haunt management and owners as the current decline in the size of the middle-class accelerates and the ranks of the poor and near poor increase. Without the great rise in the proportion of married women working in recent years, the fall of the middle-class would be precipitous. In the long-run, reducing wages in the U.S. will do little to increase employment. How can we compete on the basis of low wages when there are so many millions in other nations willing to work for pennies a day?

Perhaps these fears of decline seem misplaced given the past five years of economic expansion: falling energy and food prices and a high exchange rate that attracted foreign investment (mostly in our debts) coupled with expansionary deficit spending. Our recent growth is based on borrowed money and a temporary fall in energy and food prices. It is clear that energy prices have bottomed out and will likely go up again and the same can be said about food prices. Low interest rates are curbing foreign investment in the U.S. but are failing to stimulate domestic investment. The current budget deficit is about 5% of GNP and our national savings rate about 3% (and falling!). The long-term prospects for net investment are not good. Lester Thurow suggests that we are today merely "enjoying the calm in the eye of the hurricane."

The standard of living that this country has achieved is based on high labor productivity. In the past, many jobs were made into middle-income jobs by the unions through their demands for higher wages. Higher wages were then paid for through increased productivity. But today, growth is not occurring in those industries abundant in middle-income jobs or in the unionized sector. Employment growth is centered in industries with many low-wage jobs and some high-wage jobs. In California, the semi-conductor industry typifies this pattern -- low-wage production workers and high-wage professionals hold most of the jobs and there are few middle-income workers.

There is no reason to be confident that we can continue to produce many high-wage professional and managerial jobs either. In Fremont, at the NUMMI plant, American workers build the cars, but the Japanese did the engineering and manage the plant. Efforts to export our financial and manageria talent to the rest of the world may not be welcomed. Japanese and Korean managers are available at lower salaries. British banking did not survive the decline of British manufacturing and American banking may face a similar fate if we give up our manufacturing base. The loss of production jobs is not just a problem for the worker -- once these jobs leave the U.S., who will want our over-paid managers and financiers?

Thurow argues that protectionism, the current effort to reduce imports by raising tariffs, will only gain us low-wage jobs and we can only protect our domestic market. Already 12% of our national output is sold abroad -- we cannot protect these markets with tariffs. In California we are gaining low-wage apparel jobs but are losing high-wage aircraft jobs.

Current policies assure us of a lower standard-of-living in the future and have given us little comfort in the present. We need to re-invest in the American economy in a big way. This means spending more on education and research, promoting capital investment to raise the ratio of capital to labor (making labor more productive) and inducing management to seek innovative arrangements in partnership with labor to reduce workplace friction and improve total performance. To do this, we will have to give up some current private consumption and we are going to have to decide who has to give up how much consumption. This requires concern for equity and fairness. Current policies that favor the wealthy have not worked -- there has been no trickle down of anything good. Let us try policies that will advance economic growth while reducing poverty and once again enlarging the ranks of middle-income earners. This is not impossible -- this is what the competition is doing.

-- Tom Larson

For further reading, see Lester Thurow, The Zero Sum Solution, Simon and Schuster, 1985.