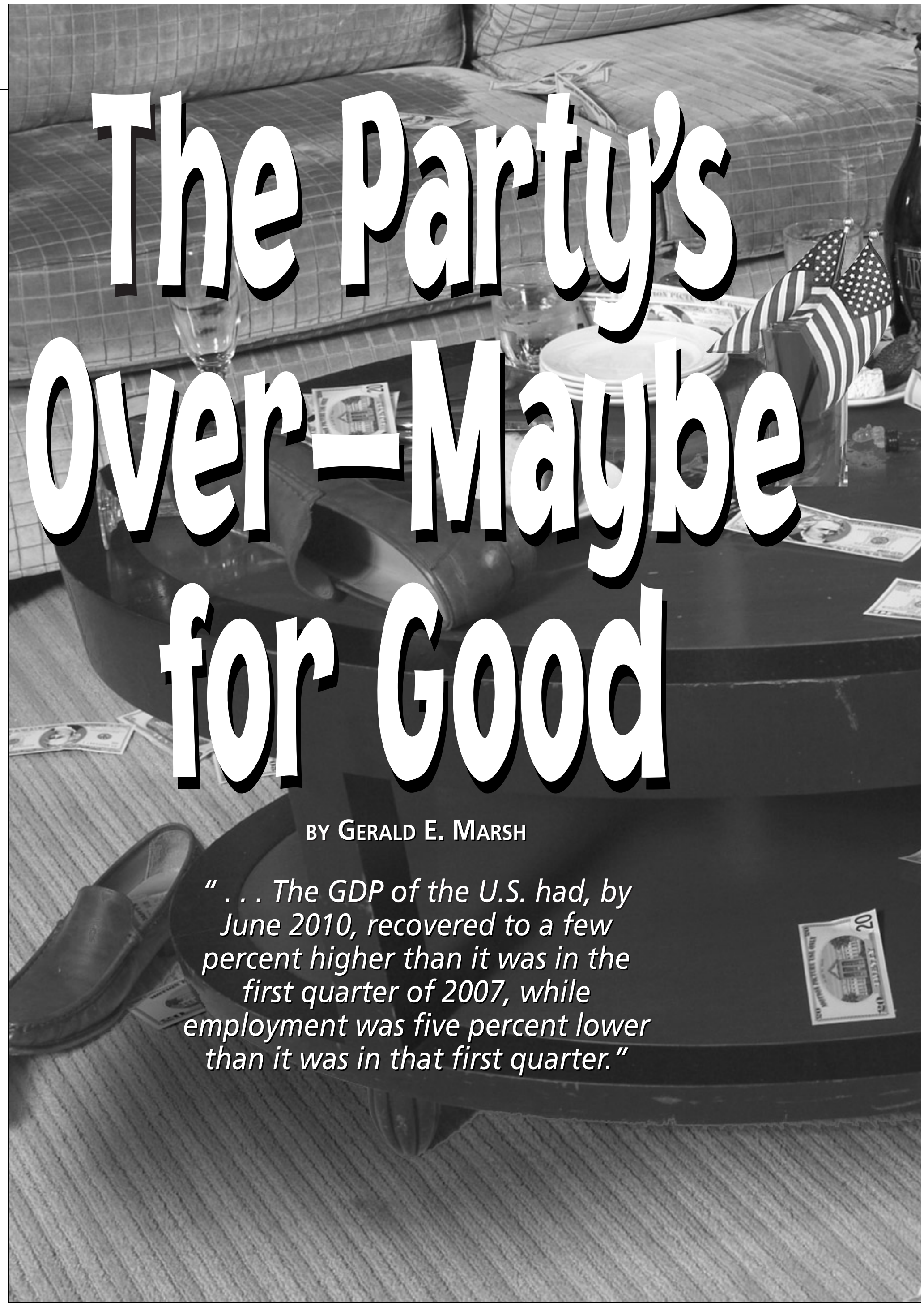

The Party's Over—Maybe for Good

BY GERALD E. MARSH

" . . . The GDP of the U.S. had, by June 2010, recovered to a few percent higher than it was in the first quarter of 2007, while employment was five percent lower than it was in that first quarter."

IN THE MID 1960s, Robert Theobald, in *Free Men and Free Markets*, proposed that the advanced nations seriously consider the possibility of instituting a guaranteed income as the "only way to prevent the emergence of a technologically dehumanized consumer society." He felt the problems raised by automation had no known solution, and that the present socioeconomic system would lose its legitimacy if it could not provide jobs which paid a living wage to those seeking them. In his view, automation would eliminate the high-paying industrial jobs and, because individuals with low skills and inadequate education would become more dependent on government programs, they increasingly would lose control over their own lives.

What has happened since then? Surprisingly, perhaps, automation has not been the principal reason for the loss of high-paying manufacturing jobs, and the U.S. has taken initial steps towards the introduction of a guaranteed annual wage—it is called the Earned Income Tax Credit. How did this happen?

The 1960s were a time when American corporations were beginning to feel the competition from the newly rebuilt productive capacity of Europe and Japan but, rather than expand and modernize existing facilities at home, these firms found it increasingly attractive to establish "export platforms" in the Third World. Since then, the operations of multinational corporations have evolved into an integrated, interdependent worldwide network of resources and capabilities best characterized as transnational—and while there are some structural differences, the same holds true for European and Japanese firms.

While China may follow this evolution in the future, if and when the wealth of its population as a whole becomes comparable to the developed world, it currently follows a predatory mercantilist policy, where its trade surplus is maintained at an artificially high level by currency manipulation. Chinese companies also appropriate intellectual property "often [by] 're-innovating' technology sucked out of joint ventures," as so succinctly put by the *Financial Times*.

The principal reason for the loss of jobs in the U.S. and, increasingly in the other developed countries, has been the creation of a genuine world economy. The scale of the internationalization of production that has accompanied the emergence of this global economy is unprecedented in history, and developing countries—where the costs of labor and raw materials are low—will continue to have a competitive advantage over the advanced nations in the production not only of basic industrial goods, but relatively sophisticated products, ranging from consumer electronics to automobiles. The global economy has been made possible because of the revolution in communications and transportation that allows a global corporation to be managed effectively as a single coherent entity.

To understand the extent of the change, consider that, while the percentage of world markets held by American corporations exporting from the U.S. has declined steadily, such declines have been offset by the gains of American corporations exporting from other nations. The value of the output produced overseas by U.S. corporations far exceeds the value of the goods exported from our shores. In 2008, the value of U.S. exports of goods and services was about one-third of the $500,000,000,000 in revenues of American-owned foreign affiliates. According to the Commerce Department, only about one percent of U.S. companies do any exporting and, of those, 58% sell to just one other country. Nonetheless, the U.S. remains the largest manufacturer in the world.

The real problem is that the manufacturing sector's share of the gross domestic product has shrunk over the last four or five decades to about eight percent. As put by Leo Hindery, former chief executive of AT&T, "No country as economically mature, large, and diverse as America can prosper with only eight percent of workers in the manufacturing sector."

Increasing this fraction will, however, be difficult for a variety of reasons. Foremost among them, as a consequence of increasing automation, is the lack of needed skills in the workforce to qualify for the remaining higher-level jobs, as well as differing and less-stringent environmental and labor standards lowering costs in many countries hosting production by U.S. companies. Yet, perhaps one of the biggest factors is that the U.S. is the only advanced exporting country where most workers get their medical care paid by employers with a relatively small contribution from participants. This, and higher corporate tax rates, significantly raise the cost of manufacturing in the U.S.

Europe may appear to be an exception to this but, even there, where most countries have some

form of national health care, other costs are high enough to provide a substantial incentive to move manufacturing abroad. Of course, there always is an exception and, for a variety of reasons, Germany has been that special case. However, as the manufacturing capability of China and the rest of the developing world becomes more sophisticated, as put to the *Financial Times* by Jürgen Heraeus, chairman of the Supervisory Board of Heraeus Holding GmbH, "German companies are in danger of being pushed ever higher on to the technological ladder, until one day the market niche will be too small."

The internationalization of production, along with the increasing export of service jobs, has created significant domestic problems for the U.S. and other Western economies—and will continue to do so. In fact, from the perspective of an American worker, it is equivalent to the effects of automation feared by Theobald. This is compounded by the fact that automation also has become a growing factor in reducing the size of the workforce. That is, after all, what "productivity" is all about.

Domestic companies that need to expand production can utilize one of two approaches: capital investment in highly sophisticated and automated production facilities in the U.S. so as to achieve adequate productivity, or they can invest significantly smaller capital in developing nations where labor and other costs are relatively small. Which they select depends on a variety of political, social, and financial factors. In the end, they will choose the best combination of risk and cost. In either case, their "productivity" will be high, even in the scenario where large numbers of semiskilled people are employed in developing nations. How could that be? The reason is simple: productivity as a measure of the American workforce fundamentally is flawed since labor productivity, as calculated by the Labor Department, only counts worker hours in the U.S. This means that a manufacturer having U.S.-based headquarters with a large and very low-productivity workforce in a developing nation where labor and other costs are minimal, will be listed as being highly productive. A true measure of productivity would consider the real total number of worker hours.

While the real productivity of U.S. workers has increased significantly, no amount of productivity increase will survive competition with the developing world's standard of living. This shift to international production is, for better or worse, essentially irreversible, although it does raise the unrealistic idea that protectionist policies could shield the domestic workforce. It is limited only by the lack of infrastructure in many developing countries and the fear of capital loss through nationalization or civil strife.

To call on the government to reverse or ameliorate the effects of the globalization of production is futile. Much of the economic power of the U.S. is not under the immediate control of the government, and it is not clear that the extent of the government's regulatory powers would be adequate for the task, nor is it obvious that such intervention would be beneficial. The people are unlikely to call on the government for action in any case, since there is no consensus as to what should be done, and the government increasingly is viewed by them as representing not the people as a whole, but rather special interest groups, with corporate interests comprising the largest and most powerful such group.

Furthering this view is the fact that much government activity abroad is aimed at promoting U.S. corporate interests. So long as the corporation and the state had common boundaries, corporate growth and well being meant the creation of well-paying jobs for the mass of the people, and high-paying jobs for those with the requisite skills and talent—but this no longer is the case. Only those with exceptional skills—obtainable by members of an ever-diminishing elite—are able to secure well-paying jobs. In these difficult times, social services for the people are under attack, while massive subsidies to the financial industry and corporations are legislated—to ameliorate a near collapse that they themselves caused—in the face of great public confusion, opposition, and anger.

As production has become more internationalized, the service-based sector of the economy has grown in response. While there is nothing wrong in principle with having a nonmanufacturing-based economy, domestic social tranquility cannot be maintained through the creation of large numbers of jobs barely able to sustain a family at the poverty level, especially if such jobs lack even basic benefits.

It often is stated that the solution to the problem of low wages is an educated workforce and, indeed, the level of education in this nation is abysmal. Despite the unquestioned excellence of U.S. universities, too many of American 18-

year-olds are functionally illiterate, and far too many of today's high school students drop out before graduation. The problem is not the quality of education available to the relatively small elite, but rather the general level of education and training available, through primary and secondary education, to the population as a whole. While better general or vocational education can help, it will not solve the problem. One need only look at the large numbers of highly qualified scientists and engineers scrambling to find a position to be convinced of this. Young doctors and lawyers, who often carry large burdens of debt from the costs of their education, are following quickly in their footsteps, as the number of people who can afford their services declines.

In the long run, the country faces a problem whose nature will put our current economic and social structures under increasing stress. The reason derives from some fundamental aspects of human capabilities and intelligence. First and foremost, human intelligence cannot properly be encapsulated in a single factor like I.Q. Intelligence has a multidimensional nature, the components of which vary across populations. Whatever capability one chooses to measure (the most often mentioned being verbal and spatial abilities), the results of the measurements taken across populations will fall in roughly bell-shaped curves known as normal distributions, with the peak being at the mean value. One might argue that certain abilities might be distributed along a somewhat different distribution, but a normal distribution will serve well enough here. A normal distribution means that half of the population will have a given capability above the mean and half below. Any given person will have a range of capabilities, some above the mean and some below. Each will be due to a mix of inheritance, upbringing, and general environment—the result of nature and nurture.

After the Great Depression and World War II and, to a decreasing extent, in the present, the economy was diverse enough to allow most people with whatever range of capabilities and skills to find a job that could provide at least basic needs. Our current social and economic structure is finding it increasingly difficult to do this. Many jobs no longer pay enough to provide an adequate standard of living; those without marketable skills often are forced to work two or more low-paying jobs to make ends meet, and families may have several workers. Thus far, this has kept the median family income at around $50,000. Sounds good, but this means that half of families in the U.S. have incomes below that level, and some significantly below.

In real terms, it may not be possible to sustain this level of family income in the future. This is due to two factors: increasing automation and offshoring eliminating jobs for people with low skill levels, and rising educational requirements for the remaining jobs. For whatever capability is required, individuals in the lower half of the bell-shaped curve will be forced to compete with those in the upper half and will find it increasingly difficult to find a job that pays enough to satisfy basic needs. Honesty, decency, a willingness to work, and a strong back no longer are enough.

After the recent banking debacle, and the declaration in mid 2009 by the National Bureau of Economic Research that the Great Recession is over, unemployment still stands at close to 10%, with at least another 7.5% who have given up looking for a job or are employed only part time, and this does not even include the young who are extending their school years and those who never had a job and have little, if any, prospect of finding one. To compound the problem, many of the jobs lost will not come back as companies use the opportunity to restructure. One possible indicator that this already is underway is the fact that the GDP of the U.S. had, by June 2010, recovered to a few percent higher than it was in the first quarter of 2007, while employment was five percent lower than it was in that first quarter.

Buying Time

What can be done? Not much. We are living through what only can be characterized as a second Industrial Revolution. We could buy some time by creating a 10- to 20-year program to renovate our national infrastructure—acknowledged by all to be in desperate need of repair and expansion. Doing so also would create many jobs where honesty, decency, a willingness to work, and a strong back, coupled with minimal training, could be adequate attributes for employment—and the resulting improvement in infrastructure would create the basis for future growth. However, in the current economic and fiscal climate, as well as the political gridlock that shows no signs of ending, it is quite unlikely that this will prove to be feasible.

At best, one might hope to see structural alterations introduced that would help avoid the drift of the U.S. into a two-tiered society of rich and poor, changes that would help maintain the real source of creative energy in the society—the middle class. As put by Jeff Immelt, General Electric's chairman and chief executive, and now chairman of Pres. Barack Obama's new Council on Jobs and Competitiveness, "If the U.S. continues on the trend towards a service-based economy, it could end up with wealth concentrated on the two coasts and bigger discrepancies between rich and poor." This was said to the *Financial Times* in 2006, and now we are well along the path he feared. The alternative to fundamental structural changes is increasing polarization and civil strife on a scale not seen since the first half of the last century. What are some of these changes?

Maintain the Earned Income Tax Credit; it has in it the seeds of a more equitable distribution of wealth in spite of the dearth of good-paying jobs, and could help greatly in the transition we are living through, although its criteria for eligibility and its level of benefits may need to be restructured. Other institutional changes that would help avoid unrest—and are in the interests of U.S. corporations—would be to have a secure pension system and some form of national health care. It makes no sense to continue the connection between health insurance and the workplace at a time when employee flexibility and mobility are needed. Given the current dispute about Pres. Obama's attempt to provide some form of national health care, it is unlikely to be implemented fully.

In fact, secure pension arrangements and a national health care system already exist for some: Medicare, which already covers the most medically costly period of people's lives, could be extended to everyone at a reasonable cost during periods of unemployment, and all pension systems could be transformed to vested and portable plans, where people who are forced to change their jobs in response to changing conditions will not lose their employer's contributions. These changes also would allow individuals who are trapped in their jobs the flexibility to apply their talents freely where needed, as well as allow the start-up of innovative small companies that have the potential to increase employment in various sectors.

Contrary to popular belief, such changes essentially would pay for themselves through savings in efficiency. During the transition period, there is adequate money (even in the current budget) to finance unseen expenses if priorities were to change. There is no rational reason for the close to one trillion dollar budget for defense and intelligence, or the fact that these programs do not even enter into congressional negotiations in any meaningful sense. The reasons for this are that it is relatively easy to reach a consensus on military spending, particularly by overemphasizing the threat of terrorism, and the fear that a cut in spending would cost jobs. Military spending is a poor way to stimulate the economy or retain jobs compared to civil expenditures. Those who have vested interests in maintaining the current defense and intelligence budgets will adapt to these changes, which in the long run actually will benefit them and the people as a whole.

Even if some time were to be bought by these programs, the U.S. still will face similar problems at a certain point. This predicament and, indeed, the plight of the developed nations as a whole, is the consequence of the continuing worldwide evolution of the capitalist model, the only known form of economic organization that has a credible chance of bring an end to global poverty. The real challenge for the industrialized nations is to find a way to maintain the innovation and productive efficiency of capitalism, while humanizing the model so all individuals can achieve a decent standard of living. It is, after all, the disparities, and the profits that can be made from them, that are the source of many of our increasing difficulties. The growing disparity in wealth and the destruction of the middle classes must not be the answer. ★

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