

## CHAPTER 9

# The New Politics of Production

## A Progressive High-Growth Strategy

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The US is struggling to find a way out of overlapping economic crises. One is cyclical: a painfully slow, jobless recovery from a recession magnified by the 2008 financial crash. The other is structural: US economic output and job growth have fallen well off the pace of previous decades. Although liberal commentators seem preoccupied with rising inequality, America's fundamental economic problem is slow growth.

Even before the recession struck, the once-mighty American job machine was sputtering. Between 2000 and 2007, the US posted its worst job creation record in any decade since the Great Depression.<sup>1</sup> Not only have many good jobs vanished, but also real wages have fallen or turned stagnant for all but the top US earners.

Overall economic growth has been declining steadily since the halcyon years after World War II, when the babies boomed and GDP grew at a robust average of 4 per cent per year. National output fell to 3 per cent during the 1970s and 1980s, before picking up in the late 1990s. Since 2000, the economy has downshifted again, averaging under 2 per cent growth per year.<sup>2</sup> Research from the Kauffman Foundation also suggests a loss of entrepreneurial verve. The number of business start-ups, which Kauffman says generate most of US net job growth, has plummeted by about a quarter since 2006.<sup>3</sup>

If there is a bright spot in the US economy, it is the rebound of corporate profits and stock prices since 2009. Yet these gains also highlight a stark inequity: returns to capital are up, but returns to labour are down.

In President Kennedy's day, US prosperity really did lift all boats. Today, however, productivity gains do not automatically translate into higher pay for workers, especially people with middling skills. 'This is America's largest economic challenge,' says the economist Robert J.

Shapiro. 'People can no longer depend on rising wages and salaries when the economy expands.'<sup>4</sup>

Amid such dismal conditions, Obama's re-election by a comfortable margin (5 million votes) was an astounding political feat. Despite Republican challenger Mitt Romney's claims that Obama fumbled the recovery, swing voters credited the president with having prevented the economy from capsizing during the perfect storm of 2008–9. It helped too that Romney offered no theory of his own for rekindling growth beyond hackneyed calls for lower taxes and regulation.

Unfortunately, little has happened since Obama's victory to dispel the pall of economic pessimism that hangs over America. A late spring poll,<sup>5</sup> for example, found that nearly 60 per cent of Americans worry about 'falling out of (their) current economic class over the next few years'. No doubt subpar job growth is chiefly responsible for such unwonted gloom. According to preliminary figures, the number of people with jobs grew by only 28,000 (0.02 per cent) during Obama's first term.<sup>6</sup>

And there is little relief in sight. The Congressional Budget Office forecasts weak GDP growth and abnormally high unemployment persisting to the end of Obama's second term. America is stuck in a slow-growth rut. While liberal Keynesians are calling for more short-term spending to kick-start the pace of recovery, what progressives really need is a bolder plan for overcoming structural impediments to more robust growth.

Instead of devising one, Obama is bogged down in Washington's endless trench warfare over taxes, spending and debt. True, the president won a tactical victory in averting the 'fiscal cliff' and forcing Republicans to swallow higher tax rates on wealthy households. Yet this modest blow for tax fairness did little to fix the nation's debt or stimulate growth. In fact, distributional politics distracts progressives from a truly historic opportunity to lay new foundations for US prosperity in the twenty-first century.

To inspire hope for such a change, the US president must broaden his message from fairness to growth: he must put America back on a high-growth path. By setting audacious goals – say, doubling the growth rate and halving unemployment by the end of his second term – Obama would convey the requisite sense of national urgency.

A clarion call for renewed growth would create political space for progressive initiatives – public investments in training and education, broad tax reform – intended to spread economic gains more widely. And, by fanning hopes for a reversal of America's economic decline, such a call could help Democrats make inroads among white working-class voters.

These voters, once the backbone of Democrats' New Deal–Great Society coalition, have since defected en masse to the Republican camp. A conscious campaign to start winning them back, while retaining the Democrats' strong advantages with young and minority voters, is the key to building a durable progressive majority and ending the 50:50 polarisation that has paralysed Washington.

### **The Consumption Bias**

Setting out a new progressive growth narrative must begin with an accurate diagnosis of America's core economic dilemma. Many liberals believe it is weak economic demand, and they prescribe more government spending to stimulate consumption. This is the standard Keynesian remedy, but it is inadequate at best because it does not deal with the US economy's structural weaknesses: lagging investment and innovation, a paucity of workers with technical and middle-level skills, and unsustainable budget and trade deficits. None of these problems can be fixed by boosting consumption.

We should not be misled by analogies between the present predicament and the Great Depression. In the 1930s, the issue was overproduction and under-consumption; now it is the reverse. Over the past decade especially, Americans have consumed far more than they have produced, borrowing heavily to make up the difference. This model of debt-fuelled consumption brought the country anaemic growth, a shrinking job base, recurrent financial bubbles and crippling deficits.

Progressives must disenthral themselves from the notion that consumption drives US prosperity. There are few economic factoids more misleading than the claim that consumer spending accounts for 70 per cent of US economic activity. Of course, consumer spending creates

economic activity, but the question is, where? If you buy a shirt or television, you stimulate manufacturing jobs in China, or perhaps Mexico.

Progressives in the US do not begrudge these countries opportunities to grow. But the problem with borrowing massively to buy imports is that it does not encourage domestic investment. Business investment in the US is a stunning 25 per cent below its long-term trend.<sup>7</sup> America's job drought is in fact an investment drought.

Making production rather than consumption the organising principle of US economic policy will not be easy. For a generation, Washington has relentlessly increased subsidies for consumption, assuming that the productive base of the economy will take care of itself.

For example, around 44 per cent of the federal budget today goes to the big three social-insurance programmes: Medicare, Medicaid and Social Security. Automatic spending on these programmes is expected to double by 2050 as America ages. For every five dollars it spends to support consumption by retired people, Washington invests just one dollar in the health, well-being and future productivity of America's children. Federal spending on non-defence tangible and intangible investment – in science and technology, in education and workforce skills, in public goods such as transportation – amounts to less than 10 per cent of budget outlays.<sup>8</sup>

The consumption bias pervades government and society. It is evident in the growing federal deficits, which have swollen America's national debt; in monetary policies that drive the cost of borrowing towards zero; in tax policies that put greater burdens on labour and capital investment than consumption spending; and in trade policies that encourage a deluge of low-cost imports, even at the expense of domestic production and jobs.

We see it at work at the household level as well. Americans are digging out from under mountains of debt amassed during the speculative binge that saw household savings rates dip into negative territory. The bursting of speculative bubbles in stocks and housing triggered the previous two recessions, leaving millions of homeowners 'underwater' (they owe more than their houses are worth) and devastating the construction industry.

Americans today collectively owe over \$11 trillion, or about 95 per cent of the country's disposable income.<sup>9</sup> Leveraged to the hilt, they can

no longer rely on cheap credit and low-priced imports to compensate for lost jobs, dwindling production and stagnant middle-class wages. In a world of cheap labour and rapidly narrowing technology gaps, advanced countries can thrive only by speeding the pace of innovation and capturing its economic value in jobs that stay at home.

For all these reasons, progressives need to replace the old growth model with a new strategy that stimulates production rather than consumption, saving rather than borrowing, and exports rather than imports. The goal should be to make America once again a global centre for production rather than the world's consumer of last resort.

### **Progressives for Production**

This shift will require fundamental changes in policy that cut across conventional partisan and ideological lines and challenge entrenched interests. Liberals in the US, for example, are unquestionably right that America needs to boost public investment. But conservatives also are correct in calling for lower taxes on entrepreneurs and urging government regulators to take a light hand to encourage investment in innovative industries.

Political polarisation, in fact, may pose the most daunting obstacle to a high-growth strategy. The two parties are deadlocked in a witless 'government versus markets' argument even as it becomes blindingly obvious that both a more dynamic private sector and a more strategic public sector are necessary to create the right conditions for a US economic comeback.

Let's get specific. What policy changes are required, and what political adjustments do progressives need to make?

First, they must get serious about breaking the fiscal impasse in Washington. Liberals are right that, with the economy still weak and US interest rates hovering around zero, there is no need for austerity. But they are wrong to oppose controlling the growth of federal spending on health and retirement benefits for seniors.

Thanks to Republican support for the 'sequester', the budget axe has fallen instead on defence and domestic spending, imposing fiscal drag on the US economy at exactly the wrong time. Not only is the endless

wrangling over deficits and debt hogging centre stage politically, but it is also undermining confidence in the federal government's basic competence. Most importantly, US prosperity cannot be rebuilt on the quicksand of chronic government and household borrowing, overconsumption and a soaring national debt.

A high-growth strategy requires a credible framework for long-term debt reduction that boosts public investment now while gradually raising revenues and cutting public spending on consumption. There is no way for America to create more jobs or hone its competitive edge without more investment in modern infrastructure, science and technology, and education and workforce development. Also essential are institutional innovations, such as a national infrastructure bank that would use federal dollars to leverage private capital investments in transport, energy and water projects that can generate measurable economic returns.

How to pay for new investment while also whittling down the nation's \$16 trillion debt? By rebuilding the tax base and slowing the unsustainable growth rates of the big three entitlements: Medicare, Medicaid and Social Security. Health benefits especially are set to balloon as the number of Americans over 65 will double by 2030. But, just as conservatives have adopted a pigheaded stance against tax hikes, too many liberals are in denial about the need to rebalance the nation's massive social-insurance programmes.

Like some kind of fiscal doomsday machine, automatic, formula-driven spending on consumption by retirees is relentlessly crowding out space in the federal budget for future-oriented investments in things progressives ought to care about – early education for poor children, child nutrition and health, access to colleges, environmental protection, and more. The Congressional Budget Office projects that entitlement spending will more than double, from 7.3 to about 16 per cent of GDP, by 2037. Spending on everything else will fall from 11 to 7 per cent.<sup>10</sup>

The long battle for universal coverage has accustomed progressives to think in terms of health-care access. Now, as Obamacare is phased in, they must grapple with the systemic drivers of soaring health-care costs. To deal with the coming demographic tidal wave, Washington will need to trim benefits for the wealthy retirees who need them least. By spurring more efficient ways of delivering health care, injecting more

competition into the big public programmes could also put downward pressure on prices. It is also crucial to raise productivity in the health-care sector, which will require more technological innovation, not less, as is commonly assumed by analysts who mistakenly blame health-care inflation on high-priced medical equipment.

Beyond the modest hike in tax rates Obama forced on Republicans in the fiscal cliff deal, progressives also should push for a sweeping reform of federal taxes. This is essential for restoring the government's revenue base, but, done properly, it could also be a powerful catalyst for economic growth.

Consider America's absurd corporate tax system. Its top rate (35 per cent) is well above global norms. It is riddled with loopholes that distort economic decisions and introduce mind-boggling complexity. And it leaves \$1.7 trillion in profits earned by US companies stranded overseas. Can progressives overcome their habitual suspicion of big business and lead the long-overdue overhaul of corporate taxation? We will likely find out in 2013.

## High-Tech Innovation and a Manufacturing Revival

In addition to reorienting fiscal policy around saving, investment and growth, the Obama administration needs a balanced strategy that fosters both high-tech innovation and a manufacturing revival.

The US leads the world in a crucial new category of economic activity: 'data-driven growth'.<sup>11</sup> According to Progressive Policy Institute economist Michael Mandel, the digital realm of internet publishing, search and social media has become one of America's fastest growing sectors, posting an 80 per cent gain in jobs from 2007 to the present. As US telecommunications companies invest heavily in high-speed mobile broadband, sales of mobile devices and data services are growing exponentially. Mandel's research shows that, since the first smartphone was introduced in 2007, 'app' developers have created 500,000 new jobs. Jacques Bughin of McKinsey & Company estimates that companies that make strategic use of 'big data' grow twice as fast as those that do not.<sup>12</sup>

Progressives should give high priority to protecting the innovation ecosystem responsible for the dramatic rise of the data-driven economy.

Yet they have often sided reflexively with self-styled ‘consumer activists’ who demand more regulation in the name of privacy, competition, low prices, or a general suspicion of big and successful companies such as Apple, AT&T and Google.

Since innovation is America’s main comparative advantage in global competition, striking the right balance between innovation and regulation is crucial. This means recognising, for example, that the sheer accumulation of rules, regardless of their individual merits, imposes mounting compliance and opportunity costs on US entrepreneurs. The problem is not that government creates new regulations but that it almost never rescinds old ones. To rectify this problem, the Progressive Policy Institute has proposed a ‘Regulatory Improvement Commission’ that would meet periodically to retire or modify old rules.<sup>13</sup>

Of course, progressives must stand firm against right-wing attempts to roll back vital health and environmental regulations. But, if they are serious about growth, they will embrace a more strategic approach to economic regulation, one that stresses the impact of rules on innovation, productivity and competitiveness as well as traditional concerns about market power and consumer prices.

Innovation is also integral to expanding manufacturing jobs, another key element of a progressive growth strategy. There is promising news here. Thanks to a confluence of economic factors, some major companies (such as Apple, General Electric and Otis Elevator) are beginning to bring production back home. Such factors include rising wages in China (about 17 per cent a year); the higher productivity of US workers; automation that reduces labour’s share of company expenses; rising transportation costs; and an influx of cheap natural gas in the US. Companies are also increasingly worried about intellectual property theft and leery of separating their research and production centres.

These trends raise workers’ hopes for relief from wage compression and suggest an opportunity not to reverse globalisation but to rebalance it in favour of domestic production. Policies that encourage ‘inshoring’ of production could reverse the hollowing out of America’s middle class by creating millions of good jobs for workers with both high- and middle-level skills.



All this, of course, implies rising consumer prices, since the US will be making more commodities at home and buying fewer cheap imports. But a modicum of inflation is a price worth paying to rebuild a diverse job base that offers opportunities to all workers, not just those with advanced degrees. After all, unless you are retired or on the dole, to be a consumer you first have to be a worker.

Finally, a high-growth strategy will also take advantage of America's shale gas and oil windfall. Since the 1970s, the idea that the US is running out of fossil fuels has been the planted axiom of the country's energy policy. Advances in drilling technology have turned this assumption of energy scarcity on its head, by unlocking vast reserves of natural gas and oil trapped in shale formations.

This truly is an economic game changer. In just a few years, the US has become the world's largest natural gas producer, and the International Energy Agency predicts America's oil production will overtake Saudi Arabia's by the end of the decade.<sup>14</sup> Already, the influx of cheap shale gas (and associated liquids) is cutting home heating bills, reviving the petrochemical industry and lowering US manufacturing costs. It has brought environmental benefits as well: in the power sector, fuel switching from coal to gas has cut US greenhouse gas emissions by 430 million tons over the past five years.<sup>15</sup> There is growing interest in using natural gas as a transportation fuel, which would lessen US reliance on imported oil and bring further carbon reductions.

Yet the shale boom has stirred deep unease among 'green' activists, who see it as prolonging America's addiction to dirty fossil fuels. Eco-fringe groups have launched a campaign to demonise 'fracking', despite scant scientific evidence that it is harming people or ruining the environment.

Americans deserve better than a false choice between the left's fantasies of a fossil-free world and the right's atavistic demands to 'drill, baby, drill' heedless of environmental consequences. A truly progressive alternative would tap all fuels – shale gas and oil as well as nuclear and renewable – to power robust economic growth, and also adopt a carbon tax or cap to steadily reduce greenhouse gas emissions.

No country, even one as wealthy and fundamentally sound as the US, can afford to consume more than it produces indefinitely. It is time for

progressives to refocus the nation's energies on building a more productive version of democratic capitalism that leads the world in innovation, generates good jobs in abundance and raises returns to both labour and capital.

## Notes

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