

The Honorable Paula Stern, Ph.D
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A lot has happened in the ten months since Barack Obama became President. This summer, the U.S. debate was dominated by the battle for universal healthcare – vaguely dubbed “healthcare reform” in the U.S – which was President Obama’s signature campaign promise. In the last month there has been more focus on joblessness and budget deficits, although healthcare is still a very active area. The President is trying to link both these issues to the longer term issue of American competitiveness, but the pressure for quick solutions makes that especially difficult.

Today’s economic news itself centers on the employment picture and its political ramifications. Is the United States coming out of the worst recession since the Great Depression, or is it likely to have a second dip? Will job growth pick up in time to prevent Obama from losing a significant portion of his political majority in the 2010 elections? What will happen to the U.S. recovery when the optimism based on the fact that the country survived the financial meltdown subsides and last winter’s stimulus spending runs out? It is hard to know how to answer these questions and whether to be optimistic or pessimistic, but one thing on which we probably can all agree is that this recession has been the worst since the 1930s because it has affected the whole world. The recovery is likely to be difficult, too, because many of the painful adjustments that are needed, especially in the U.S., have not taken place.

I will focus on America’s prospects for becoming more competitive; the policies the Obama administration wants to adopt to promote American competitiveness; and the political odds for President Obama to achieve these changes.

I shall look at seven specific issues. 1) the current economic situation in the U.S., 2) the policies that the Obama administration wants to follow to improve the economy in the short and long term, 3) green energy’s role in that policy, 4) healthcare’s role in that policy, 5) the role of trade policy, 6) the central economic relationship with China that Obama wants to develop, and 7) the related question of whether China can become a consuming country while the U.S. becomes a saver and investor.

You will be relieved to hear that I will not talk about Iraq, Iran, the Israeli/Palestine problem, Afghanistan, Korea, and other problems that the President has on his plate! The economic short term and long term ones are hard enough!

The Current Economic Situation: A Report from Washington

First, let me talk about the economic situation in the U.S. as I see it. Mike Duke, the CEO of Wal-Mart, on whose board I sat during the 1990s, has “a good perch” from which to view the American economy, and I agree with him that there is a “new normal” in America characterized by a “new focus on frugality, and especially on the deferral of

purchases for things that aren't needed right now." Mike does not "believe this will change as the economy gets better. The deferral of purchases (of things that are not needed immediately) will be with us for a long, long time," he says.¹

So how is the American economy doing? Clearly, it is showing some signs of recovery. Wall Street is doing much better, but consistent with Wal-Mart's analysis, American consumers are reducing debt and saving more. Consumer purchases, which represent over 70 percent of the U.S. economy, have been essentially stagnant because consumers have much less money to spend than they had a few years ago. The reality for most Americans is that it is far harder to borrow and spend than it was before December 2007 when the Great Recession started. The practice of American consumers to borrow money using home equity loans has fallen drastically as housing prices have come down.

American households are heavily in debt. In 2007 Americans borrowed \$350 billion in home equity loans. In 2008 that figure fell by two-thirds to \$116 billion. The value of housing assets was down by \$2 trillion dollars in 2008, with 11.7% of owners owing more on their mortgage balances than their homes are worth.² Homeowners are angry because huge government guarantee programs that they believed would help them deal with their mortgage problems seem instead to have favored the banks, big auto producers, and AIG – and done little for them.

Unemployment in October was 10.2 percent. The President and Democrats are very concerned about the political implications of this as well. The total number of unemployed has reached almost 16 million people. Eight million jobs have been lost since late 2007 during the recession. Over half of the US unemployed have exhausted state jobless benefits, and many are reaching the end of makeshift emergency extensions. What is worse is that these very high unemployment numbers are only part of the grim reality. Many millions more are underemployed or have seen their hours cut or are working part time.³ Millions of additional employees have become so discouraged that they have stopped looking for work. This pushed the effective unemployment and underemployment rate in October to 17.5 percent.⁴

For the President, boosting job growth in America and dealing more effectively with the mortgage problem are political and economic imperatives. To quote former Clinton advisor and pollster Mark Penn, "Joblessness is where economics and politics converge...no statistic is more vital in human or political terms than unemployment."⁵ Creating more jobs during a soft recovery will not be easy, so it is no surprise that President Obama has called for a jobs summit on December 3rd citing the need to, "consider every additional, responsible step that we can to encourage and accelerate job creation in this country."⁶ The President is trying to get out ahead and set a stronger agenda for dealing with this enormous problem, but as I have said before, it will not be easy. Political pressure for a significant second stimulus program focused on public works, but there are many people who do not share my view because of concern about deficits and future inflation.

Returning to the issue of the state of the U.S. economy, business investment, like consumer spending is another problem area. Businesses, small and large despite improving balance sheets, are not able to spend as they did before the recession. Despite all the liquidity provided by the Federal Reserve and the Troubled Assets Relief Program (TARP), banks are not lending to businesses that in the past would have easily been able to borrow. Fed Chairman Ben Bernanke has declared that the recession is “very likely over”. But on November 16 in New York Bernanke expressed concerns that, “Some important headwinds – in particular constrained bank lending and a weak job market (which) – likely will prevent the expansion from being as robust as we would hope.” The economic and political reality is that many businesses and the public are not feeling the end of the recession. Mr. Bernanke has said repeatedly that credit conditions in the U.S. will remain tight despite very low interest rates so that the moderate economic growth he expects in late 2009 and in 2010 will lead to little improvement in the job market and, therefore, will keep consumer-spending weak.⁷ This is reflected in the Conference Board’s index of consumer confidence which dropped from 53.4 in September to 47.7 in October.

American businesses, as I suggested above, do seem to be returning to profitability, but profits are only a part of the equation. The weekly figures provided by the Federal Reserve show “bank loans to businesses having dropped at a 24 percent annualized pace.”⁸ The credit crunch is particularly acute for small businesses, defined as companies with less than 500 employees, where 60 percent of the nation’s private sector job growth has traditionally come from.⁹

Among small, privately held companies, the debt they carry as a portion of their equity has dropped, reflecting their desire to pay down debt, but also the banks’ tightening credit terms when they look to borrow.¹⁰ Further, the delay in passing comprehensive health care legislation, has led small businesses to freeze hiring and delay expansion plans on account of uncertain future health care costs. Nor is big business immune either. Ivan Seidenberg, Verizon Communication’s CEO aptly framed the mood stating, “CEOs are beginning to see an uptick in expectations for sales, which is good; however, this demand has not yet translated into increased capital spending or hiring.”¹¹ All in all, this has created the perfect recipe for a long and painstakingly jobless economic recovery.

So, technically America may be emerging from the worst recession since the Great Depression, but President Obama’s immediate problem is unemployment...and the discontent that this causes among voters! His longer-term goal has to be to ensure that the buds of economic recovery that have appeared over the past several months blossom into a renewed prosperity based on a more competitive and balanced economy, but the politics of getting there is not easy to see at this time.

So what are the Presidents options and what kind of economic policies are likely? To answer this question I shall focus on several policy arenas: Energy policy, healthcare modernization, and trade exports.

In my view – and I believe in President Obama’s view – the United States must be at the forefront of the next great economic ‘revolution’ if it is to maintain anything like its current position in the world. This ‘revolution’ will likely occur in the energy and ‘green’ technology sectors. President Obama spoke of this revolution in terms of competitiveness at the Massachusetts Institute of Technology in September. He said, “The nation that wins this competition will be the nation that leads the global economy. I am convinced of that. And I want America to be that nation.”

What he is emphasizing is that revitalizing America’s economic competitiveness by modernizing its energy policy and technology is more than just reviving the American jobs machine that functioned so enviably during the booming 1990s; it is important to preserving America’s role as a leader in the World. Even General Jim Jones, President Obama’s National Security Advisor declared “The most dramatic threat to our national well-being over the next two decades is going to be around the issue of competitiveness.”¹²

The President’s economic agenda, to tackle short and long term challenges, is ambitious and audacious following closely his hard charging Chief of Staff Rahm Emanuel’s mantra, “never let a serious crisis go to waste.”¹³

US Competitiveness through Green Economic Recovery: Innovation, Energy, and R&D

As for American competitiveness, the President noted in his speech in Tokyo, “...we have now reached one of those rare inflection points in history when we have the opportunity to take a different path”. America must pivot its economic growth strategy away from emphasizing consumer spending and onto its long-term investment for the future. This is no easy task, because it is not a short term problem. American presidents have tried to steer consumption away from consumer goods and energy for decades with little success. This problem is confounded by the fact that if America moves away from consumer-led growth, it will have far-reaching implications around the globe as well as at home. World exporters China, Germany, and Japan will no longer be able to rely on the United States to be the buyer of their products as they have consistently since the end of World War II. The “new normal,” a culture of saving and frugality in the U.S., has emerged with annualized savings soaring to \$566 billion in the second quarter of 2009 alone – quadruple the rate at the start of 2008.¹⁴ President Obama’s Economic Advisor, Larry Summers aptly questions, “How...to think about economic recovery that is not driven by unsustainable consumer borrowing and spending or by the public sector?” To answer Summers’ question, I refer back to President Obama’s November speech in Tokyo: “We must strengthen our economic recovery, and pursue growth that is both balanced and sustained...[which] will mean a great emphasis on exports that we [the US] can build, produce, and sell all over the world? For America this is a job strategy....These are jobs making everything from wind turbines and solar panels to the technology that you use every day.”¹⁵

U.S. companies in the last two or three years have also developed what might be called “semi-green” technologies including the technology to release vast quantities of natural gas from shale reservoirs.¹⁶ It is a potential game changer in the energy area that policy makers must closely consider.

The President’s dedication to American leadership in the energy and high-tech sectors is readily apparent in the monies allocated in the February 2009 “stimulus bill” that was the President’s first legislative priority. The Act channels at least \$80 billion to energy related areas. The money should help stimulate growth among a wide range of private sector industries helping to weatherize homes, upgrade to smart electric meters, install solar panels, assemble wind turbines, and more.

I was comforted to see the other day that my friend Jonathan Silver, who is a savvy businessman, has been appointed to roll out the Department of Energy’s Loan Guarantee Program as well as the Advanced Technology Vehicles Manufacturing (ATVM) loan program. Mr. Silver will steer \$50 billion in loan guarantees that the Department has to advance nuclear, clean coal, and advanced renewables and “efficiency” technologies. A prime example is the \$3.4 billion dollars in stimulus grants to advanced electricity-grid projects.¹⁷

Funding for green technologies and initiatives coincides with a comprehensive plan to tackle the energy challenges facing America now and into the future. The Waxman-Markey bill, known as American Clean Energy and Security Act, passed June 26th in the House of Representatives by a razor thin margin, with a number of Democratic representatives from energy intensive industrial states voting against it.¹⁸

Both House and Senate versions of legislation deploy cap-and-trade provisions cutting carbon emissions by 20 percent in 2020 in the Senate version and 17 percent in the House version.¹⁹ They look to bolster domestic renewable energy industries, including solar and wind, as well as US manufacturing of hybrid vehicle batteries.²⁰

The President’s dilemma is that representatives from manufacturing groups have lobbied for a less stringent emission cap for 2020 and more allowances to energy-intensive industries. Some heavy industries argue that the President’s “green project” will bleed jobs and push many companies to move overseas.²¹ These companies argue that they cannot compete with foreign entities that are not undertaking greenhouse emissions controls. Pressure persists to pass controversial tariffs or ‘border adjustments’.²² (I wonder however, what the gradual realization that less polluting natural gas may be available in large quantities to replace coal will do to this debate.)

The climate change debate has spilt a number of prominent business associations in Washington. The US Chamber of Commerce, America’s largest business association opposes climate change legislation, declaring it anti-competitive. The struggle between higher tech businesses and more traditional large energy users has reached such a fever pitch that it has lead to an internal split within the organization, with Apple and others resigning or reducing their role in the Chamber.

It would be naive to assume that America's focus in regaining its competitiveness in global markets rests principally on the cost of energy and energy legislation. Startup companies in the renewable energy sector and large-scale high-tech manufacturers also face challenges, but different ones. Business Week devoted a cover story which listed impediments to US business. First, it claims that America's corporate taxes are among the highest in the industrialized world. Second, it can take a company "two years to obtain environmental health, and safety permits for modern electronics plants – a lifetime in the tech world".²³ In addition, over the last decade America has short-changed the key component in its growth model – basic research. World renowned research facilities, such as Bell Labs, RCA Labs, Xerox PARC, and DARPA, which historically were able to capitalize on public-private partnerships, have seen major cuts in funding for basic research leading to staff reductions limiting future innovation.

In past recessions, after a hemorrhaging of high-paying manufacturing jobs to low-wage countries, these jobs were replaced with new high-paying jobs in industries whose inception could be traced back to science and research started decades earlier. "The boom of the 1990s – driven by 8 consecutive 10 percent per year increases in investment in machinery and equipment – can be traced back to research done decades earlier on the PC, Internet and cellular industries which helped to offset the job-loss in the steel and consumer electronics sectors."²⁴ However, with companies focusing on short-term profits in this recession, and with previous cuts to basic R&D (which typically does not produce tangible results for 15 years or longer), the US now faces an even more difficult climb out of our current Great Recession.²⁵ America will need 6.7 million jobs to replace the losses from the current Great Recession, with an additional 10 million just to keep up with population growth and spark further demand.²⁶ The challenge is daunting, but one that President Obama is trying to meet.

American industry, declared Business Week, runs the risk of becoming pegged with, "invented here, industrialized elsewhere."²⁷ Asia overall, not just China, offers lucrative tax and other government incentives to companies. In addition raising low cost investment funds, which used to be a U.S. advantage, is now easier in some other places because finding funds for investment in America remains tight.²⁸ America now runs the risk of losing high-tech startups to countries like China that for example already dominates the \$30 billion dollar global solar industry.²⁹

Nuclear energy is another renewable option that needs to fit in the mix that President Obama is seeking to promote. Nuclear energy already generates one-fifth of US electricity reliably and affordably.³⁰ The Waxman-Markey bill calls for the addition of "low- or zero-carbon energy technologies to electricity supply to increase 38 percent by 2050....An additional 180 nuclear power plants (104 operate today) will be needed to meet the legislation's emissions targets, the U.S. Environmental Protection Agency (EPA) says."³¹ The nuclear industry has 25 new reactors in the federal permitting process; four to eight more are expected to be completed by 2017 with the industry looking to invest \$8 billion in the next few years to begin construction of carbon-free nuclear plants in 2011-2012.³² The debate over whether increasing America's nuclear

industry as part of a new toolbox to combat climate change is contentious, to say the least. However, if President Obama believes, as he stated, that this is a competition, then the United States needs to promote as many options as possible because it is not at all clear where the winners are.

The Role of Health Care in the US Economy

I cannot emphasize enough how closely tied the debate over healthcare is to American economic growth and competitiveness. Larry Summers discussed health care reform in economic terms in a recent speech, “If reform succeeds in containing the growth rate of costs, it will accomplish some combination of reducing business’ hiring costs and increasing households’ take-home income.” These are two outcomes the President would dearly love to see, but the chances that they will happen, and happen quickly enough to have a political impact are questionable at best.

All one has to do is search on YouTube for health care ‘town halls’ to get a glimpse of how contentious and passionate the healthcare debate was this summer. In mid-October, the Senate Finance Committee Chair Max Baucus was able to get his highly anticipated plan out of committee for full Senate consideration. Democrats claimed bipartisan support thanks to moderate Maine Republican Senator Olympia Snowe’s vote. The Congressional Budget Office projected the bill would cost up to \$829 billion over ten years, while at the same time satisfying President Obama’s “wish list” of cutting costs and expanding coverage without “busting the budget”.³³ The bill would prevent insurance companies from picking only healthy clients and cutting off ones with costly illnesses. It would expand consumer protections, and provide subsidies for people to help buy insurance, while helping to offset these costs by imposing higher fees on insurance companies and taxing ‘Cadillac policies’.³⁴ Currently the two versions of health care legislation in the Senate, from the Finance Committee and from the Health Education Labor and Pension Committee, have been merged. The new bill retains a version of the public insurance option which would allow states to decide by 2014 not to participate in the government plan. Labeled the ‘opt-out’ provision, it has raised the ire of many liberal Senators who fought for a more robust version of the public insurance option. It raises money to pay for broader coverage by taxing very expensive health plans, which offends upper income and government workers who have such plans. The public awaits the outcome of the final Senate debate.

On the House side, late in the evening of November 7th, the first major piece of health care legislation in 40 years passed 220 to 215. It also includes a compromise on the public insurance option.³⁵ The total cost of the House version is projected at \$1.1 trillion over 10 years and includes a surtax on high earners to offset fully its impact on the federal budget, producing a net savings of \$30 billion over the first 10 years.³⁶

As I said before, health care is directly tied to America’s long-term economic competitiveness. The Business Roundtable, a business association representing major CEOs, produced a recent report asserting that if the Democratic health care bills in Congress are done right, they have the potential to tame runaway medical inflation.³⁷

The Roundtable estimates that if carried out correctly, the legislation could “yield a savings of \$3,000 per worker. A more aggressive approach – with hospitals and doctors paid for quality, not quantity – could save \$5,000 per employee.”³⁸

The Economic Relationship between China and the U.S.

China has reacted quickly to the changing economic and industrial climate of the Great Recession. The Chinese government seems to realize that for its economic growth to resume its previous record pace, it cannot rely on an export driven strategy aimed at the US market. China’s leaders say they see their economic fortunes lying in domestic growth, exemplified by a stimulus program focused on the expansion and modernization of its own infrastructure.³⁹ However, former Labor Secretary Bob Reich sees China, moving in the opposite direction of “rebalancing” its economy from production to consumption.

“Its productive capacity keeps soaring, but Chinese consumers are taking home a shrinking proportion of the total economy. Last year, personal consumption in China amounted to only 35 percent of the Chinese economy; 10 years ago consumption was almost 50 percent. Capital investment, by contrast, rose to 44 from 35 percent over the decade. China’s capital spending is on the way to exceeding that of the U.S., but its consumer spending is barely a sixth as large.”

Reich’s argument is reinforced by Michael Pettis, a China expert who has recently shifted his observation post from Beijing to Washington. Pettis posits that US savings will far outpace Chinese household consumption. Chinese consumption will remain constrained by stagnant household income and because the government of China continues to subsidize, “unviable state funded investments” through undervalued yuan and artificially low interest rates. Consequently, the US-China bilateral relationship will remain strained by continuous friction over bilateral trade imbalances.

President Obama demonstrated cautious concern during his recent trip to Beijing carefully focusing America’s political capital on trying to achieve a successful, long-term, macroeconomic “rebalance” despite the strong political pressures at home to protect industries buffeted by Chinese competition. Newsweek business columnist, Robert J. Samuelson, frames this dilemma in the context of recent tariffs imposed on Chinese tire imports. “For years, American presidents have faced a China conundrum: How to deal with a country that practices predatory trade without unleashing global protectionism?” Attacking China too aggressively may undermine U.S.-China cooperation on other issues, such as climate change, as well as North Korea and Iran’s nuclear aspirations. To date little has come of President Obama’s “get tough” actions: the Chinese have requested talks on the matter at the WTO, hardly what one would consider aggressive retaliation. Today’s leaders should be careful to avoid the wasted time and resources which distracted us two decades ago when Japan seemed to loom as America’s competitive economic successor.

I am no China basher just as I was no Japan basher. China should get credit for its response to the global Great Recession.⁴⁰ But even with these positive indicators China's currency the yuan, although appreciating in 2007-2008, will remain undervalued as long as it is pegged to the dollar.⁴¹ Since the yuan is tied to the dollar, however, the two currencies have sunk in tandem, allowing China to keep its prices low, while simultaneously expediting its recovery.

Conclusion

This brings me back to my central point: America's initiatives on trade with China and the developing world-- in tandem with historic changes to its health care system and environmental and energy legislation--are crucial steps on the way to retaining its global economic competitiveness and influence. America must step up once again as the leader in global innovation while simultaneously retaining its competitiveness in an increasingly diverse and rebalanced global system. If the Great Recession has taught the World anything, it should be that it is dangerous to depend on America to be the consumer of last resort. For decades Americans have wanted to get out of that position, but foreign policy as well as domestic concerns has prevented the United States from doing so. I believe we are seeing a tectonic shift in the geopolitical balance-of-power, with America sharing more of an interest with its global partners in moving toward a more balanced global growth strategy. It needs to happen. But whether what needs to be done will be done is always an open question.