

# Focal Points for US in Achieving Stable Long-term Economic Growth

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## Challenge Now Faced by US Democracy

Alexander Tytler, a Scottish lawyer and historian in the late 18th and early 19th centuries who was a professor of history at the University of Edinburgh, held some cynical views on democracy. He took a particularly grim view of democracy, as follows:

“A democracy cannot exist as a permanent form of government. It can only exist until the voters discover that they can vote themselves largesse from the public treasury. From that moment on, the majority always votes for the candidates promising the most benefits from the public treasury, with the result that a democracy always collapses over loose fiscal policy, always followed by a dictatorship. The average age of the world’s greatest civilizations has been 200 years.”

The US democracy is now facing a serious challenge over the dispute on the government spending between the Democrats and the Republicans. Whether Tytler’s above remarks on democracy are true of the US or not should be a crucial question for the world’s other democracies as well, emerging as a key to win over the political economic turmoil on the government deficit observed worldwide today. It is to be noted in this context that the Rogoff-Reinhart finding in their recently published book, *This Time is Different*, leads you to the fact that after financial crises economies only grow at a slow pace and never recover the GDP lost in the crisis due to below-trend growth.

## Short-run Outlook of Economy

At the end of the last year, observing that the US economic data during the last few months of 2011 have had a decidedly firmer tone, symbolized by the fall in initial claims for unemployment compensation and a decline in the unemployment rate, many economists note a recovery of the business mind of US corporations and that a so-called double dip seems to be being avoided. The latest Real GDP growth rate in the US has been running at about a 2% pace, which is quite stable and robust economic growth overall. (Table 1 summarizes the structure of the latest US real GDP growth.)

However, on the following points, we should be as prudent as possible in assessing the current US macroeconomic situation.

Firstly, though as in Chart 1 the growth of personal consumption in real terms recently turned positive and the savings rate has started to decline, the Lehman shock in 2008 still has a lingering effect on household behavior, since the household debt service ratio is still kept rather high. (In the third quarter of 2011, it was around 11.1, whereas before the Lehman shock, in a number of years, the ratio was recorded at less than 11.0.) Namely, the US consumers are still exposed to pressure to reduce the debt and improve their balance sheet inflicted by the financial crisis. Therefore, they would raise the

savings rate eventually, which could lower the consumption growth rate. Besides that, the growth of disposable income is still stagnant in spite of the abovementioned recovery of job creation and the decline in the unemployment rate. Furthermore, the lack of an effective policy to deal with the budget deficit and the uncertainty about the future of the Euro crisis could worsen consumer psychology and work as an impediment to drag the growth of personal consumption, which used to be a primary engine of US economic growth and also lead global economic growth in the last decade. In particular, on the matter of budget deficit reduction, an important policy decision-making process will most likely be postponed until after the presidential election in 2012.

Secondly, there is still a concern about inflation. Chart 2 shows us the recent growing trend of the US CPI mainly due to the increase in food and energy prices. The US economy is thus falling into stagflation these days and its macroeconomic policy options should be narrowed, since a stimulating policy could provoke further inflation.

Thus, on the US economy outlook for the future, as much as one might wish to upgrade the forecast for 2012, the prudent response to current data is to assume growth slightly below trend, with the risks to the forecast skewed to the downside.

## Long-run US Growth Strategy

In considering the growth strategy of the US, we need to focus on the long-run perspective of the economy beyond 2012. There are three points deserving deep reflection on which the inflection of the US economic growth path depends.

Firstly, the US budget deficit is a key not only to the US economy in 2012 but also to its long-run economic performance. Some argue that under present circumstances where households and business firms are reducing their debts, the government should be the only player to maintain the economy by keeping a stimulatory position, and thus the government should not reduce its debt. However, as Rogoff and Reinhart found out in their latest book, referred to above, there must be a limit to the government deficit in the light of sustainability of the economy. How the US democracy could work in the presidential election in 2012 and after the election to manage the budget deficit in favor of sustainable growth is a crucial question for the US long-run economic performance.

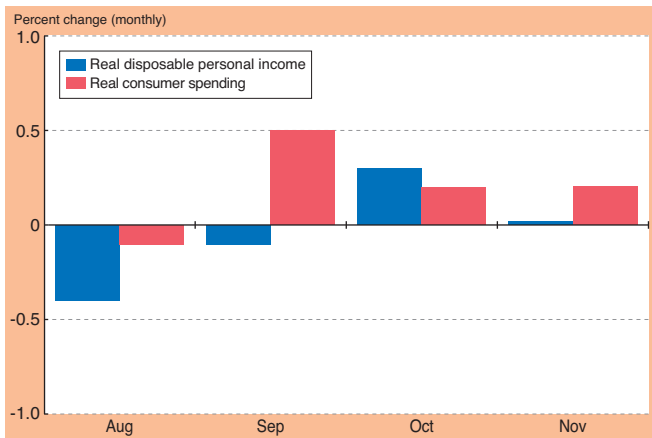
## First Engine – Trade

The second point concerns the US foreign and trade policy.

On the question of national security, which usually occupies a major part of US foreign policy, in 2012, for the first time since 2000, it is said that a crisis is unlikely to emanate from Iraq or Afghanistan

CHART 1

## Real disposable personal income & real consumer spending



Source: Bureau of Economic Analysis, US Department of Commerce

but rather from North Korea's remaining as unpredictable as ever in the wake of Kim Jong Il's death and its leadership transition, or a possible Chinese foreign policy misstep, most likely in the South China Sea connected to Beijing's ongoing leadership transition, which could increase tension in Asia. However, if there is no significant unexpected crisis in Asia, US foreign policy will focus on the economy.

Assuming that the contribution of government spending and personal consumption to economic growth will be limited for a while as mentioned above, the key role to advance growth should be pursued in private business activities. One of the expected significant contributions emanates from exports. The Obama administration's trade policy commitment to double exports in five years from 2010 would need on an average a 15% annual growth in exports. The current actual exports growth rates, such as 16.7% in 2010 over 2009 and 15.8% in Jan.-Sept. of 2011 over the same period of 2010, are in line with this commitment.

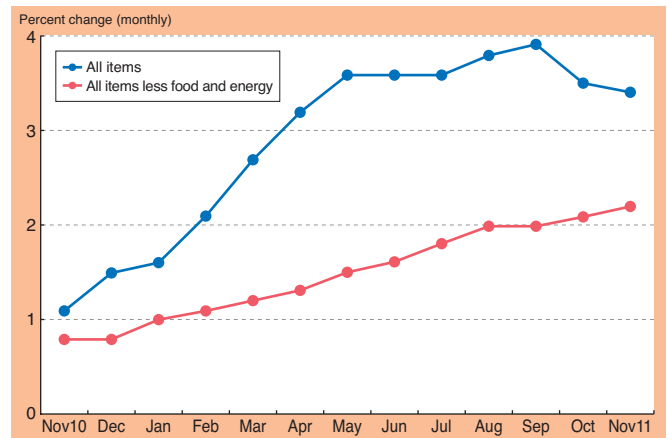
US trade policy based upon such a mercantilistic idea emerges in promoting the regional and bilateral trade liberalization through FTAs or RTAs. Above all, the Trans Pacific Partnership (TPP) is considered by the US government the most important vehicle to achieve free trade in the Asia-Pacific area and a significant growth in US exports, a major goal of the US growth strategy today. While a multilateral trade liberalization process of the WTO such as the Doha Round is deadlocked, TPP or other regional trade liberalization efforts are to replace its expected role and mission.

The US regards TPP as a possible replacement of the WTO process in pursuing an ambitious liberalization in tariffs as well as non-tariff barriers. Among the US's important trading partners in Asia, China in the long-run is the most crucial. China is currently not part of TPP and how the US can engage her in the regional trade regime in order to accommodate the environment for US exports to China is very important in the light of the US growth strategy.

Though it is predicted that trade tension between the US and China will not worsen for a while, the trade relationship between China and the US is inextricably linked to macro-stabilization policy, in terms of currency policies. Without a change in currency policies, there will have to be an extremely painful structural adjustment on both sides.

CHART 2

## 12-month percent change in CPI for all urban consumers (CPI-U), not seasonally adjusted



Note: Personal saving rate for Sep is 3.5%, Oct 3.6%, and Nov 3.5%.

Source: Bureau of Economic Analysis, US Department of Commerce

## Second Engine – Innovation

Finally, in considering the future long-term path of the economic growth of any country, innovation is considered vital to achieve high growth potential on the supply side of the economy. Active innovation would emerge as a significant growth of private-business investment in the form of an embodiment of new technologies. This is another channel of private business activities rather than the abovementioned exports, which would sustain the economy on the demand side.

The business environment for innovation in the US is very well accommodated in comparison to Japan. The US socioeconomic system is much in favor of innovation. The cultural diversity of the people engaged in innovation is highly instrumental in creating new ideas. In Silicon Valley, a center of US innovation, a wide range of ethnic groups such as Chinese, Indians, Vietnamese, etc., and also people with a wide range of colorful backgrounds such as engineers, lawyers, artists, and economists, as well as academics and businesspeople, intermingle and stimulate each other with different thoughts and ideas; all are engaged in creating business as entrepreneurs, enjoying not only the sunny Californian weather but also the freedom to choose their goals in life, as individuals. That is the outcome of US democratic politics. All of them are working for themselves and not for any other goal enforced by a company which they belong to.

Many individuals with double degrees of a college or graduate school such as engineering and law or medical science and business, etc., work as mediators between academia and business, so that an academic invention can be immediately applied to business. That is the source of the strength of Silicon Valley.

Even though Information Technology, a staple industry of Silicon Valley, has reached saturation, there are other seeds of new technologies such as green technology.

As long as such a Silicon Valley model survives in the US, innovation in the US, a symbol of the victory of US democracy, will never cease to be a stable source of the nation's economic growth. **JS**

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