Debate: A Second American Century

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WHY WE WILL REMAIN NUMBER ONE

The American economy is in the eighth year of sustained growth that transcends the "German miracle" and the "Japanese miracle" of earlier decades. Everything that should be up is up -- GDP, capital spending, incomes, the stock market, employment, exports, consumer and business confidence. Everything that should be down is down -- unemployment, inflation, interest rates. The United States has been ranked number one among major industrial economies for three years in a row. America is riding a capital spending boom that is modernizing its existing industrial base and expanding its industrial capacity. The Dow Jones Industrial average is more than four times as high as it was six years ago. The New York and NASDAQ stock exchanges have added over $4 trillion in value in the last four years alone -- the largest single accumulation of wealth in the history of the United States. By contrast, Europe is stagnating and burdened with double-digit unemployment, and Asia is floundering in the wake of financial collapse.

This is no fluke. The unique American brand of entrepreneurial bottom-up capitalism is made up of structural elements that have wrought the stunning economic success of the 1990s and are likely to provide the basis for extending America's comparative advantage over time.

Consider where the country has come from and where it is undoubtedly going. America was all but written off in the 1980s because of its apparently uncontrollable fiscal deficit and its products' steady loss of competitiveness in the global economy. Downsizing and restructuring depressed everyone, but that valley is now largely traversed. In a literal application of Schumpeter's notion of creative destruction, the United States lost some 44 million jobs in the process of adjusting its economy but simultaneously created 73 million private-sector jobs -- a net gain of over 29 million jobs since 1980. A stunning 55 percent of the total work force today is in a new job, some two-thirds of them in industries that pay more than the average wage. Contrast all of continental Europe, with its larger economy and work force. It has created an estimated 4 million jobs in the same time period, virtually all of which are in the public sector. Since 1991, the European Union has lost about 5 million jobs while the U.S. economy has created more than 14 million new ones. Today a record 64 percent of American adults are working, the unemployment rate has fallen to 4.6 percent, and GDP growth has accelerated at the rate of close to 4 percent over the last two years.

In the past, such figures have raised the red flag of inflation. But inflation is at a 30-year low and, like unemployment, is still falling. This contradicts the historical experience of the late phase of a traditional business cycle, where accelerated growth usually correlates with higher inflation. Disinflation is emerging in commodities, which are hitting record lows, and was present in manufactured goods even before the impact of cheaper Asian exports. All this is happening despite an economy that seems close to the maximum sustainable level of growth. Nowhere does there seem to be an imminent inflationary threat. The markets do not anticipate it, and many in the private sector accept what many economists, including Chairman Alan Greenspan of the Federal Reserve, believe -- that the official consumer price index overstates inflation by at least a percentage point. If that is correct, it means the United States is closing in on a zero-inflation economy.

Low inflation means lower interest rates, more capital investment, rising productivity, and higher growth -- a virtuous cycle not likely to be broken by external forces. Despite a slowing and riskier global economy, the United States remains a balanced economy with the world's most buoyant domestic demand and a more limited exposure than other major industrial nations to exports, which account for only 13 percent of U.S. GDP. Moreover, U.S. exports are less vulnerable because they are diversified around the world and consist primarily of value-added goods, worldwide branded products that incorporate sophisticated technology and intellectual capital and do not have to compete on price alone. Exports are rising three times as fast as the overall economy, which is especially notable because it takes place not as a result of dollar devaluation but in the face of dollar appreciation. Exports are growing even more rapidly in the sectors where America dominates, such as advanced semiconductors, computer network servers, personal computers, software and services, entertainment, finance, and telecommunications. The United States dominates the knowledge industries of the future. Americans spend vastly more on research and development in these areas than their competitors, and the gap between the United States and the rest of the world will grow, not contract. America dominates the world of the Internet. Some 90 percent of web sites are American. U.S. companies are the major suppliers of the information age's silicon brains and sinews.

On the brink of the 21st century, the United States is at a point reminiscent of its entry into the twentieth. Frederick Jackson Turner pronounced the end of the American frontier in 1893. The newly settled continent, linked by rail, lay open as a vast, tariff-free marketplace, conducive to mass-produced products at prices the masses could increasingly afford -- Edison's electric lights, Singer's sewing machines, Bell's speaking tubes, Ford's automobiles. Unimpeded access to that burgeoning marketplace was the one indispensable condition for the flowering of American enterprise.

EXPLAINING SUCCESS

Today, of course, the new frontier is the global economy. Evidence is growing that the United States is as well placed to exploit that as it was the new continental marketplace of a century ago. There are structural strengths that explain U.S. economic success and why it can be sustained.

An examination of these structures of advantage can begin with the improvement of American management skills. American managers were unprepared when global competition began to emerge in the 1970s and 1980s. Long sheltered by domestic regulation, lucrative contracts with the Defense Department, and earnings and growth boosted by inflation, they had a nasty awakening. Foreign competition took market share at both the high end and the low. Profits plummeted, thousands of companies failed or fell to takeovers, and famous brand names were humbled. Business managers, shocked out of their smug parochialism, began years of restructuring, reengineering, and cost-cutting that saw their companies become vastly more efficient. America is now the lowest-cost, most flexible producer among the industrial nations, with something like a $10-an-hour cost per worker advantage, fully loaded, over Japan and a $20-an-hour cost advantage over Germany.

To bring this about, American managers invested in new technologies, high-tech training to exploit these new advances, increased quality control, and improved information systems to adjust supply, prices, and output more quickly to market conditions. U.S. companies were the first to realize the importance of computers and information technologies and have invested massively in them, accounting for over 40 percent of the world's investment in computing. They spend more than twice as much per capita on "infotech" as Western European firms and eight times the global average; there are more than five times as many computers per worker in the United States as in Europe and Japan. U.S. manufacturing has replaced large mass-produced consumer products with sophisticated goods derived from intellectual output in knowledge-based industries, the fastest-growing segment of the world's economy. Management has been assisted by labor flexibility that is the envy of both Europe, where the legacy of the steam age is craft, union, and management demarcations that limit management's role, and Asia, where management is stifled by large oligopolistic networks and government mandates. Management incentives were increased by linking compensation to shareholder returns through stock options.

These are some of the reasons why profit margins in American corporations, once among the world's worst, are now among its best. Return on equity has more than doubled, to over 20 percent, and retained earnings have become the principal source of America's capital regeneration. This microeconomic vitality has translated into the macroeconomic success of the American economy.

RUGGED INDIVIDUALISM

The achievements of business in America grew out of a culture that has long valued individualism, entrepreneurialism, pragmatism, and novelty. This legacy has outlived the passing of the frontier and still inspires millions. American culture nourishes its mavericks, cherishes its young, welcomes newcomers, and dramatically opens to energy and talent rising from the bottom up. In the nineteenth century, men like Carnegie, Frick, Rockefeller, and Morgan seized their chances. Today, their heirs are Bill Gates, Ted Turner, Larry Ellison, Craig McCaw, and the many others who vie for the top of Forbes' list of the 400 richest people in America.

American history uniquely encouraged the development of a management culture. The anthropologist Lionel Tiger showed that the development of American corporate management was America's response to a huge market, vast distances, and diverse populations, and the administrative and economic challenges they presented. Furthermore, what has dominated our business world is contract and law rather than kinship and custom, not primogeniture but an impersonal, monetized market economy and a belief in technology and scientific management. Indeed, the science of management was invented by an American, Frederick Winslow Taylor, who pioneered the time-and-motion study and was the father of mass-production techniques. No other country met the requirements of an emerging industrial system that needed people to be mobile, both physically and psychologically. No other country, for example, shares the American belief in numbers and statistics as the basis for decision-making. No other country has a population so prone to self-help, self-improvement, and even self-renovation in a manner that carries over into business life. No other country invests so much in the business training and retraining of its people -- some $100 billion a year -- in addition to having the largest and best graduate and undergraduate business schools in the world. And no other country sees its most talented move so overwhelmingly into the private sector, where the most successful are celebrated and rewarded as symbols in a nation of doers.

Entrepreneurialism and individual initiative in this country are so widely accepted that in the 1990s approximately 1.8 million businesses will have been started, on top of 1.5 million in the 1980s. Smaller companies have demonstrated their capacity to compete in this swiftly changing environment with flexibility, rapid response, openness, innovation, and the ability to attract the best people. Blue chip, large-scale companies no longer have a lock on recruiting the best and brightest graduates of elite business schools. Thousands of these smaller companies have had the potential to blossom and grow, even as thousands have gone belly-up. And as soon as new products and services are developed, American business' unique marketing and advertising skills establish their success at home and abroad.

From among these business start-ups have emerged the smaller companies that have provided the energy in our economy and the sources of our job growth. In contrast, the sprawling Fortune 500 companies lost approximately 3 million jobs in the 1980s and are expected to lose another million in the 1990s.

America's economy is even better suited for today's rapidly changing knowledge-based economy than it was for the mass production, industrial economy of earlier times. The new bottom-up economic environment is tantamount to a giant information processing system that enhances its capacity to absorb, adapt to, and manage ongoing revolutions in technology, information, and logistics that are too dynamic and complex to be handled by a top-down system, no matter how talented its bureaucracy, government, or corporate oligopoly. The marriage of a new economy and an older American culture promises a comparative advantage that will endure.

A THOUSAND POINTS OF FINANCIAL LIGHT

The energy in the business economy is matched by a unique and remarkable world of finance capital. This realm has proven its capacity to provide the multiple sources of entrepreneurial capital needed by entrepreneurial management, thereby demonstrating its ability to meet the needs of a modern, rapidly changing, globalized economy. The "old-boy" financial institutions -- primarily the major banks and insurance companies -- proved to be less entrepreneurial, more risk-averse, and more bureaucratic than was necessary for American growth in a dramatically changing economic environment. They tended to concentrate their lending to investment-grade companies when approximately 95 percent of American companies were not investment-grade.

In the 1970s and 1980s, access to capital was thrown open by the burgeoning American middle class. In the 1970s, they watched the decline in the stock and bond markets; in the 1980s, they witnessed the focus on shareholder values and superior market performance of the Fidelities, the Alliance Capitals, and investors like George Soros. Their capacity to invest was enhanced by the erisa pension legislation, and especially by 401(k)s, which gave some individuals the right to direct their investments. With scorecards to measure performance, middle-class Americans voted with their savings and abandoned the practice of investing their money with elite banking and insurance firms with illustrious pasts. Instead, as the American middle class gained economic sophistication, they increasingly trusted their funds to those who demonstrated a capacity to respond to change and whose relative performance could be measured by regular calculations of their gains and losses. The result was an explosion of the share of their household wealth that has gone into stocks -- now 28 percent, compared with just 12 percent in 1990.

The diversification of investment outlets means that elite institutions no longer dominate the commanding heights of finance as they did earlier and still do in countries like Germany and Japan. American elite banks' involvement in both lending and managing financial assets dropped precipitously, while those of mutual funds and other managers rose correspondingly. As a result, the number of places to go for money exploded. Accompanied by financial market deregulation and financial product innovation, the stock and bond markets, mutual funds, investment managers, hedge funds, opportunity funds, high-yield funds, bridge funds, venture capital funds, and initial public offerings

(IPOs) grew in amounts and varieties that vastly exceeded the total in all other countries -- a veritable thousand points of financial light.

Only when money is there to back good ideas will the necessary economic synergy emerge, especially when U.S. capital markets allocate money to firms that seem likely to earn the highest return, rather than lending to friends or relying on established corporate relationships, as is common elsewhere. That is why America is the only country that funds so many of its young, who are the most comfortable and creative with the new technologies. America's capital markets increasingly fund the future, not the past -- the new, not the old.

Nothing better illustrates this than the annual investment over the past several years of $35 billion to $50 billion in IPOs and $10 billion to $15 billion in venture capital -- numbers that dwarf similar investments in the rest of the world. This is not short-term capital, but long-term, risky investments. In the 1990s, the United States has funded approximately 4,000 companies, in amounts approximating $250 billion, through ipos. All of Europe, by contrast, has funded just a few hundred new companies over the same period, in amounts that are less than ten percent of the U.S. total.

The IPO process reveals America's merit-based, diversified financial environment. Companies wishing to appeal to the market are vetted initially by one of numerous investment banks. Once that support is secured, the managers of supplicant companies go on the road, all across America, to present themselves and their business strategy to individuals representing hundreds of institutional investors, mostly mutual funds, and persuade them to invest. This is the principal way entrepreneurial capital has been found to fund young talent, new ideas, and the long-term risks associated with high-tech, high-growth, and high-concept companies. The results can be seen in NASDAQ's increase in value from about $90 billion in 1980 to approximately $2 trillion by 1998. Combined with the rate of business start-ups, these IPO and venture capital investments show an economy growing primarily from the bottom up.

The flooding of money into various financial pools is supplemented in the United States by a remarkable transparency bred in the depression days of the 1930s and more recent catastrophes like the 1980s savings-and-loan scandal. Unlike the Asians in particular, Americans know more or less what is being done with their money. Accounting systems in the United States strive for clear corporate information. No other country's financial system reflects such a willingness to bring financial problems to the surface rather than bury them in arcane financial documents. This allows regulators and shareholders to retain the confidence so critical to the democratization of capital.

The synergy between business and finance has helped break a pattern that has afflicted investment decisions in conventional business cycles. Previously, the fear that the boom was running out led to cuts in investment that guaranteed supply bottlenecks and ultimately inflation. This time, real spending for plant and equipment has grown three times as fast as the economy as a whole. New orders for capital goods are increasing at double-digit levels, to a postwar record of 12 percent of GDP today, compared with 7 percent in the 1980s. These expenditures are driven by intense competitive pressures, quicksilver technological change, strong earnings growth, and the falling cost of capital. The results can be seen in a manufacturing capacity that rose by only around 2 percent annually in the 1980s and early 1990s but has risen dramatically since then, by 2.6 percent in 1994, 3.5 percent in 1995, 4 percent in 1996, and approximately 5 percent in 1997. This capital goods spending cycle is a true supply-side recovery, providing an increasing capacity that is intrinsically deflationary.

With the rise in capital investment has come an emphasis on the regenerating power of incorporating knowledge and sophisticated technology into capital goods. America was the first to realize the importance of computers and information technologies. American industry spends some $130 billion on industrial machinery but over $220 billion a year on computer and communications hardware, on top of tens of billions on software and systems development. U.S. computing capacity is growing by more than 35 percent per year and semiconductor capacity by about 30 percent per year.

One major source of this flow of investment funds is the elimination of federal deficits that reached $290 billion in the early 1990s, when the Treasury was borrowing $6 of every $10 raised in U.S. credit markets. Now the United States is enjoying a surplus that looks likely to continue as far as the eye can see. The era of the deficit is over, assisted, of course, by the slowdown in military spending after the Cold War. The contraction of the federal deficit has boosted the available savings pool, lowered nominal interest rates, and helped companies break the cycle of booms crippled by undercapacity.

This remarkable turnaround in fiscal policy has been supplemented by confidence in current Federal Reserve policy as a brake against inflation. By anchoring the yield curve for federal funds at 5.5 percent, the Fed has, in effect, damped inflation by real interest rates (that is, the difference between nominal interest rates and the inflation rate) of 4 percent -- double the usual margin. Thus monetary policy has, in fact, tightened in recent years as rates were held steady or raised, while inflation continued to decline and the dollar appreciated against other currencies.

The United States is reaping the benefits of the best political climate in 50 years for the practice of such noninflationary fiscal and monetary policies. The structural element here is demographics -- the rising proportion of our population that is retired or will be over the next several decades. The elderly and the baby boomers are making government listen to their anxieties about inflation. As some 70 million baby boomers approach retirement, they are putting their savings into mutual funds and other equities, determined to protect these savings from inflation. Their desire for a stable dollar is more politically important today than the pressure for job creation for the young, which dominated policy for most of the postwar era.

Public policy has also significantly sharpened competition and reduced inflation through deregulation -- a trend that is unlikely to be reversed. Today oil, gas, transportation, railroads, airlines, and telecommunications companies have to compete or die. The steel, textile, and auto industries are no longer fully protected by tariffs and "voluntary" quotas. Even agriculture is facing deregulation.

Finally, there are the gains from a public policy that articulates not just what government does but what government does not do. In the United States, unlike Asia, the government is not involved in the formulation of industrial policy or in mandating funding or other support to specific industries or companies. Nor is there the intimacy between government and business characteristic of much of Europe. In the United States, the private sector makes the overwhelming majority of strategic and tactical business decisions. This is all to the good in a rapidly changing economic ecology in which only the markets have the capacity to process vast amounts of information rapidly enough to make the best decisions for allocating resources and developing products and services. Other dimensions of the limited role of government are reflected in the ease with which new companies can be started and new products introduced. This systemic difference between the United States and the rest of the world serves U.S. economic prospects well.

IGNORE THE CASSANDRAS

Pessimists say U.S. growth is not really so impressive and cannot be sustained. If inflation is lower, the argument goes, the United States may just be on the verge of a wage-increase-driven inflation. If U.S. productive capacity is growing, they warn, it is not growing fast enough. Bottlenecks and price increases lie ahead. The pessimists find discomfort even in the fact that today's productivity improvements may be understated for an information economy, rather than an industrial economy. That would mean growth is even faster, enhancing the risk of inflation.

The practical experience of U.S. business leaders suggests otherwise. They understand that the low level of inflation Americans are enjoying is self-perpetuating. With long bonds at their lowest levels since the government started to issue 30-year Treasury bonds in 1977, companies are laying down an even better future by investments in machinery and systems that will enable them to prosper without raising prices. The gains in productivity offer the chance to simultaneously increase profits and wages and decrease inflation. Business leaders assert that productivity increases are genuine and revealed in the form of rising profits, despite stable prices. If statistics suggest that productivity increases are still around 1.5 percent annually, far less than the 3 percent rises of the 1950s and 1960s, then business leaders say something is wrong with the numbers -- numbers that are more relevant to an industrial economy than to a service and information economy, where so much investment goes to improve quality and speed of output.

If productivity truly is lagging comparatively, what will happen to inflation if labor begins to demand an increased share of the new wealth? It is a fair question. Low inflation and high profits could be attributable to the apparently slow growth in wages. The transitory nature of the slowdown in wage demands has been suggested in a recent study by Tara Lawn and Robert W. Rich of the Federal Reserve Bank Board of New York. They argue that lower inflation is, in fact, due not to increased productivity but to the uniquely lower pressures from wage earners. Compensation now trends higher, closer to its traditional path. So the good days may only be temporary. But how long is temporary?

Relatively low wage pressures are due in large part to job security having become more important than wage increases. In the 1990s, workers witnessed an involuntary job loss at rates double that of the 1980s, at a time when unions have declined to about one-tenth of the private sector work force. Everyone knows, white-collar workers included, that wages of workers in poorer countries are critically relevant in an era of global production. The "few hungry men at the gate" that Henry Ford warned would always control the level of wages are not here anymore but abroad. Psychologically, they might just as well be across the street. The wages of foreign workers are now very much a factor in corporate planning and labor reactions.

American workers understand that their employment today depends far more on the global competitiveness of their industry or plant than on the phase of the business cycle. Even in good times, workers and management are constantly conscious of waves of downsizing and restructuring and the need to cut costs. Those who survive restructuring always fret that they may not next time. In 1996, 46 percent of workers in large firms feared being laid off -- twice the 1991 level, despite five years of economic expansion and a sharply lower unemployment rate. Worker anxiety can be seen in the backlash against trade with other countries, as reflected in the opposition to granting the president renewed "fast track" authority to negotiate trade deals. But worker anxiety has undoubtedly given greater flexibility to American management, and labor has accepted the need for companies to be competitive and for labor to be both adaptable and mobile -- far more adaptable than Europe or Japan.

Another factor restricting the translation of wage pressure into inflation is that the demand for workers in the traditional industrial sector has been growing at the meager rate of under two percent annually -- not enough to drive up wages. But in the high-tech industries where demand is strongest and wages have risen more dramatically, competition-driven improvements in design and productivity have absorbed so much of the pressure of wage increases that product prices have been falling by approximately 20 percent annually for the last five years. So wage increases have not translated into inflationary pressure.

This litany of America's economic successes may sound tinny to those who feel their lives buffeted by forces over which they have virtually no control. People are working harder than ever before. The gap between the well-to-do and the poor has been growing. The options for unskilled workers keep shrinking, as does the safety net that is supposed to protect them if they fall out of the economy altogether. Yet other benefits do, in fact, radiate from the flourishing economy. Young families today are two-thirds better off than their parents were at the same age. If today's material abundance feels inadequate, it is only because Americans today view as essential many things that used to be considered luxuries. But who can doubt that the quality of life has improved? Lower crime rates, dramatic reductions in the welfare rolls, more varied leisure activities, greater opportunity (even in a society renowned for equality of opportunity), record numbers of people entering colleges and universities -- all feed a national optimism and sense of renewal that rides over the potholes of politics and defies predictions of calamity.

There are many explanations for this buoyant, confident mood. One is the get-up-and-go spirit that has always typified America. But surely another is prosperity. This survey of the American economy shows that this is not a transient prosperity but one that derives from a series of structural advantages that today only America enjoys. The rest of the world may improve their public policies through accelerated deregulation and prudent fiscal policy. They may reform their closed and opaque financial systems; they may embrace more fully the technological and logistical revolutions sweeping the business world; they may send their sons and daughters to business schools; they may strive to open up their more parochial business and national cultures. But America will not be standing still. If anything, American business should widen its lead over the rest of the world. France had the seventeenth century, Britain the nineteenth, and America the twentieth. It will also have the twenty-first.

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