America's Economic Outlook: Innovation and Jobs

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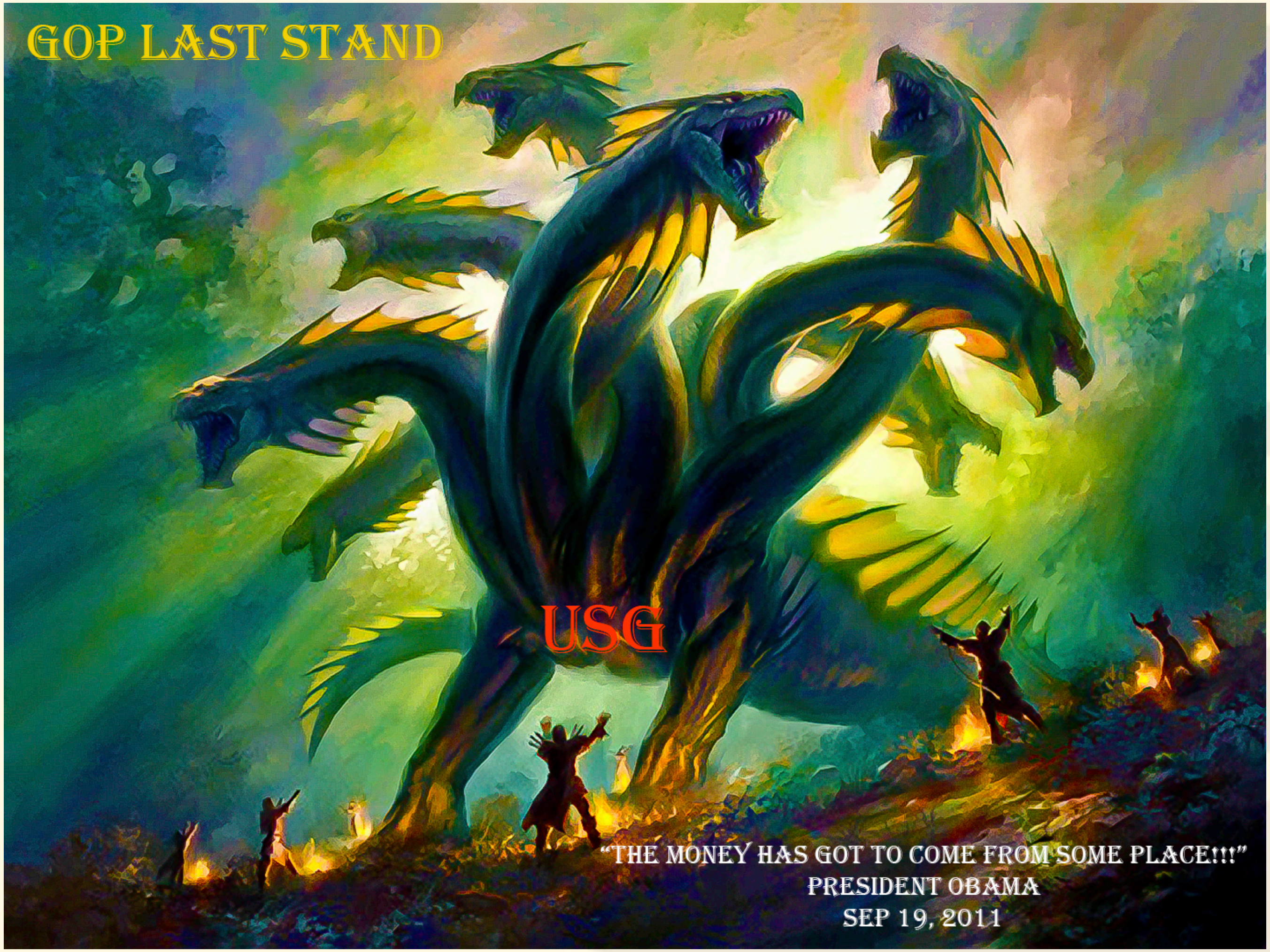
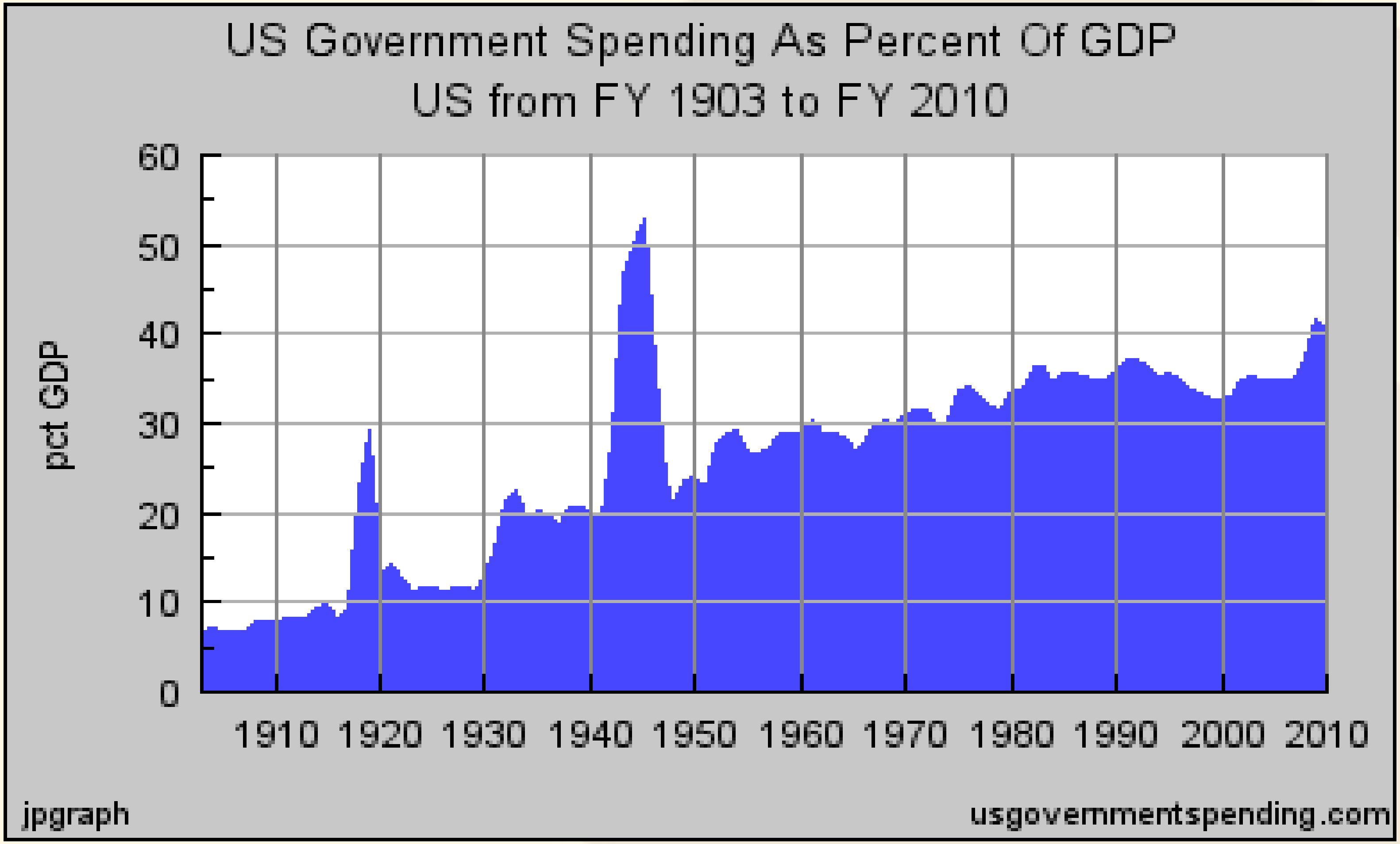
Turning Transitions Into Prosperity



Art by Todd Lockwood
Text by Michael Bleyzer

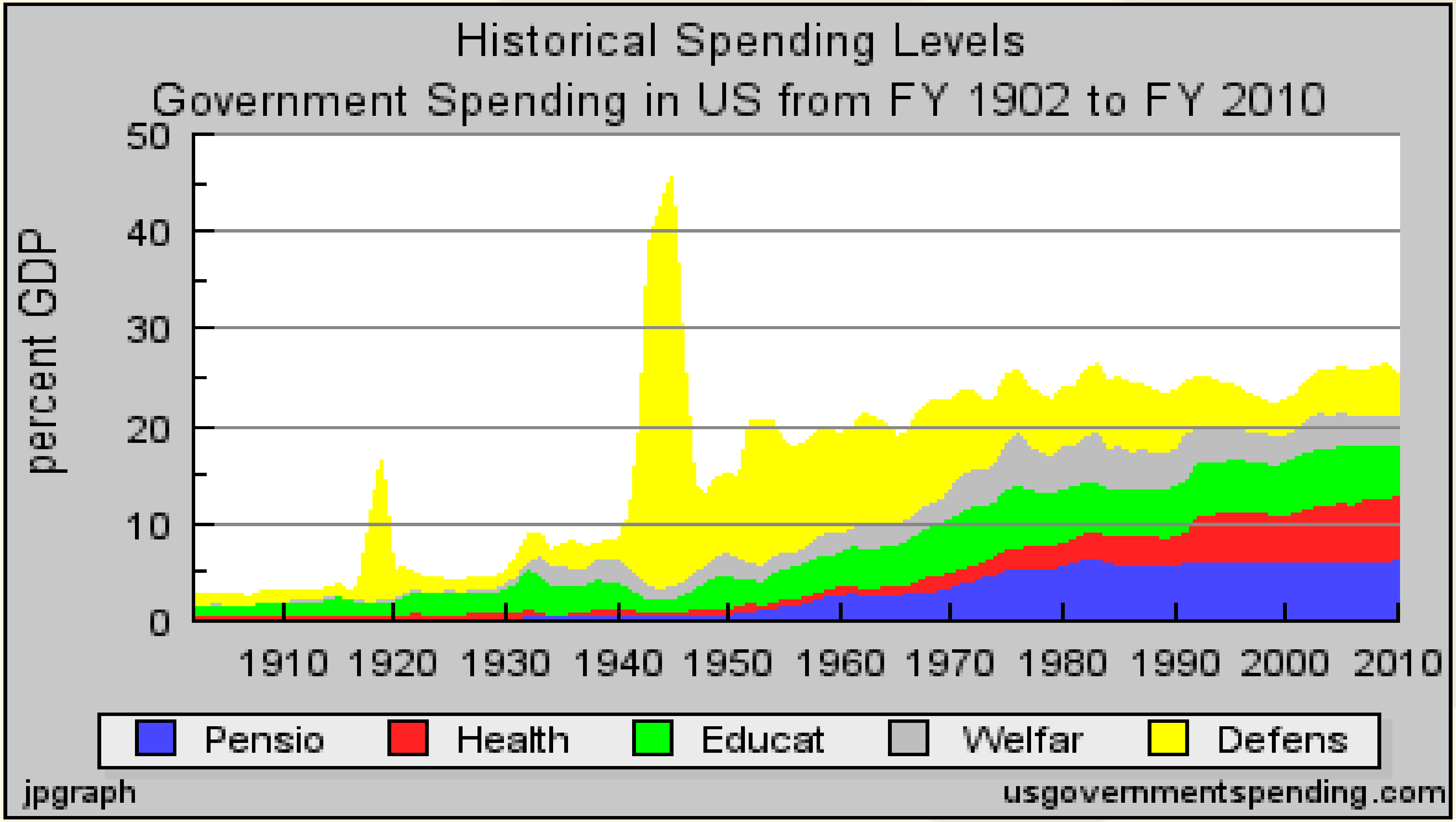
The Size of the US Government is Out of Control



Note: US Total Government spending includes Federal, State and Local governments

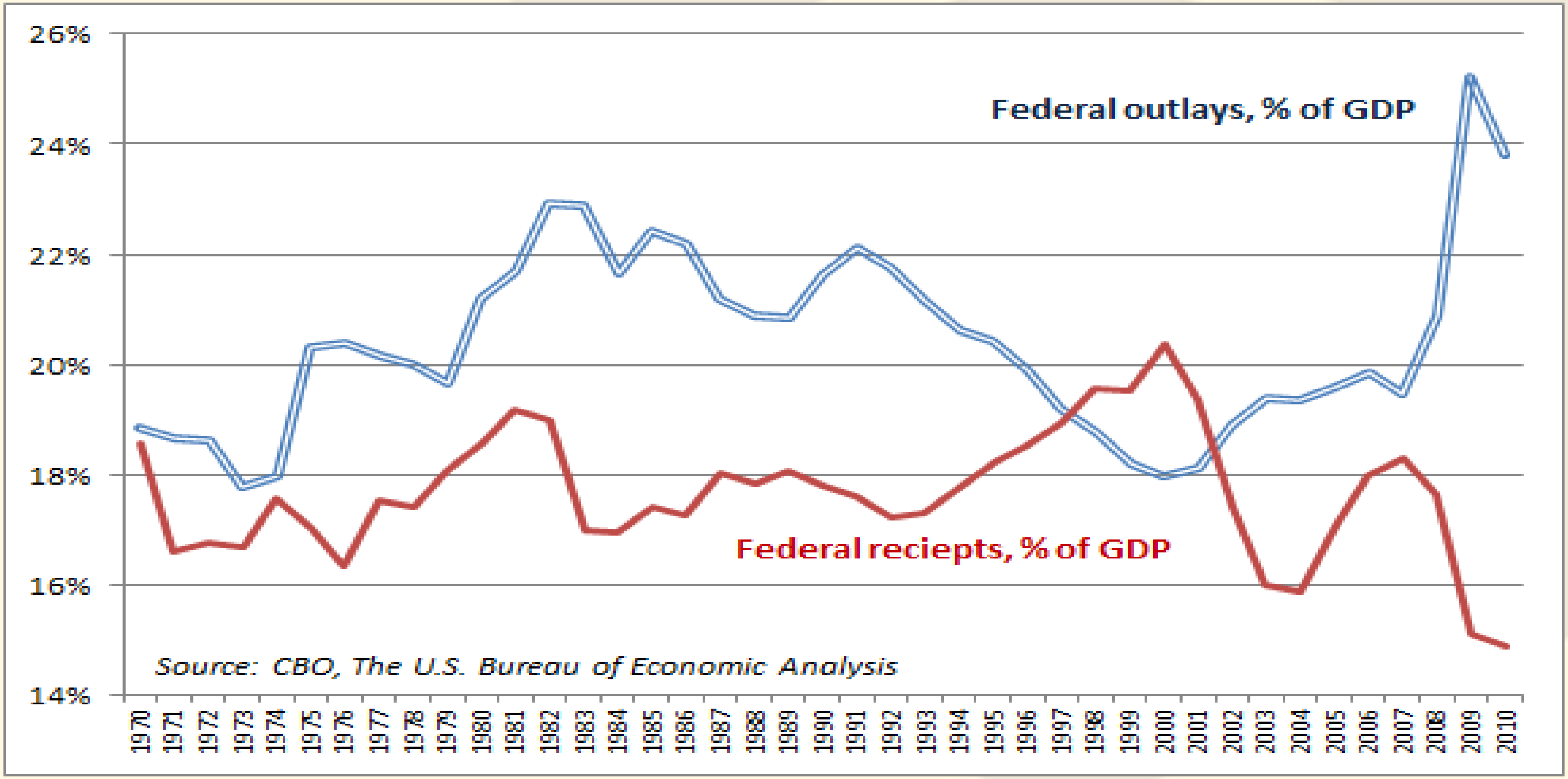
Composition of Government Expenditures

Over the last 30 years, large increases in Health Care expenditures offset reductions in other categories and led to overall increases in expenditures.



Federal Government Spending Has Accelerated in the Last 2 Years

Although fiscal revenues have declined, the major cause of the large fiscal deficit is the increase of spending above the trend



Government Expenditures and Public Debt

Country	Government Spending %GDP	Public Debt % GDP
Zimbabwe	97.8	241
Cuba	78.1	96
France	52.8	84.2
Belgium	50.0	100.2
Ukraine	47.3	39.5
Greece	46.8	130.2
Germany	43.7	74.3
United States	38.9	92.7
Japan	37.1	225.8
Australia	34.3	21.9
Russia	34.1	11.1
China	20.8	19.1
Hong Kong	18.6	0.7

- Except mainly for Europe, the US has one of the world's highest ratios of Government Spending to GDP
- It also has one of the highest ratios of public debt to GDP
- At 93% of GDP, public debt is not sustainable and may increase exponentially, unless the economy were to growth at a rapid pace

Effects of Fiscal Deficits and Debt on Economic Growth

	GDP real growth, %	
	2010	2011f
US	3.0	1.5
Japan	4.0	-0.5
Germany	3.6	2.7
Italy	1.3	0.6
Spain	-0.1	0.8
Portugal	1.4	-1.5
Ireland	-1.0	0.5
Greece	-4.5	-3.0
Russia	4.0	4.3
Poland	3.8	4.0
Romania	-1.3	1.6
Kazakhstan	7.0	6.4
India	10.1	7.8
China	10.3	9.5
Brazil	7.5	3.8
Argentina	9.2	7.0
Mexico	5.4	3.8

- The combination of high fiscal deficits and public debt in Europe have led to low rates of GDP growth averaging 1.8% in 2010 and 1.6% in 2011 for Europe.
- The USA is approaching European countries in government size and debt and also growing at a low rate.
- Asia and most Latin American emerging countries have managed to maintain smaller governments, lower levels of public debt, and have been able to maintain higher rates of economic growth averaging 7.3% in 2010 and 6.4% in 2011.

Source: IMF, TBF

Confronting the Nation's Fiscal Policy Challenges
Conclusion

Given the aging of the population and rising costs for health care, attaining a sustainable federal budget will require the United States to deviate from the policies of the past 40 years in at least one of the following ways:

•Raise federal revenues significantly above their average share of GDP;
•Make major changes to the sorts of benefits provided for Americans when they become older; or
•Substantially reduce the role of the rest of the federal government relative to the size of the economy.

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Public Policy Prescription for the new US Government

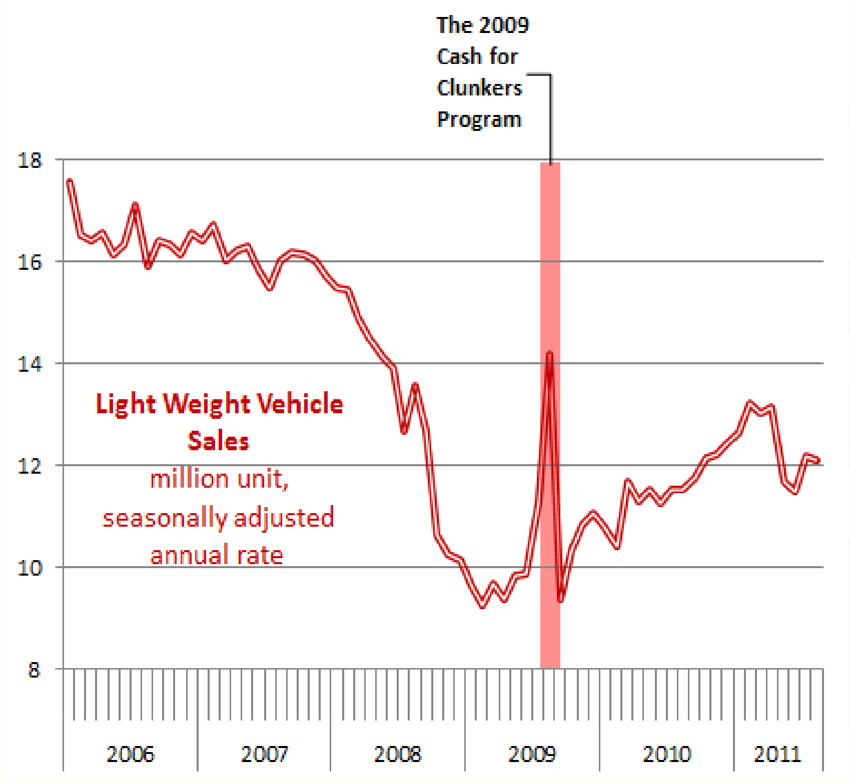
- The priority of US policy should be to **reduce the size of the federal government.**
- The new government should undertake a broad review of all programs and functions currently performed by the federal government to **ascertain if a program should be retained, transferred to the states, privatized, or just eliminated.**
- This approach was pioneered and successfully tested in many countries, including Canada, New Zealand, Australia, and Poland. These countries found that through this approach, the fiscal budget deficit could be reduced permanently to sustainable levels.
- Programs that are not intrinsically tied to national policies should be transferred to the states. For example, a good portion of Medicare and Medicaid could be more effectively managed and financed at the state level.
- This approach is consistent with international experience on how to reduce fiscal deficits effectively. Only expenditure reductions resulting from elimination of ineffective programs are sustainable. Tax increases are not an effective way to reduce the deficit as they discourage investment and stunt growth.

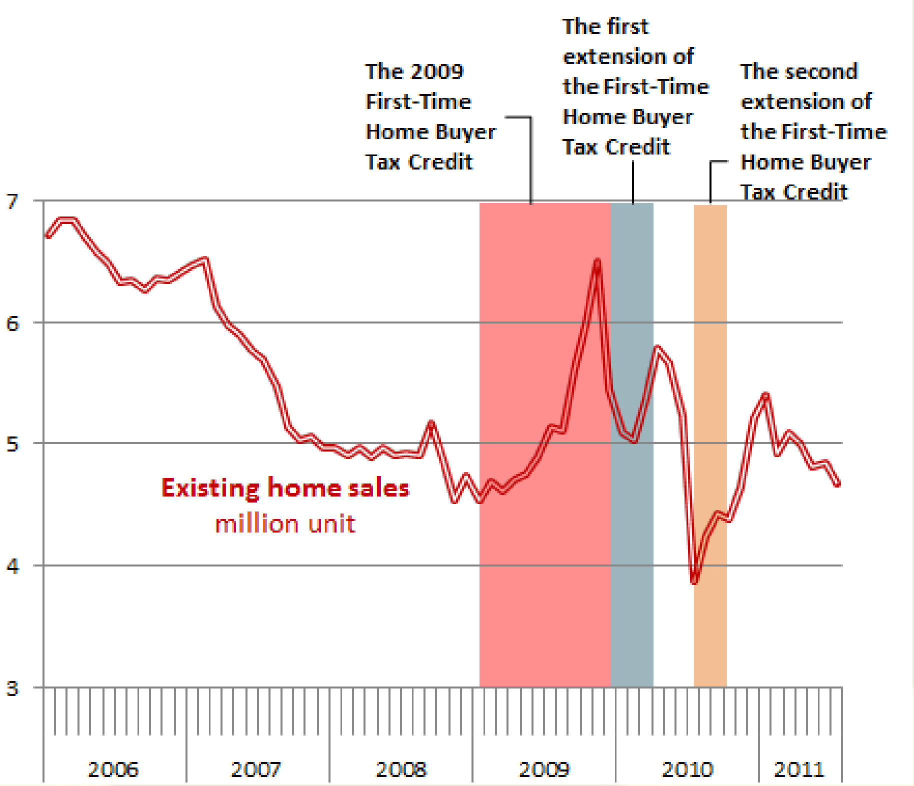
Role of Federal and State Governments in Creating Jobs

- The government is not effective in creating jobs. Additional public sector jobs cost more money to taxpayers and are rarely sustainable.
- Current federal policy regarding job creation ignores the historical failure of similar policies and reflects a fundamental lack of understanding of the causes of unemployment.
- Private sector jobs can only be created by private sector, but government can play a useful role in facilitating that by improving the business environment and supporting innovation and new technologies.
- Supply side measures are the only ones that create permanent jobs. Many demand side measures have failed.
- Several past government programs tried to create jobs by boosting private demand, but many of them represented temporary shifts in fiscal policy, such as temporary tax cuts or temporary jobs in infrastructure.
- These temporary increases in government spending usually fail to trigger a sustainable shift in consumer behavior because of the expectations of policy reversals in the future. As a result, few new jobs are created. The proposed America Jobs Act follows the same pattern.

Evidence of Failure of Demand Side Policies

- There is ample evidence that demand side programs fail.
- For example, both the cash-for-clunkers and the first-time home buyer tax credits programs failed to reverse the downtrend of car and home sales (see charts below).





Why we should focus on supply, not demand measures

- The main reasons for supply side measures are **globalization and outsourcing**, which were less important in the 1980s during the last severe recession.
- Due to globalization, the US has lost many manufacturing jobs in the last few decades and, more recently, construction-related jobs. **These jobs will not return.**
- With reduced international competitiveness, of the roughly 27 million jobs created during 1990 and 2008, 98% were in the non-tradable sector of the economy, the sector that produces goods and services (such as housing) that cannot be exported and must be consumed domestically.
- On the other hand, employment barely grew in the tradable sector of the U.S. economy, the sector that produces goods and services that can be consumed anywhere, such as manufactured products, engineering and consulting services.
- With the collapse of non-tradable jobs, which are unlikely to return, the US needs to come up with new sources of growth (areas in which we can be internationally competitive).
- This can only come with much greater efforts in innovation and new technologies.

Manufacturing Jobs Trends

- In 1960, manufacturing accounted for 25% of the economy.
- By 1990, its share of GDP had declined to 17%.
- By 2000, it accounted for just 14% of GDP.
- Today, for the first time since the Industrial Revolution, fewer than 10% of American workers are employed in manufacturing.
- The US has lost over 7 million manufacturing jobs since 1980 (a loss of about 6% of today's labor force).

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US Loss of Competitiveness

US Rank in Global Competitiveness Index

	Rank (out of 142 countries)
Basic requirements (20.0%)	36
Institutions	39
Infrastructure	16
Macroeconomic environment	90
Health and primary education	42
Efficiency enhancers (50.0%)	3
Higher education and training	13
Goods market efficiency	24
Labor market efficiency	4
Financial market development	22
Technological readiness	20
Market size	1
Innovation and sophistication factors (30.0%)	6
Business sophistication	10
Innovation	5

Source: World Economic Forum, The Global Competitiveness Report, 2011-12

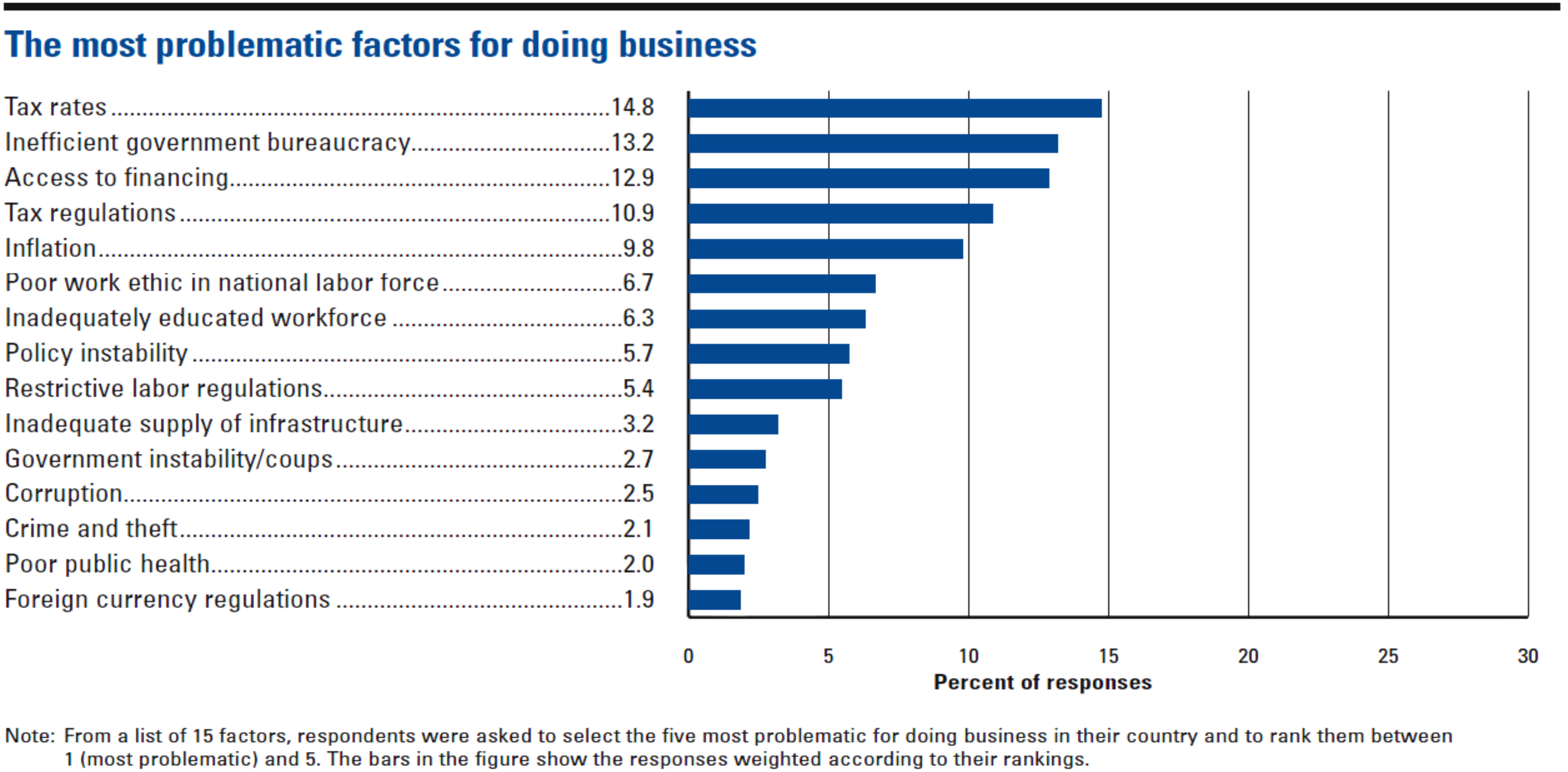
- The US loss of competitiveness is shown in the most recent competitiveness ranking by the WEF.
- In basic competitiveness requirements, the US is now ranked number 36.
- Even in technological readiness – an area where the US used to excel – it is now 20.
- Its overall competitiveness ranking is good only because of market size. But even here it has competition from the EU, China and India.

Why has the US lost Competitiveness?

- The US used to be one of the most competitive countries in the world.
- This was due to ample availability of one of its most valuable resources – a "**favorable business environment**" that included: a free and competitive market, small government with few interferences in business, plentiful human capital, entrepreneurship, and lots of innovation promoted by good business opportunities.
- These resources enabled the US to compete in tradable and non-tradable goods.
- But these "unique" resources have been partly depleted by two recent developments that have affected our competitive edge:
  - First, the large size of government has led to **encroachment** on private sector activities, through increased taxes and tax regulations, over regulation of market activities by inefficient public institutions, inadequate education, etc. Excessive public debt has also crowded out financing to the private sector.
  - Second, other countries (principally in Asia and Latin America) have moved in the opposite direction – they have introduced features that used to characterize the US: fiscal discipline, smaller government, lower taxes, business deregulation, etc.
- To regain competitiveness, the US must replenish its unique resource of a **favorable business environment** by reducing the size of the government and putting increased emphasis on promoting innovation and new technologies.

Problematic Factors for Doing Business in the US

Out of the four most problematic factors for doing business in the US, three of them are related to the large size of the US Government.

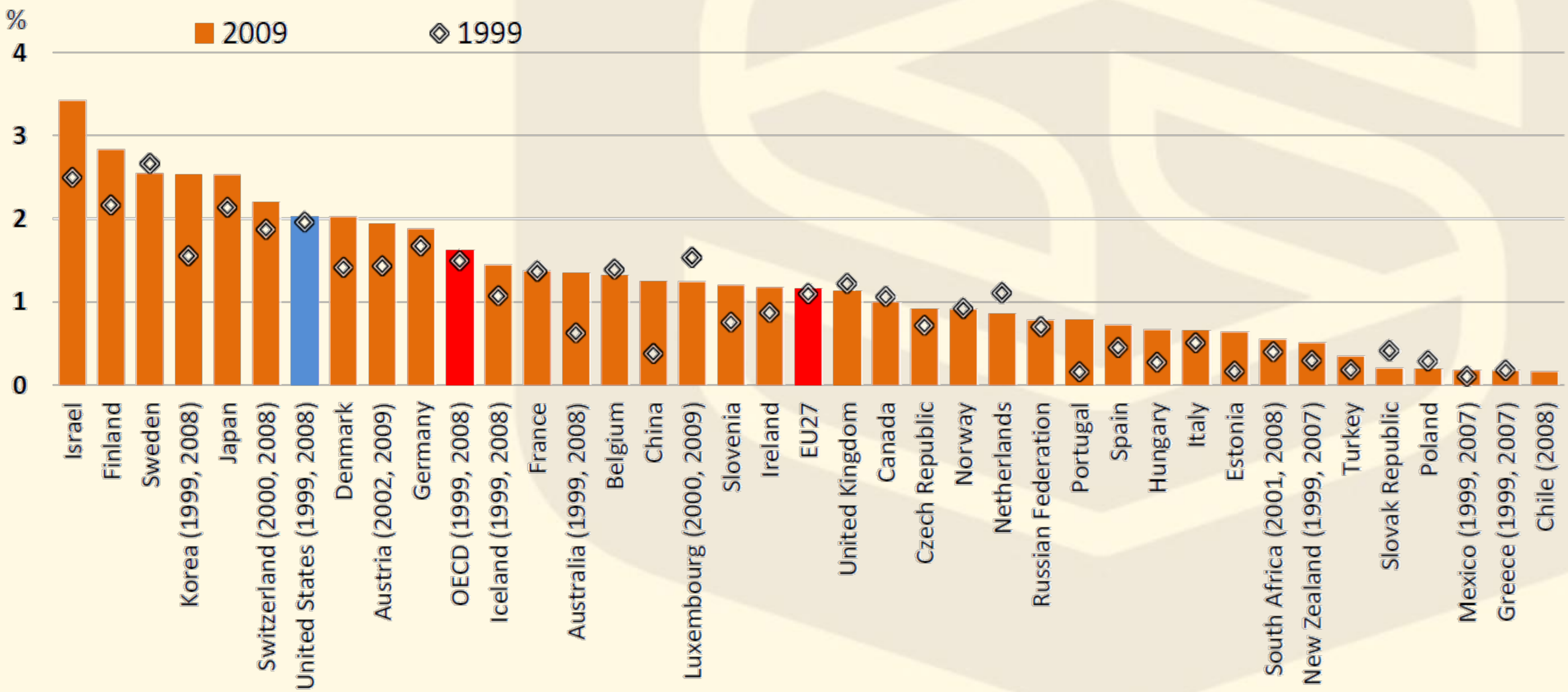


The Global Competitiveness Report 2011-2012 © 2011 World Economic Forum

Creating Jobs through Innovation and New Technologies

State governments should focus on promoting innovation as the key to improving competitiveness and creating permanent jobs. Unfortunately, the US has lost its leadership in R&D investments and has been surpassed by many countries. This trend must be reversed.

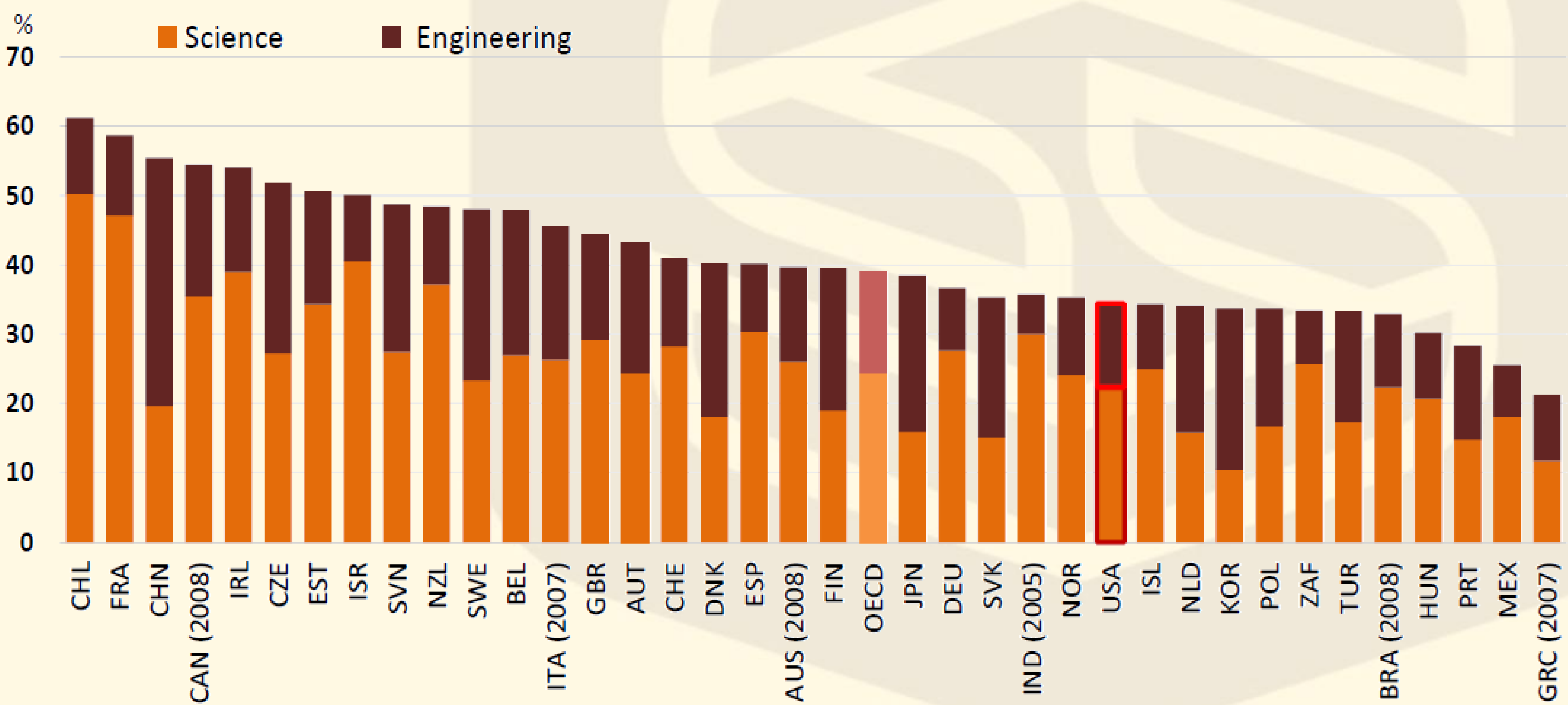
Business expenditures on R&D (*As a percentage of GDP*)



Education's Role in Innovation and Technology

University education in the US is also less focused on science and technology subjects:

Science and engineering graduates at the doctorate level, 2009
As a percentage of all new degrees awarded at the doctorate level



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Drivers of Innovation and Technology

Several think tanks, including The Bleyzer Foundation, have identified 5 primary drivers that could initiate a boom in innovation and technology:

Reduce the Cost of Doing Business

- Some of the conditions that need to be addressed at both the state and federal level are high taxes, border constraints, inefficient bureaucracy, and access to financing.

Invest in Information Technology Infrastructure

- At the state level, encouraging and promoting growth in technology not only benefits those directly accessing government resources, but the spill over effects can positively impact the economy as a whole.

Establish Better Links Between Government, Business and Universities

- Communication and collaboration is required between these entities so businesses can tap into the growing wealth of global knowledge, adapt it to consumer needs and transform it into products valued by the market.

Invest in Education

- Universities play a significant role in research and development.
- State governments should find creative ways to encourage greater private sector financing of educational facilities at all levels of education.

Establish Technology Parks with Government Infrastructure Support, Managed by the Private Sector

- Well-designed technology parks have a proven track record of reducing the cost of business for technology firms.
- State governments can facilitate and support these developments through strong infrastructure, while allowing the private sector to manage them efficiently.