

Economic Stimulus without Industrial Policy* Won't Work (Feb 2009)

Obama economic stimulus payments drive offshore, not U.S., production.

Consumer activity constitutes over two-thirds of U.S. Gross Domestic Product (GDP). Given this, the goal of the economic stimulus program of the Obama Administration is to put money into the hands of consumers who will go out and purchase goods and services. The expectation is that this burst of purchasing will jump start domestic industries which ramp up production and hire more workers to meet the increased demand for consumer goods.

Unfortunately, an economic stimulus like this was more effective in the past than today because much of the production of popular consumer goods for the U.S. market in the past was domestic rather than offshore as today. (The manufacturing of consumer goods in the United States has diminished to the point where it is no longer set up to produce most popular consumer goods that Americans want.)

Most common consumer goods are made offshore.

For example, suppose U.S. taxpayers receive their rebate/stimulus and decide to replace some of their worn out or obsolete consumer goods. They pick American brands they are familiar with and buy a new Proctor-Silex toaster, a Cuisinart Blender/Food Processor, a Black & Decker Dustbuster, and two new HP Pavilion Desktop computers and printers (in fact, we made these purchases recently). However, these purchases are not going to stimulate domestic production and create jobs here because these products are manufactured in China, not in the United States. (Note: Consumer goods imports are a large percentage of the overall U.S. goods imports and contribute significantly to the chronic U.S. trade deficit – every year starting in 1975.)

Offshoring: Good for U.S. CEOs in the short-term

but bad for Americans in the long-term

Since the 1970s and 1980s, U.S. companies have moved manufacturing offshore so they could produce more cheaply and have a price advantage for selling these products back

into the U.S. market. Their lobbyists have told us how the American standard of living has risen because of access to much cheaper consumer goods produced offshore.

However, they have **not** told us

- that this is fundamentally a short-term benefit
- that once these productive technologies have been moved out of the United States, the wealth created by adding value to inputs to make products would no longer accrue to American workers
- that these wealth-creating activities could erode or disappear in the United States.
- and that eventually, no matter how cheaply American companies could produce consumer goods offshore, Americans would not have the means to buy them.

"Once factories or industries are gone, they almost never come back."

Unfortunately, As Clyde Prestowitz writes in *Three Billion New Capitalists* (2005), "Once factories or industries are gone, they almost never come back. The cost of a restart is enormous and the competitive circumstances usually worse." (p. 210). He cites "Other industries [which] simply disappeared" (p. 127) and "many imported products [which] are simply not made in the United States." (p. 214) Prestowitz thinks that "the U.S. manufacturing base may have atrophied to the point that it no longer has the capacity to respond" to a burst of consumer spending from a stimulus package. (p. 214)

Myopically leading us off a cliff

What the previous sections show is that, despite its energy and creativity, capitalism in a laissez-faire environment (which has been dominant in the United States since the Reagan Administration) can be myopic and can lead us off a cliff. Consider an example: Company A, an American manufacturer of PCs (perhaps in Silicon Valley), moves its manufacturing to cheaper regions offshore.

- This gives Company A a price advantage over companies B, C, and D for selling its PCs back into the U.S. market, the most lucrative consumer market in the world.

- The CEO of Company A looks better than the CEOs of companies B, C, and D in quarterly earnings reports.

Then Companies B, C, and D are compelled to follow suit, and they move their U.S. manufacturing offshore to stay price competitive in the U.S. market with Company A (and to look good on their quarterly earnings reports). While offshoring manufacturing makes CEOs look good in the short-term, it further erodes the manufacturing capability of the U.S. to produce popular consumer goods.

Diminishing the wealth-creating capabilities of American workers

As companies have myopically pursued this strategy of **offshoring** U.S. manufacturing (especially consumer manufacturing and always with an eye on quarterly earnings), they have eroded the value-added manufacturing capabilities of American workers that have created much wealth in this country and have made the U.S. market so lucrative and attractive.

We have tried laissez-faire capitalism twice in the twentieth century.

So where do we stand. We have tried laissez-faire capitalism twice in the twentieth century:

- During the 1920s, laissez-faire capitalism was very popular in the United States and contributed significantly to the onset of the Great Depression
 - During the Reagan administration (1981-1989), laissez-faire capitalism gained renewed popularity in the United States, exacerbated the offshoring of U.S. manufacturing, and worsened our trade deficit**. In 1980, the U.S. trade deficit was \$25.5 billion. The deficit continued to widen throughout the 1980s, reaching a peak of \$159.5 billion in 1987. (Ronald Reagan was elected President of the United States on November 4, 1980.)
- (* A trade deficit for the U.S. occurs when we buy more from other countries than we sell to them. The counterpart for a household is to chronically spend more than you earn.)

Harnessing the energy and creativity of the private sector

We need government economic policies (a national economic strategy) which harness the energy and creativity of the private sector but which guide it and prevent it from self-destructing. Prestowitz writes that "markets tend to excess." "They overshoot" and cannot be depended on to self-correct. (p. 192)

A U.S. Competitiveness Policy

What we need goes by several names: an industrial policy, an economic strategy (Prestowitz, p. 217), a **competitiveness policy** ((Prestowitz, p. 256), or even at times mercantilism. Yes, Ronald Reagan scoffed at government's ability to "pick winners," but look what his laissez-faire policies have done to American manufacturing. Meanwhile, our economic competitors, e.g., China, are effectively "picking winners," and Americans are buying their consumer products rather than their American-made counterparts which often are no longer made.

Our economic competitors understand the need for a national economic strategy.

Prestowitz writes, "Economists policy makers in Europe and Japan accept the legitimacy of and the need for an economic strategy. They accept the notion that the structure of the economy has a significant influence on its long-term performance and must therefore be studied and attended in policy. In both regions there are officials whose job is to worry about economic structure and how various legislative and regulatory proposals might affect it." (p. 217) Their economic policies aim to harness the energy and creativity of the private sector while not entrusting the economic future of their countries to the "invisible hand" of Adam Smith.

China's blend of communism and capitalism (about 2/3's of China's economy)

The above quote Europe and Japan should also include China. Newsweek reports that "The Middle Kingdom's blend of communism and capitalism gives it an edge in tough times." (January 19, 2009, p. 38) China harnesses the energy and creativity of capitalism, but prevents it from leading the nation over a cliff. While, "it [the state] has unleashed a private sector that now controls at least half the economy, and as much as 70 percent if

you include state-owned companies that operate as private firms," "The state still exerts a strong and stabilizing hand." China's economy is expected "to grow more than 7 percent in 2009."

The Obama Administration doesn't want rebate/stimulus checks to be spent on imported consumer goods.

The Obama Administration is apparently aware that if the stimulus package just puts money directly in people's pockets, they will likely spend a goodly portion of it on popular consumer goods such a new cell phone, flat-screen TV, or microwave oven which are made offshore, not in the U.S. So, the Obama Administration has proposed using the stimulus for infrastructure projects like repairing roads since this work must be done here; it can't be done in China. However, the infrastructure approach has some insufficiencies:

- Firstly, even if the work by its nature must be done locally, when the workers are paid and decide to buy a new cell phone, flat-screen TV, or microwave oven (which the U.S. does not produce), the stimulus will be offshore, not domestic.
- Secondly, To earn the wealth to purchase these products (which we do not produce), we must export at least as much as we import. We could do this by exporting other products we do produce that other countries want to buy. This would provide us with the wealth to purchase imported cell phones, flat-screen TVs, or microwave ovens that we do not produce.

Exporting at least as much as we import enables our high standard of living.

We can't get wealthy by paying each other to build new roads and houses. If this approach worked, every poor country in the world would do this to get wealthy. We must first gain the wealth to afford new roads and houses by exporting at least as much as we import. We cannot gain the wealth to build new roads and houses by living on debt, i.e., running huge deficits in international trade (every year since 1975. In 2008, the U.S. merchandise trade deficit was \$920.7 billion, an increase of \$24.2 billion (3% from the previous year.) We need to export value-added products, and to regain this

capability we need a competitiveness or industrial policy. Economic stimulus alone won't work. If we continue to rely on Adam Smith's "invisible hand," CEOs, driven by pressure from Wall Street and investors (especially quarterly earnings reports), will continue to focus on short-term profitability and will continue to outsource American manufacturing as they have done for three decades.

William E. Jackman, PhD

Statistician/SAS & SQL Programmer

Jazz and Popular Pianist

Oakland, California

February, 2009

I am a second-generation Irish-American who grew up with immigrant Irish grandparents and aunts in Oakland, California. I am a graduate of Oakland High School and of the College of Engineering at UC Berkeley. I am fluent in Spanish.

*** A U.S. Competitiveness Policy or Industrial Policy**

An industrial policy, an economic strategy, and **a competitiveness policy** are essentially the same thing.

A national competitiveness policy

A national competitiveness policy is a set of strategic measures and actions taken by a country to enhance its ability to create, produce, distribute, and service products in international trade while earning rising returns on its resources. These policies aim to improve the productivity growth of the country at both the macro and micro levels. They are designed to create an ongoing process of economic change and competitive upgrading, mobilizing the private sector, government, educational institutions, and civil society. The effectiveness of these policies is crucial for the country's long-term value creation and economic growth.

A national industrial policy

Industrial policy refers to government strategies and interventions aimed at promoting and supporting specific industries or sectors within the economy. This can include a variety of tools such as subsidies, tax incentives, regulations, and research and development support to encourage growth and investment in strategically important areas. The goal is often to reshape economic activities, enhance competitiveness, and foster innovation, particularly in sectors that may not receive sufficient private sector investment.

A national economic strategy

National economic strategy comprises a vision of a desired future state of the economy, a time frame within which that state is to be achieved, and a set of policies and institutions for influencing the mobilization and allocation of resources and for promoting their efficient utilization.