

America's Opportunity

We live in a world of constant change. Some changes are quick, dramatic and obvious such as those caused by earthquakes. Other changes, like those caused by erosion, are gradual, unexciting and often imperceptible. While earthquakes are scary and do cause sudden changes, ultimately it is the power of erosion that shapes the land as mountains are worn down and massive canyons are formed by the relentless power of water.



In economic terms the “earthquakes” would include the 1987 market crash, Enron’s bankruptcy, or the more recent sub-prime / credit crisis. While these events receive much attention, it is “erosion” that causes the greatest long-lasting changes. Two examples of this erosion are the results of changing demographics and globalization.

Demographics: Most countries in the Western world have a decreasing population. Maintaining a steady population requires a fertility rate of 2.1 (the fertility rate is the number of children that the average woman will have in her lifetime). If the average woman has exactly two children in her lifetime, this is just enough to replace herself and one man. In Western Europe the fertility rate is 1.5, in Japan its 1.3 and in the United States the fertility rate is 2.0, just below replacement. In the U.S. the population is still increasing (for now) because of immigration. The challenges of supporting an aging population with fewer younger people are great. For example, who will pay for higher healthcare bills? If funded through taxes the extra burden may cause young people to delay starting families, causing further reductions in the fertility rate. Suffice it to say these demographic changes will have an erosive power as they will occur gradually over time, without major fanfare.

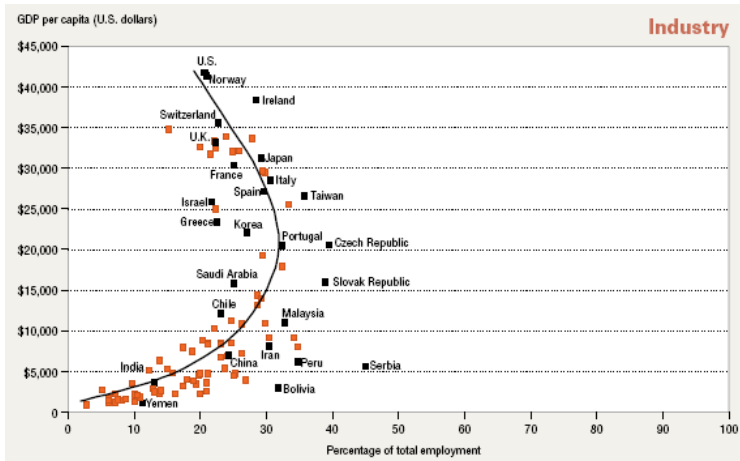
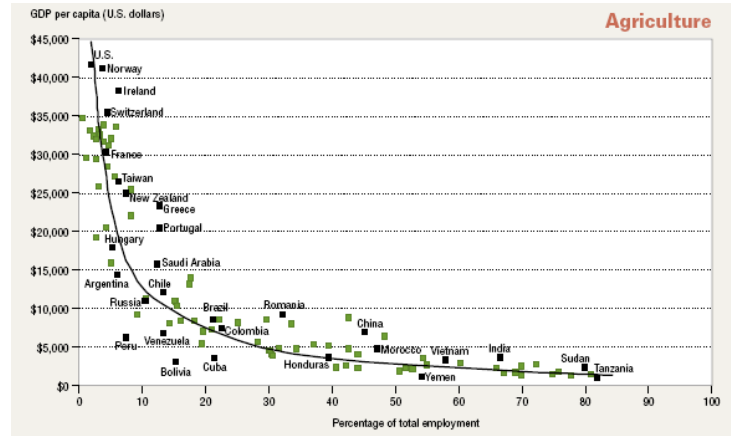
Of course, while a declining population may be inevitable; this doesn’t mean that we are doomed to suffer. It just means that we must find ways to adapt to the changes. One potential remedy is to pay people (with tax credits) to start families. Also, immigration policies are important as many countries have plenty of young people who may be willing to fill the gap. How we adapt to this challenge remains to be seen.

“Never have children, only grandchildren.”

Gore Vidal

Globalization: It is well known that the U.S. economy has become a “service” economy. According to a recent report from the Federal Reserve Bank of Dallas, the service sector now accounts for 80% of our jobs. In addition, services are a major export of the U.S. In 2007 an estimated \$490 billion worth of services were sold outside the U.S., accounting for about 30% of our total exports. This transition to a service economy has occurred gradually as there has been an “erosion” in agricultural and industrial jobs. According to the Dallas Fed report, “services are the path to prosperity, not poverty.”

Nations with 30% or more of their labor in agriculture usually have incomes below \$6,000 a year (see top chart). U.S. farms and ranches employ just 1.5% of the nation's workers. The adoption of more-productive farming techniques frees up rural labor, which migrates to cities to work in industrial jobs. This trend only takes a country so far, as there appears to be a natural limit of about 30% to 40% employment in industrial jobs (see middle chart). In the U.S., manufacturing, mining and construction jobs peaked at about 33% in 1950 and now account for fewer than 20% of total employment. Labor resources no longer needed by industry find their way into services. Per capita incomes rise quickly once services constitute more than 50% of jobs. In services, workers' incomes are highly dependent upon education levels attained - high incomes and services jobs appear to go hand in hand.



For many, the notion of a service economy has negative connotations (e.g. a nation of burger flippers at McDonalds), but such a downbeat view ignores the opportunity that globalization offers. It provides an opportunity to sell our services to the world. We hear a lot about American companies laying off workers and outsourcing to foreign locations, but we hear little about U.S. companies creating jobs by expanding service offering overseas. For example, U.S. architects design office towers, airports and stadiums in places like China and Dubai. In the industrial engineering sector, exports are about 24 times imports. In film and TV, exports exceed imports by a factor of 13. In healthcare, foreigners spend 10 times more on U.S. medical services than we spend overseas.

The Dallas Fed report concludes with some thoughts about "America's Opportunity": "Enduring the economy's constant churning is the only way nations climb the ladder leading to higher-value-added production and rising incomes. Poor countries stand on the lower rungs. They can move upward by adding physical capital and reallocating resources from agriculture to industry. Rich countries have already climbed to the higher rungs by shifting their economies toward services (see lower chart). Their best bet for rising even further lies in sharpening their ability to deliver higher-value-added services. The way to do that is through investing in human capital - more and better education. Domestic demand will continue to fuel America's services industries, but we have an epochal opportunity in the global marketplace. Trade surpluses in an array of service industries prove America can compete in a global marketplace. We need to become smarter and even better educated. We need to embrace globalization and recognize the bright prospects for selling our services to the world. It's time to seize the opportunity."

