



Friday, July 2, 2010

Made in _____?

Paul Krugman in [a column in Monday's New York Times](#) shook up the financial press and investors alike with his claims that "The Third Depression" may be upon us because of the "triumph of orthodoxy" evidenced in the G20's endorsement of deficit reduction. Krugman a liberal economist and staunch Keynesian believes that government stimulus is the only way to create jobs, and that belt-tightening at this time would be disastrous. Unfortunately, the bond and stock markets seem reflect a similar fear at present with the benchmark 10-year Treasury at just over 3%, a level not seen since April 27, 2009, and the S&P 500 Index sliding to a nine-month low yesterday.

Alen Mattich of the Wall Street Journal argues there is no alternative to austerity for Europe. He says that "as Greece showed, and Spain and Portugal threatened, relatively small and highly-stressed European economies will be quickly shut off from the capital markets without a big effort to clean up their government finances." He points out that some of these countries' balance sheets are stronger than those of Japan or the US, but unlike Japan, they rely on foreign creditors. The US has a heavy reliance on foreign creditors (nearly 50%), but maintains the status of safe haven which keeps its cost of debt affordable – for now.

In the US, nearly 75% of new jobs are created by small businesses. Last week's Brief noted an article by David Brooks making the case that government stimulus does not induce small businesspeople to hire and expand. In fact, it scares them. They rightly conclude that the growth isn't real and that big tax increases loom to pay for the 'stimulus.'

It is clear that the billions spent by the government so far in the name of stimulus have had little or no impact. Alan Meltzer in Wednesday's WSJ said the administration's 18 months of stimulus measures have not worked. He said "first, administration economists and their outside supporters neglected the longer-term costs and consequences of their actions. Second, the administration and Congress have through their deeds and words heightened uncertainty about the economic future. High uncertainty is the enemy of investment and growth.

Meltzer points out that most of the early spending was very short-term and ignored the role of expectations. Economic theory predicts that temporary tax cuts have little effect on spending. Unless tax cuts are expected to last, consumers save the proceeds and pay down debt. Past temporary tax reductions, as in the Carter and first Bush presidencies, confirm this outcome.

According to Meltzer, "the two most successful fiscal stimulus programs since World War II were under Kennedy-Johnson and Reagan. Both took the form of permanent reductions in corporate and marginal tax rates. Economist Arthur Okun, who had a major role in developing the Kennedy-Johnson program, later analyzed the effect of individual items. He concluded that corporate tax reduction was most effective."

In 1981, President Reagan reduced marginal and corporate tax rates and slowed the growth of nondefense spending. Recovery began about a year later. After 18 months, the economy grew more than 9% and it continued to expand above trend rates.

We learned today that employment fell in June for the first time this year, due to reductions in federal census employees without offset from the private sector. Payrolls declined by 125,000 last month as the government cut 225,000 temporary workers conducting the 2010 census, according to the Labor Department. The jobless rate fell to 9.5% from 9.7% as the labor force shrank.

If government stimulus is not the answer what brings us back from the brink, if indeed we are on the brink? All economists agree that jobs play a critical role in the process of recovery. How they are created is the stuff of heated debate. Obviously, government jobs are created when government expands. The latest crises give the President and Congress near carte blanche to add new programs and entitlements with little regard for cost effectiveness or productivity.

Private sector job creation has none of the luxuries afforded to government job creation. A private employer must justify not only a payback for the expenses born in creating the job, but also a profit to reward his risk and to fund future growth. Economic and policy uncertainty are two significant reasons private job creation is not happening. Another is that the recovery is not sufficiently robust to justify new jobs and the risks they entail.

Andy Grove of Intel expresses some fascinating observations on Bloomberg's website today. He notes that our loss of jobs overseas isn't simply to lower Asian costs. He says it's our own misplaced faith in the power of startups to create U.S. jobs. We have held to this myth that our innovation will save us as an economic super-power. But unemployment in the Silicon Valley area is 9.7%, higher than the national average. Grove says, "Clearly, the great Silicon Valley innovation machine hasn't been creating many jobs of late -- unless you are counting Asia, where American technology companies have been adding jobs like mad for years." We aren't manufacturing the stuff our innovation creates.

According to Grove, scalers figure out how to make things affordably, build factories, and hire people by the thousands. Scaling is hard work but necessary to make innovation matter. He says that "plowing capital into young companies that build their factories elsewhere will continue to yield a bad return in terms of American jobs."

Some 250,000 Foxconn employees in southern China produce Apple's iPhones, iPads, Macs, and other products. Apple, meanwhile, has about 25,000 employees in the US. For every Apple worker in the US there are 10 people in China building their stuff. Grove says the same 10-to-1 relationship holds for Dell, disk-drive maker Seagate Technology, and other U.S. tech companies.

Grove concludes with a piercing question for policy makers and businesses alike. "You could say, as many do, that shipping jobs overseas is no big deal because the high-value work -- and much of the profits -- remain in the U.S. That may well be so. But what kind of a society are we going to have if it consists of highly paid people doing high-value-added work -- and masses of unemployed?"

It's time to get the politics out of the debate and innovate our way back to "Made in America." Hope you have a Happy Fourth of July.

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