

America is rotting at its core

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For years we have been told not to worry about China's growing strength, because America is even stronger. No matter how far China rises, our leaders have said, America will be the world's omnipotent power. "You can do anything," the Prime Minister told the US Congress just six months ago.

This has always been naive. As long as China keeps growing fast — and our entire economic policy assumes it will — the laws of arithmetic guarantee that it will soon overtake the US to become the world's richest country. And wealth is strength, as America itself has shown for over a century.

But until now it has been easy to assume that America itself is not in decline: that the global power shift is driven by China's growing strength, not by American weakness. China might grow stronger, but America would remain a uniquely vibrant, resilient and innovative country, and a beacon to the world.

Now one has to wonder. It is possible that we are witnessing not one but two remarkable national transformations, as America stumbles while China ascends. If so, that will make the shifting power balance between them much faster, more destabilising and more risky than we thought.

We should not exaggerate the importance of Congress's debt fiasco and the S&P credit downgrade. But nor should we overlook their significance as evidence of deeper, long-term shifts in America's economic and political foundations. We have assumed that America will bounce back from its present troubles because it has always bounced back before. This time might be different.

Look at the economy first. The US economy has changed a lot over the past few decades. The first and most important of those changes has been the decline of manufacturing as a share of the economy and a source of well-paid jobs. Manufacturing has always been the bedrock of American economic might. Thirty years ago 20 million Americans worked in the sector. Today only 12 million do, and that number is falling by 50,000 a month. The biggest cause is competition from China.

As manufacturing has declined, its place has been taken by new "knowledge" industries such as finance and IT. But these industries do not create the vast numbers of well-paid jobs that once provided the bedrock of American society. Instead they provide very high paying jobs for relatively few people. This produces the second big long-term change in America's economy — the stagnation in average incomes.

While the relatively few people who work at the top end of America's growth industries have done very well, average incomes have hardly risen for the past 30 years. That's a very sharp contrast to what's happened in Australia, for example, where average incomes have been rising steadily.

So one problem with America's new knowledge economy is that it doesn't produce many well-paid jobs. The other problem is that it's not clear what it does produce. Value is an elusive concept, but to put it mildly it is hard to see how much value the bankers of Wall Street have added to the US economy over the past decade or two, compared with the contribution of Detroit in its heyday.

And while it is easy to see how Windows and Word make real differences to productivity throughout the economy, that's less clear for later generations of software. Facebook, for example.

This raises some rather unsettling questions. Can America's post-industrial knowledge economy support its global power? Can it create millions of well-paid jobs to replace those lost in manufacturing? Indeed, how can the US maintain a high-wage economy without rebuilding manufacturing?

And how could America rebuild manufacturing in the face of China's competition? America's genius for innovation will help, but only if it can stop China adopting the same innovations itself. Essentially, as long as markets for goods and ideas remain relatively open, the only way for America to rebuild manufacturing would be to drive American wages down to the point that they meet Chinese wages as they rise.

In fact, this may be what we are already seeing. But they'll have a lot further to fall before China stops taking American jobs. That's bad news for American workers, but it is also bad news for America's long-term economic and social trajectory.

Which brings us to politics. Clearly America's political system has always been untidy, but it has mostly produced good government. Governing America has, however, become harder over the past few decades. Politics everywhere is first and foremost about choosing how to distribute wealth. Until recently the choices have always been relatively easy in America, because there has been a lot of wealth to go around. Now there is, relatively speaking, less to go round, the choices become harder, and the struggles over them intensify.

Several things then happen. First, the debt grows, as both government and people try to avoid choices by borrowing money. Second, politics becomes polarised, as voters scramble harder for the choices that suit them best. Third, people become susceptible to any politician who can convince them that somehow the hard choices do not have to be made.

Americans believed George W. Bush when he said they could invade Iraq and cut taxes. And they believed Barack Obama's beguiling mantra. "Yes, we can" was a promise to Americans that they did not have to make hard choices — a promise he could never keep. Now many Americans seem to believe the Tea Party that cutting taxes will fix everything. As if.

America is a remarkable and wonderful place, with immense resources of all kinds. It will remain the world's second-strongest power for decades to come, with a big capacity to shape world affairs and provide a great life for its people. But it faces choices today about how to grow its economy and use its power that are in many ways harder than any it has faced since the Civil War. Its political system today seems incapable of making those choices. We should be worried, because we need a strong and well-governed America.

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