

Seven reasons not to write off the US

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Illustration by Eric Lobbecke. Source: *The Australian*

IN such globally unstable economic times - words such as flux, fluid, anxious and unstable are getting a solid workout everywhere -- the hardest thing of all to do is to predict long-term trends.

This column, in its fearless fashion, is now going to do just that. Let me give you the headline first: the US will be the leading, probably dominant, global economy emerging out of this period of instability.

Sorting out cyclical swings from long-term, structural trends is a big challenge in this kind of analysis. Here is a cautionary tale.

In 1997 the East Asian economic crisis hit. For a short time it was popular to pour scorn on those (your columnist humbly among them) who had been celebrating the East Asian rise and predicting its continuation. But George Yeo, one of the smartest men in Southeast Asia and for a long time Singapore's foreign minister, at the height of the crisis told me to disregard such naysayers. At worst, the economic crisis would put East Asia's rise back a few years, nothing more.

Yeo was right, as he usually was. I now apply the same spirit of his analysis to the US. It's worth noting, by the way, that through all the magnificent rise of Asia, the US's share of the global

economy shifted very little. Amid the ups and downs, Africa, Latin America and Europe declined somewhat as a share of the global economy, the US stayed rather constant.

I don't deny the US is in a troubled moment just now, but I want to offer you, future alarums and temporary reversals notwithstanding, seven reasons why the US will pull through this period and emerge triumphant once more.

- The astonishing revival of US manufacturing and exporting. There are many ways to measure manufacturing. If you measure it by employment, US manufacturing appears to be in a small recovery. If you measure it by value, it is starting to boom.

This is because of the turn of the cost structure wheel. Manufacturing jobs have been flowing out of the US and into Asia and Latin America for years because US labour rates cannot compete with China's or other developing nations.

But guess what? Labour is an ever diminishing part of manufacturing's cost structure. Increasingly, machines are making machines. This plays to US strengths.

Bigger costs, given the rise in fuel prices, are transport. Being inside a giant market like the US is a big advantage. A new term has been coined - "insourcing".

The US's flexible industrial relations system also means new manufacturing jobs are being negotiated at competitive wage rates - \$12 or \$14 an hour or so. This does not provide a comfortable middle-class life, but it's a million times better than unemployment. If you can get healthcare insurance with it, it's manageable.

Moreover, the rise of the Asian middle class means a growing demand for US-style hi-tech exports. As the economist Tyler Cowen argued recently: "The leading categories of American exports today - civilian aircraft, semiconductors, cars, pharmaceuticals, machinery and equipment, automobile accessories, and entertainment - are going to be the sweet spot of growing demand in what we call the developing world."

In 2010, US exports to China grew by 32 per cent. It might not be a huge amount of jobs, but it will be a huge amount of dollars. Watch this trend very closely.

- Then there is energy. God may just be an American after all. All this shale oil, and the new technologies to extract it, mean that at anything above \$US70 a barrel the US has commercially viable oil reserves that dwarf those of Saudi Arabia. Fracking, the technique to extract this oil, has its problems but this is a giant development. Not to mention the massive gas discoveries.

- The status of the US dollar as the world's reserve currency, and main currency of trade, is not remotely threatened. The euro, the only candidate to compete with the dollar, is in desperate eclipse. This status gives the US all kinds of institutional advantages. It might end one day, but not for a long, long time.

- The US has the most effective competitive federalism of any nation in the world. Wisconsin, of all places, passed quite tough industrial relations laws designed to improve productivity and competitiveness. There was a massive reaction and an effort to recall the reforming Republican governor. But the voters of Wisconsin endorsed the changes.

With all the talk of US political dysfunction, this is one of the most powerful competitive advantages the US political system has. States force an element of good policy on each other by innovating successfully and attracting investment, and prosperity, away from their neighbours. Competitive federalism works in the US.

- Both the size, and the composition, of the US's demographic dynamic is superior to any other developed country in the world, and superior to most developing countries, too. Alone among developed countries (except for Israel) the US has just about got a replacement level birth rate.

But it also has huge continuous immigration. This attracts many of the best brains in the world and for bulk is constantly infused with Latin American talent. Europe, by contrast, has very little legal immigration from outside Europe apart from North African asylum-seekers. But the North African story in Europe is infinitely more troubled, and less economically advantageous, than the Latin American story in the US.

By 2050 or earlier the US population will be younger than China's. This is an enormous driver of growth.

- The US is still the global centre of innovation. It has the best universities, the most patents, the biggest IT and entertainment industries, the biggest military budget (by miles) which itself generates all manner of technology. Even with shrinking military budgets, these advantages will grow.

- After the presidential election, there will be the real prospect of a budget deal. Either Barack Obama or Mitt Romney will be elected with a lot of goodwill and the losing side will have significant incentives to agree to a budget compromise.

Despite its huge debts, its budgetary position is much less dire than Europe's, because the size of government is smaller. Some spending restraint, along with some revenue measures, could solve the budget problems.

These magnificent seven don't guarantee American success. But they are powerful factors. They certainly make American success as likely as any other. The US is always strong on the rebound. I'd still bet on Washington.