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Full Employment and the Perils of Empire

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In this chapter, I assess current American economic conditions, suggest that stagnation in the medium term is not necessarily inconsistent with the American government's strategic vision, note the perilous international position of the American economy, review the vast expense of maintaining empire, question our short-sighted energy policy, and suggest economic policy alternatives that can complement the foreign, domestic, and media policies presented in other parts of this book.

CURRENT ECONOMIC POLICY

We are passing through a period of economic stagnation, and this remains true in spite of good economic news that began to flow in mid-2003. But underlying difficulties remain, and recent federal responses to them have been superficial. Stagnation is therefore likely to reassert itself *as such* after an interlude of better news.

Business investment has not recovered from the information bubble, a speculative mania which peaked and collapsed in 2000. Capacity utilization is low, and investment is unlikely to recover soon. This is especially the case for sectors like telecommunications where excess capacity does not quickly become obsolete.

At the same time, the prosperity of the late 1990s was fueled by an unprecedented willingness of American households to borrow and to spend ahead of their incomes. Through the entire postwar period, American households had tended to spend a couple of percent of gross domestic product less than they earned. After the middle 1990s, they started spending more. Spending went up by 3 to 5 percent of gross domestic product, actually ahead of incomes. That could not and did not continue. The adjustment of spending toward income began in 2000, slowing down the economy. Unfortunately for the future, it is not yet complete. Because of the climate of very low interest rates that has been created for American households, families have continued to add to their mortgage debt and to spend the proceeds of the loans. This, too, cannot go on forever. It is especially unlikely to form the basis of an enduring new expansion. Rather, it is more likely that household spending will slow, rather than accelerate, in the medium-term future.

We also have an enormous and continuing crisis in state and local government financing. Unlike the federal government, state and local government cannot borrow, except clandestinely, to cover current deficits. As they either cut their services or in some cases raise taxes, state and local governments are adding to the downward pressure on the economy as a whole.

In the very short run, this bleak picture is being obscured by two developments. First, there is the enormous increase in federal budget deficits, far larger than almost anyone anticipated, and which proved sufficient to jump-start economic growth last year. Some parts of the tax cuts recently enacted did flow to the middle class, and so accounted for some recent growth. As the military continues to restock its equipment following what is being used up or worn out in the course of the post-war in Iraq, that expenditure will have further effects on current economic activity.

The second development is a continuing (and also unprecedented in recent times) policy of very low interest rates. As each cut in interest rates goes through, households refinance and there is a little more spending. This is good for the economy, but not so good for financial institutions. Monetary policy will contribute to good economic news in the immediate future; the Federal Reserve has all but promised low and stable interest rates. But they will not be enough to generate a new, sustained, and strong expansion on the basis of rapidly rising household consumption spending in later years.

So while there will be good news in the short run, it is unlikely to endure. Over a strategic time horizon of a few years, it is much more likely that stagnation will continue. Conceivably, recession will return. Absent a mobilizing event like another large war, either of those outcomes is, in my judgment, more likely than the possibility that we will see another sustained expansion, carried on for four or five years, strong enough to create a return to the full employment of the 1990s.

It is quite illusory to say, as some who stand on the Democratic side of the spectrum have been saying, that the problem is one of budget deficits per se—whether the current deficit or those expected in the future. By this reasoning, if we were only to return to Clinton-era policies of balancing the budget, we would be back to Clinton-era prosperity. Such a view simply reflects a failure to understand the larger financial balances and underlying realities in America and the world today.

It is also illusory, or at least strategically ill-advised, to frame the long-term policy needed in terms of stimulus packages. Such a frame implies that imparting a single, brief, powerful impetus to the economy can bring us an enduring return to expansion. That assumption also is incorrect. I am not arguing against the usefulness of stimulus packages, but to conceive of them as comprising a recovery program is to ask more than they can deliver.

DOES THE ADMINISTRATION WANT FULL EMPLOYMENT?

The architects of recent economic policy are not entirely unhappy with this state of economic affairs. Stagnation is in line with a larger political agenda of continuing tax cuts on financial wealth. Those cuts are an extremely inefficient way to generate new spending, and to the extent that they force offsetting cuts in public investment and services, they will prove counterproductive. But they can always be justified as yet another impetus for the economy on supply-side grounds, or some other such mumbo-jumbo.

The recent tax cuts were actually something quite different. They were part of a longer-term strategy to assure that financial wealth is essentially free of tax. The purpose of this, in part, was to compensate some of the wealthy for the losses they incurred in the sluggish economy.

The economic coalition that benefited included oil firms, defense contractors, pharmaceutical companies, mining interests, and big media. These are economic interests whose basic position is maintained by government contracts, rights to natural resources, monopolies, patents, government-granted protections, and privileges of one kind or another. Their profits do not depend heavily on strong consumer demand or full employment. Full employment would itself bring other forms of political difficulty for conservatives—like stronger labor unions, pressure for higher wages, higher charitable contributions, and a stronger nonprofit sector.

THE CHESHIRE CAT: ARE SOCIAL SECURITY AND MEDICARE VIABLE?

Stagnation and the tax cuts also have returned America to budget deficits, totaling roughly around $400 billion per year. By themselves, these deficits have been large enough to start up economic growth, overcoming the drag from state and local cuts and excess capacity. But they are still not large enough to bring about a strong and enduring expansion. In relation to gross domestic product, they are not historically unprecedented. But they are large enough, in dollar terms, to make a strong political impression. If continued into the future, they could be used to justify further attacks on the basic social services that underpin the quality of American life, particularly for our older population. I am particularly thinking of Social Security and Medicare.

Conservatives plan eventual privatization of the cash flows associated with both Social Security and Medicare. The plan is a bit like the Cheshire cat, except that it's not smiling. Sometimes you can see it, and sometimes you can't, depending on whether it is politically expedient and when the next election will occur. We therefore face the possibility of a return to a rhetoric of fiscal responsibility and deficit hysteria, which will make it very difficult to sustain Social Security and Medicare as viable programs.

THE PERILOUS INTERNATIONAL POSITION OF THE AMERICAN ECONOMY

At the same time, the American economy is in international trouble. Under current conditions, if we were to return to full employment in the United States, the trade deficit would be enormous. We have lived for thirty years in a condition of progressive decline in our ability to pay our way in the world through the sale of goods and services, a decline which has been offset for most of that period, and sensationally in the last years of the 1990s, by the willingness of the rest of the world to lend the difference to us, and to do so in dollars—that is to say, in a currency whose issue we control. And therefore the debts were incurred by us on very favorable terms—terms not available, basically, to any other large debtor country in the world.

This international monetary order has also been in existence for about thirty years, which is quite a long time for any single international monetary order to persist, if you look over the last century or more. And the architecture of the present system is not stable, for it depends entirely on the portfolio investment decisions of a small number of major players—Japan and China, notably—as well as the herd mentality of powerful private speculators.

The risk is that, should we try to return to full employment without attending to the decay of our industrial system and the increasing disrepute of the country as a world leader, a great part of the international community may stop lending us back our dollars and be unwilling to hold them until they are much cheaper to acquire. Indeed, the recent dramatic gains of the Euro against the dollar are a sign that this may be happening already. While the falling dollar has some benefits for exports and is very good for the dollar-reported earnings of U.S. multinational companies, it may engender the eventual opposition of the American financial community. A defense of the dollar, effectuated by raising interest rates, would then be highly damaging to the expansion.

It is also true that to get to full employment, given the current account deficit that would then prevail and the likely reticence of households to greatly raise their debt burdens, America would need to run budget deficits that really would be enormous by the standards of American political imagination. As noted, with our large budget deficits, we are growing but not making serious progress toward full employment; we are perhaps five to seven million jobs short of what we would need. Imagine needing a budget deficit of $800 billion, twice as large as what we have, in order to receive enough traction to move down the path toward, let's say, 4 percent unemployment once again. That is a very large number. One would have a very difficult time selling it as a positive program in Washington.

These numbers are not made up by me out of things that I would like to see happen. They are simply calculations of what the public deficit would have to be if the international situation remains as bad as it is and if the household sector continues to want, as the household sector characteristically does want, to have its income at least in even balance.

Maintaining Empire: Vastly More Expensive Than Acquiring It

The economics of empire are pertinent here. Let me stop short of saying that we went into Iraq for the oil. We don't actually know whether that's true. What we do know is that, when we got there, we found that oil actually was there. And weapons of mass destruction were not.

However, there may have been people who believed, for reasons that have always been a little bit mysterious to me, that physical control over the oil fields and the supply mechanisms for oil would somehow help us with the larger instability of our international economic position. I have never been entirely clear what exactly that mechanism would be, beyond simple stabilization of the price of crude oil. Whatever the mechanism, the thinking behind it radically underestimated both the moral and the material cost of maintaining control in the region.

This is something which is quite apparent about the economics of empire, in general. Empires are acquired, and historically have been acquired quite cheaply by small expeditionary forces. The American government did not invent the idea of sending a small force to acquire a large territory in a militarily inferior part of the world. The British and the French did that in Africa a century ago. Not to mention the Spaniards, in Mexico. With very few men, Spain conquered a territory much richer than Spain itself at the time.

The problem is that maintaining empire is vastly more expensive than conquering it in the first place. India, which did not have an organized military resistance movement at all, absorbed one third of the British army at the peak of empire and proved much of the cause of the decline of the British empire. I exaggerate; of course the world wars played an important role. But India was a creditor of the United Kingdom at the end.

The situation we are facing in the Middle East is one where we put very light forces in, without calculating what a reasonable person would have estimated to be necessary to control the environment once we got there. We do not, of course, control that environment now. The initial occupation was disastrous, clearly, from the standpoint of establishing confidence that we could control the environment in the long run. That disaster gave rise to a much greater resistance than we expected, and we are now in an environment where we are suffering losses because of our initial failures. Those losses are likely to continue over time.

We all hope that the situation can be mastered and an Iraqi government established with sufficient power and confidence and support from the population to provide the security that Iraqi economic construction will require. But we should face the realistic possibility that this may not happen. America may need to choose between renewing our commitment to force and violence in a way that will horrify opinion everywhere, or abandoning the exercise and leaving behind a state which we no more control, in economic terms, than we did before. Certainly, reports are that the grand plans to build a "free market" economy in Iraq have fallen victim to the realities of guerrilla war.

Meanwhile, it is probably not correct to say that the resource drain of the imperial venture is so enormous that we simply, in some sense, can't afford it. I don't think that is true. I think that, if we wanted to keep 250,000 or 400,000 soldiers in the Persian Gulf for five years, we could do it. But such a policy would have a crippling effect on the ability of our political and social system to mobilize the resources that are necessary to deal with any other problems in a serious and sustained way, as Jeff Faux has discussed in chapter 20.

AMERICAN ENERGY FAILURE

Let us suppose, then, that one way or another we come to acknowledge failure of the scheme to exercise complete and effective control over oil supplies from the Persian Gulf. This will not mean ending our economic or our security relationship with that region. Rather, it will mean accepting that we cannot entirely control developments there, and that we ought to be better prepared for adverse events from time to time. One of the key questions that we must deal with is the energy future of the economy in which we live.

Recent American policy has not seen past the very large reserves of crude oil that exist in the Middle East. The American government wants to maintain the current basis of our economy, which is an automobile and petroleum-based system with a much dispersed pattern of housing. But at the same time, if you look over the horizon of a half a century or more, it's likely that worldwide production rates for petroleum will decline, for geophysical reasons if not also for political ones. (Oilfield production rates already started declining in this country thirty-three years ago, and we're now seeing declines in the rate of natural gas production.) It follows that even if we want to control those remaining pools of oil, it will take an increasing effort to do so against more competition from the rest of the world.

At some point, for a brighter future, it simply becomes economically sensible and even cheaper to invest in new energy policy. We need alternative patterns of American life which better conserve fossil fuels, make alternative sources of energy available, and bring about a whole spectrum of energy adjustment to create a more balanced economy.

If we *don't* develop energy alternatives, then, down the road, we are going to find ourselves in an inferior position compared with countries that face this reality sooner and invest the capital required to make life easy, tolerable, and efficient in ways that also are profitable for private business enterprise.

Here is a very basic fact about empires. However many resources you put into maintaining an empire, when you eventually leave those resources are gone. So far as you are concerned, the resources are wasted. They are no longer part of your national patrimony. They don't yield a return that can support future standards of living that an empire has come to expect. But if you invest at home, build on what you have, and make economical uses of the resources you expect to have, then those capital investments last for centuries, sometimes even for millennia.

In discussing recent federal economic policies, one is often tempted to play the game of class warfare. This game has its uses. For example, the recent policies certainly did not appeal to the working class, as the Reagan administration did. Yet class warfare is not necessarily a prudent political strategy. Specifically, not all the wealthy are opposed to the rest of us, and certainly not in terms of their objective economic interests. There is a tradeoff between having the wealth and being taxed on it. One can make a very strong case to *some* of the wealthy that they would be better off with an economic policy that generates strong economic activity and profits—and that permits those profits to be taxed to support a higher level of social activity. Not everybody will buy into this argument. But you don't need to have everybody in order to build a majority for a new policy. All successful progressive movements in America have sought alliances with the far-sighted and public-spirited among the rich.

POLICY ALTERNATIVES

Now is the time for significant alternatives. It is not the time for small or incremental changes. You can either be for imperial strategy, or opposed to it. You can either be for a strategy that relieves financial wealth of taxation, or opposed to it. If we don't have a serious alternative, it would be better not to have one at all.

But we do have serious alternatives. The first is a re-commitment to a strategy of collective rather than unilateral security, as Jessica Tuchman Mathews, Gary Hart, and others have articulated in their chapters. Collective security is more just. Collective security is more likely to be successful, but it is also wise for economic reasons. Collective security is simply cheaper. Everybody has to police themselves, and police for others, reciprocally. If a country tries to police the world, the incentive for everybody else to cooperate goes down dramatically. And the cost goes up even more dramatically. One can make a powerful argument that the strategy of unilateral assertion of American power is simply not viable on economic grounds. It is not going to work. The American military is, I believe, fully aware of this.

Empire is mainly a matter of garrisons. And, at the end of the day, if you want to maintain a garrison, you have to be prepared to sacrifice soldiers on a daily basis over a very, very long period of time.

If we don't want that, then we must revisit the early post–World War II vision, a historical high point in world history in which we attempted to build not only security institutions but also economic institutions that provided for a mutual process of development and financing on equitable terms. It cannot be done on commercial terms, on the terms that commercial bankers usually require their commercial customers to accept. It has to be done with very long-term financing, at low interest rates, and under a controlled environment. That was the Bretton Woods vision. It worked for twenty-five years. We kicked it to pieces in the 1970s. In truth, we Americans benefited from that action for a period of time. But nobody benefits if the current system collapses and no viable set of institutional frameworks is put together to replace it.

At home, we need to commit ourselves to a policy of full employment. Given that the private sector is probably not going to take the lead, as it did, very happily, in the late 1990s for quite some time, the public sector must step forward. One just has to recognize that there is a time when the public sector's intervention in these matters becomes necessary.

A great many of the things that most need doing, particularly the reconstruction of our urban fabric—transportation networks, environmental protections, education reform, and health care reform—are substantially, if not wholly, public functions. Here is where we ought to be investing high levels of energy and resources. Much can be done at the state and local levels, with the federal government assuring the stability of financing.

That brings me to a very important short-term proposal. America needs to enact a program of revenue sharing, and perhaps also loan guarantees, to stop the current, destructive hemorrhaging of state and local public services. We must permit those governments to maintain their services and to avoid regressive tax increases. Reduced services and regressive tax increases both tend to undermine the functioning of the economy as a whole.

It is essential that we stop the movement toward privatization of Social Security and Medicare, on the merits of those two programs alone. The fact is that our elderly are going to continue to be with us, and their numbers are going to continue to increase. So the only real issue here is whether we provide for them in a way that is fair to the poorest or change the systems that provide for them in a way which enriches certain constituencies and makes life much more unstable and insecure for most of the elderly population of the United States.

We need health insurance to cover all Americans. That is obviously long overdue.

We need to compress the structure of pay. While many people emphasize the problem of CEO fraud and theft, it seems to me that we should not omit the issue of the minimum wage. The minimum wage is a very important way to assure that lower-income American households have adequate resources. Likewise, we need measures which promote collective bargaining and restore an environment in which unions can work effectively.

The earned-income tax credit is a proven, effective model for fighting poverty. It is something which ought to be protected and expanded.

We ought to tip our hats to those who have tried very hard to keep the bankruptcy laws functional for individuals, because in a situation in which debts are getting more and more problematic for larger and larger numbers of American households, the last thing America needs is for millions of people to be thrown into a situation where they essentially can't escape from the debt crisis for the rest of their working lives.

Finally, we need to think in a serious way about how to stabilize our international financial position. We need a new set of institutions that permit our exports to grow rapidly. That will mean giving up claims to international debt payments—in much of Africa, Argentina—and I believe fairly soon Brazil as well—that are in any event counter-productive.

We may even have to think about whether our commitment to the free trade system, which I am very reluctant to give up, is worth the cost. If we realistically assess the cost, and if it turns out that we cannot find a way to reconcile the commitment to free trade, in principle, with the commitment to full employment in practice, I would choose full employment over free trade. I say that with reluctance because it seems to me that so long as there is an alternative which permits us to continue to be good neighbors particularly to countries like Mexico, we should pursue that alternative. The question is: can we make it work?

Obviously, to pay for this over the long run, it is implicit in everything I have said that the recent federal tax cuts should be virtually and completely repealed. Not immediately, because the issue is not revenue in the short run. And perhaps not entirely, because there was merit to some of the middle-class components of the cuts now in effect. But our economy will need a revenue system to support the level of public activity that we will need to pursue in the years and decades ahead. And for that, America's wealthier taxpayers will need to contribute more than they are doing under the Bush tax law. I believe and hope that many of them will appreciate the necessity of this.

THE MATRIX

In sum, America's long-run goal should be full employment. But our task is not merely to return to the very happy environment of the late 1990s. Even Republicans can keep the economy growing at 2 or 3 percent. But I don't believe the Republicans will get the economy growing more rapidly than that for years on end, beyond the sprint we will probably continue to see as a result of war spending and one-time tax measures and easy credit timed for the election year.

Our more basic task is to think very seriously about the strategic horizon. We need to look very hard at how the world is unfolding in front of us, about the way the United States is fitting, and ought to fit, into that world. That, I believe, is the project the Eisenhower Foundation is engaged in. We must put together the full matrix of foreign, economic, domestic, and media policies necessary to make a true alternative work.

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