

They Stole Our Mojo!

May 2010

The International Monetary Fund (IMF) recently suggested the “Age of America” will soon come to an end, as Chinese economic output will surpass that of the U.S. in 2016, only five years from now. Whoa! What makes this even more dramatic is that ten years ago the U.S. economy was three times the size of China’s. A double whoa!

There is a catch to the IMF’s prediction. Rather than compare these two giants on an exchange rate basis, the IMF is using “purchasing power parity” (PPP). Some people may want to argue that the U.S. economy will still be bigger, but that would seem a moot point at this stage. It is obvious China is catching up to the U.S. pretty fast.

According to the IMF, from now to 2016 the Chinese will expand from an \$11T to a \$19T economy, while the U.S. will grow from \$15T to not quite \$19T. But a lot can happen in five years. Assumptions and projections can be tough to nail down in these dramatic times.

We still have numerous potentially disruptive Black Swans hanging around, including rising global inflation, overwhelming sovereign debt in many OECD countries, social revolutions in the Middle East and the yet to be fully realized Technology Hangover. Will the Armchair prove to be a legend in his own mind, or is *technology truly destroying jobs faster than our economy can replace them?*

The IMF’s prediction coincides with the Armchair’s recent reflection on *American Exceptionalism*. This concept suggests the U.S. is qualitatively different from other nations, that the ideology of liberty, social egalitarianism, individualism, populism and laissez-faire economics is unique to America, inspiring the country to its global leadership position. The U.S. has possessed these wealth building socioeconomic attributes for a good many generations. And now?

Have the Chinese stolen American Exceptionalism? Have they stolen our mojo? And what was it that stirred this American Exceptionalism in the first place? Where did we get that mojo?

To the Armchair it seems the Chinese and American paths to prosperity share a couple similarities. In both instances, the farm to factory economic transition inspired a virtuous growth cycle. As people moved from the rural farm to the urban factory environment, needs expanded, and as needs expanded, so did the economy. In addition, each country started its path to prosperity possessing a wealth of resources, which served as the foundation to their economic development.

Prosperity is always the result of the productive exploitation of resources. In America’s case, it all started with a bounty of magnificent natural resources, including timber, coal, gold, oil, natural gas, iron ore, fertile land, ample water and a tremendously productive natural transportation system.

Is there a greater natural transportation resource than the Mississippi River? Or what of America’s very large coastlines on both the Atlantic and Pacific Oceans? What sort of economic bird’s nest on the ground is it to have the best natural trade infrastructure in the world? And let’s not forget America’s accommodating temperate climate. Combined with ample fresh water resources, it gives America a huge advantage in agricultural production.

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One might argue that American Exceptionalism was only possible because this vast land mass was blessed with a hoard of unexploited natural resources. What America lacked were human resources, the sweat that turns natural resources into economic value. No surprise that immigration exploded. America's natural resource bounty provided immigrants with plenty of economic opportunity.

So the question may be...was it American Exceptionalism or was it the bounty of untapped natural resources that inspired the development of an empire? Which is the chicken and which is the egg?

We certainly can't forget the early American's Puritan work ethic, or discount the constitutional foundation set by our Founding Fathers. But would those early Americans have grasped at independence without at least a strong feeling that abundant natural resources were available to support the building of a new nation? Could there have been American Exceptionalism without those resources?

China's economic explosion was ignited by a different catalyst, an immense pool of human resources. Modern technology has allowed the production of many things to be outsourced to this cheap labor pool, fueling the rise of China's economy. Even today there are still hundreds of millions of Chinese living a life of self-sustenance. From toys and t-shirts, to machine tools and transportation equipment, China seeks to use its human resource pool to build a global economic powerhouse.

But in order to keep this human resource pool busy, China needs to import substantial natural resources. Those natural resources are purchased in dollars, so China stubbornly sticks to its currency parity and export model. Exports provide China with dollars and Euros – currencies accepted around the world. Even enemies of the U.S. will take dollars in trade for their natural resources.

The need for natural resources also inspires China to keep supporting profligate OECD countries by buying their sovereign debt. Only with a stable global currency and trade system can China pay for the natural resources needed to sustain their farm to factory transition. For China, the current American dollar based global trade economy is certainly too big to fail.

So China does not have a naturally rising tide that will lift all ships. Its economic present is dependent on exports, and its present and future are highly dependent on importing natural resources. Those natural resources must be constantly purchased to keep prosperity growing, which reduces the risk of another Chinese Cultural Revolution between the haves and have-nots.

China has another natural challenge. While the U.S. has its grand geographic advantage, China has a significant geographic impediment. Many of China's poor are stuck deep within the country's interior. Blocked by a formidable mountain range, they have no west coast from which to import or export. Trade can only flow through China's eastern coastal cities.

Maybe with today's modern transportation systems, China can better connect its interior poor to its wealthy coastal production and trade centers, but it still must find some way of lifting the interior's economic circumstances. The natural resources needed to inspire economic prosperity don't exist in China's interior. And shipping natural resources to interior production centers to then ship finished goods back to eastern trade centers would not seem very economically competitive.

Even with its economic challenges, China has a few major advantages over the U.S. They have much lower fixed social structure costs. There's no talk in China of socialized health care or pensions. Labor

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is cheap because it is still so plentiful. It is also much easier for a society to aspire to prosperity than it is to maintain prosperity; there is less to lose when you just have aspiration. China also doesn't see a need to serve as the world's policeman. And then there is China's enormous savings account, generated over many years of trade surplus.

We should all know by now the U.S.'s challenges. Over the years, we have legislated in massive social entitlements, which we no longer seem able to afford. We have an economy that for at least a decade seems dependent on government policy and stimulus. We've not just volunteered for the global policeman role, but also assumed the great majority of the cost. Some would also suggest we've set up the rules for the haves to have more and the have-nots not to have enough. Others would suggest the have-nots can't get ahead because Washington has its foot on industry. Whatever the case, maintaining rather than just aspiring to prosperity would seem a more difficult task. And for a good while, we have marginalized the part of our economy that served as the nation's foundation – our natural resources.

How was it that the U.S. lost its way? How did the U.S. lose its mojo?

As you have heard from the Armchair before, *there is nothing like prosperity to numb the mind of self-discipline*. For several decades after WWII, the U.S. enjoyed such great success that the country began to assume prosperity would continue in perpetuity. We are finding out now that perpetual prosperity is not something you can depend on, much less create through legislation.

It seems that China has **not** stolen our mojo. Instead it appears we may have just lost it as a natural consequence of prosperity. This isn't something we can blame on any one President, or any one Congress, or any one industry. Entitlement creep, both economic and sociological, occurs over a long period of time. The loss of self-discipline, the building of over confidence and complacency just creep in. This isn't much different from being 50-years-old and realizing you've gained 30 pounds since college. That didn't happen at one dinner. It happened over many years of meals, a gradual change from an active to a more sedentary lifestyle.

When might the U.S. find its next rising tide lifts all ships economic environment? How can we get back our mojo?

It would seem no different from trying to lose those 30 pounds. It won't happen over night. It will take significant discipline and effort. And obviously it will require major changes to our lifestyle. The bad habits one develops over a few decades are not simply exorcised over a weekend.

Should America return to its natural resource roots? It would seem logical to at least re-embrace that fertile ground which inspired American Exceptionalism. But if the Technology Hangover is real, if *technology is truly destroying jobs faster than our economy can replace them*, then we may need a brand new economic engine. We have passed the rural agrarian based economic period. And we now seem to be passing the urban production based economic period. So, what's next? Time will tell.



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