
What Will Replace The American Consumer?

The Bernard L. Schwartz Economic Symposium

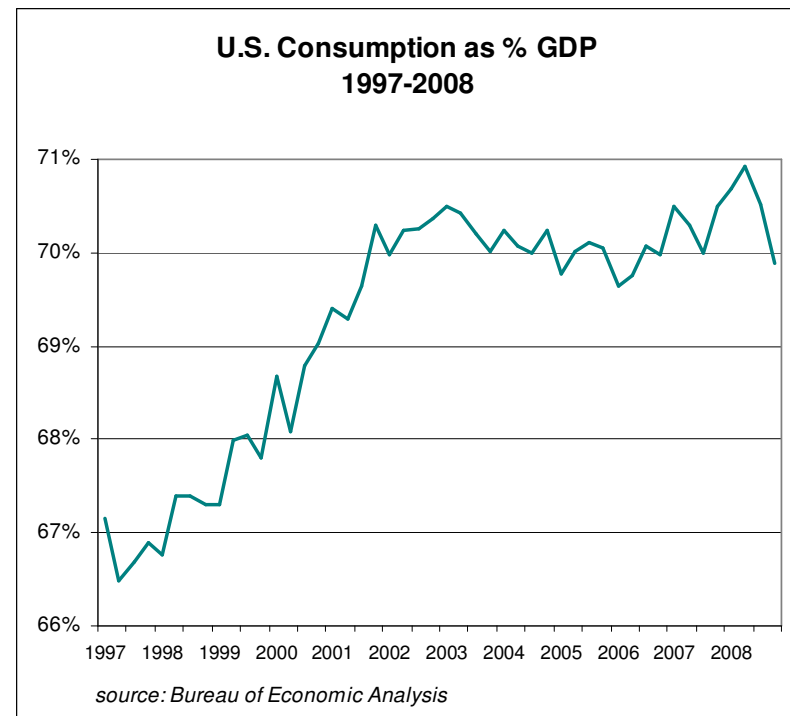
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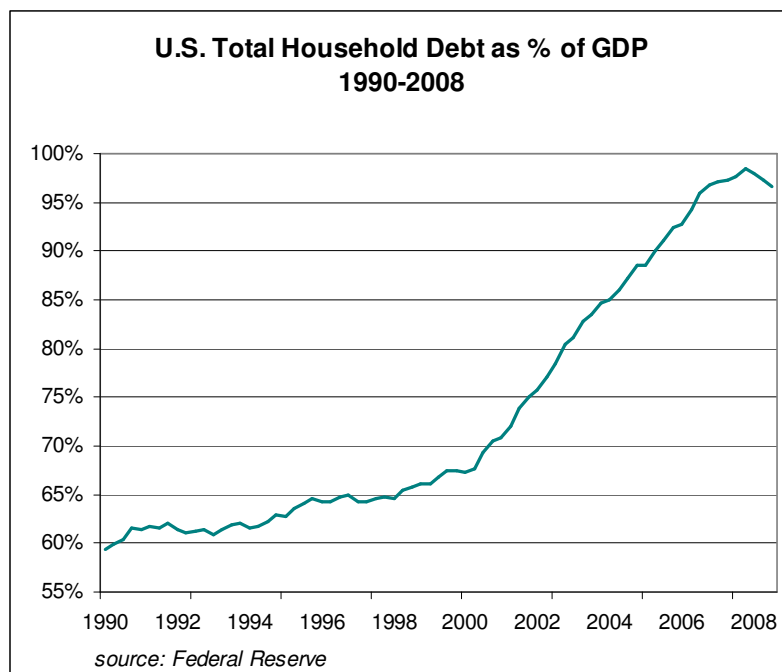
I. The Role of the U.S. Consumer

What will take the place of the American consumer is the biggest question hanging over the world economy. For the past decade and a half, U.S. consumption has been the principal driver of world economic growth, supplying demand for the fast-growing export economies of Asia, whose growth in turn increased demand for capital goods from Europe and Asia and for oil and commodities from Latin America, Africa, and the Persian Gulf. From 1997 to 2008, personal consumption as a percentage of GDP in the United States increased from 67 percent to over 70 percent.



Debt-Financed Consumption

The consumption boom was made possible by the dramatic increase of U.S. household debt, which increased from 62% of GDP in 1994 to nearly 100% in 2008.



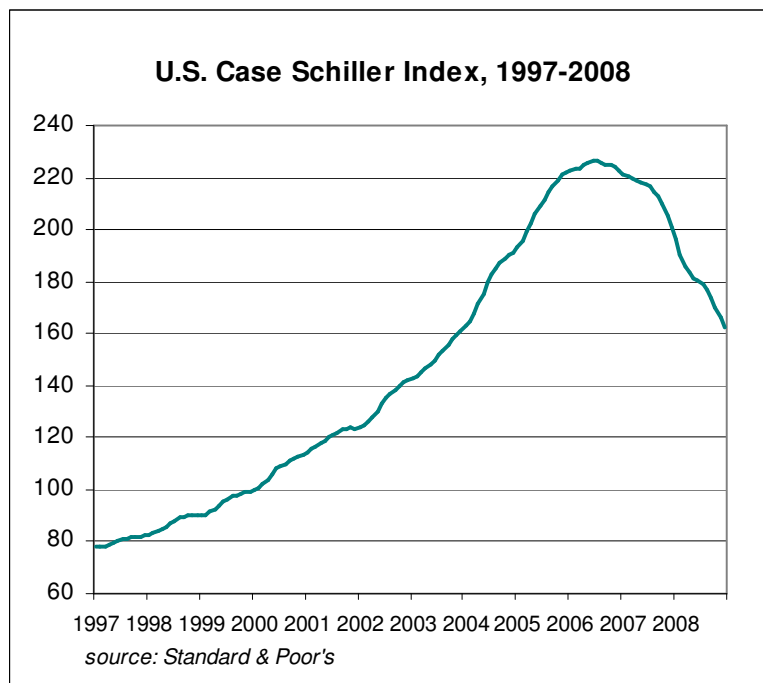
“At more than 70 per cent of US GDP, the bubble-infected American consumer actually poses a much greater risk to today's US economy than that imparted by Japan's bubble-induced capital-spending boom, which accounted for only about 17 per cent of Japanese GDP at its peak in the late 1980s... The US faces stiff headwinds. And until the rest of the world uncovers a new consumer - which is not likely during the next few years - a protracted global slowdown is distinctly possible.”

Stephen Roach
Chairman, Morgan Stanley Asia

Rising House Prices

America's Vehicle for Debt-financed Consumption

The increase in consumption was made possible by the increase in U.S. housing prices, which allowed consumers to tap rising home equity to increase consumption.



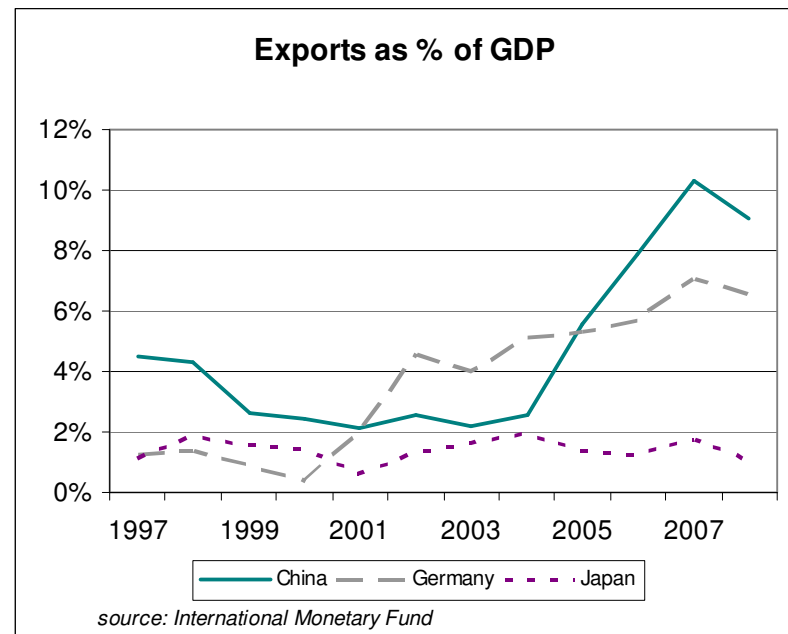
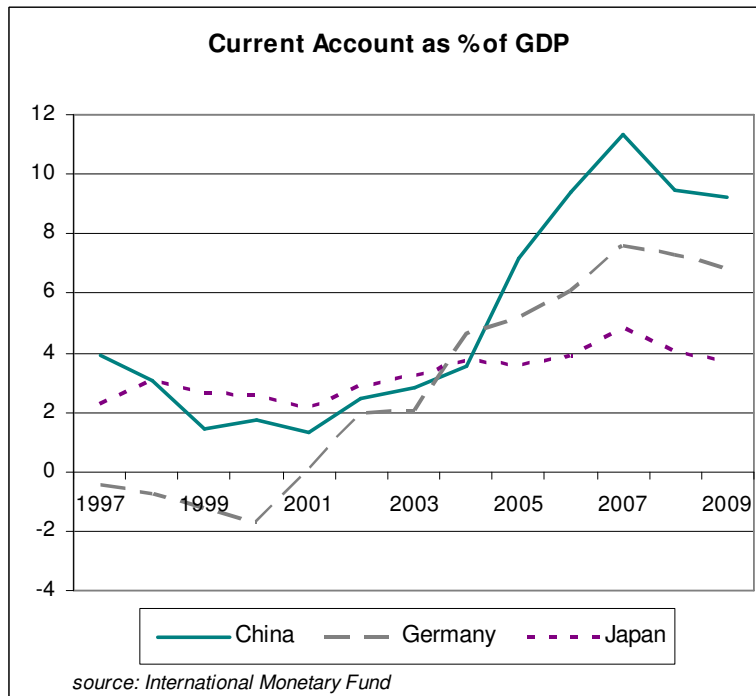
“First, for a very long period, household consumption in the United States and a number of other smaller developed countries, particularly the United Kingdom, Australia, Spain, played a very large role in supporting demand around the world, at home and abroad, because these households were spending much more than their incomes consistently and borrowing, consistently, to make up the difference in an era of easy credit. This was supported by a series of asset-price bubbles, far-and-away the most important in this regard was the house price bubble in recent years.”

Martin Wolf
Chief Economics Commentator
Financial Times

II. America's Counterparts

The High-savings, Export-dependent Economies

The increase in U.S. consumption and household debt levels was intimately connected to an explosion in global savings and foreign exchange reserves.



Export oriented economies accumulated huge stores of foreign exchange reserves.

Building a Stockpile

The Cause and Consequence of Export-oriented Policies

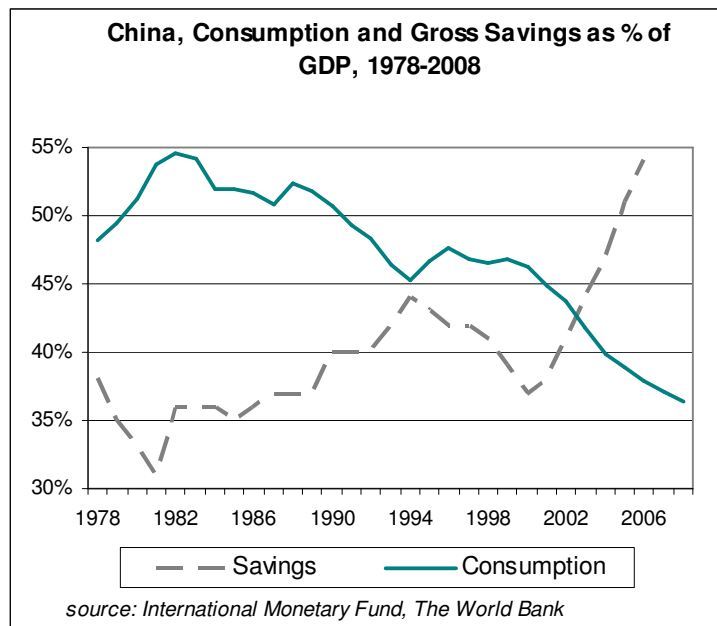


“These “war chests” of foreign reserves have been used as a buffer against potential capital outflows. Additionally, reserves were accumulated in the context of foreign exchange interventions intended to promote export-led growth by preventing exchange-rate appreciation... Following the 1997-98 financial crisis, many of the East Asian countries seeking to stimulate their exports had high domestic rates of saving and, relative to historical norms, depressed levels of domestic capital investment--also consistent, of course, with strengthened current accounts.”

Ben Bernanke
Chairman, Federal Reserve

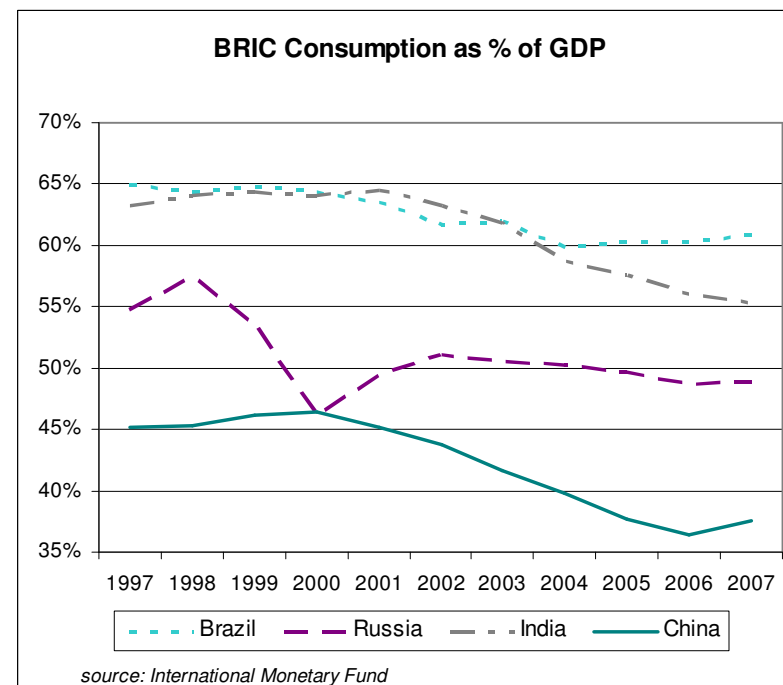
China

A Special Case of Low Consumption and High Savings



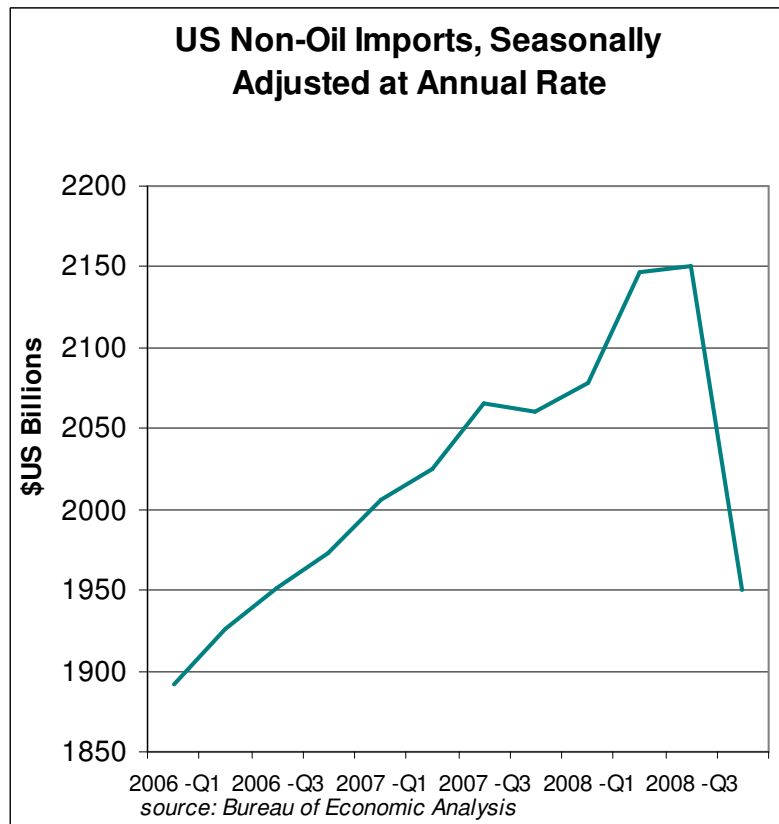
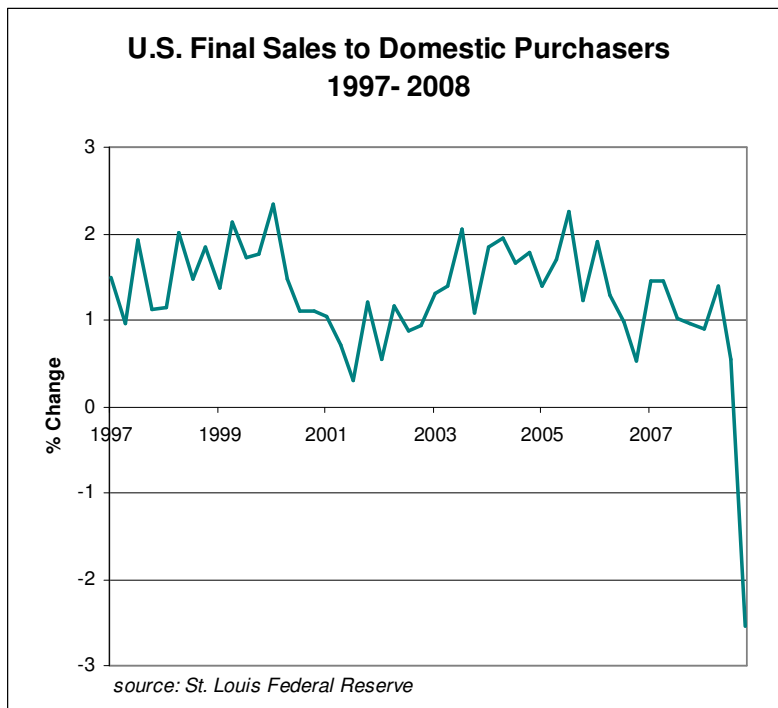
Since market reforms began in the early 1980s, consumption has fallen and savings have risen. From 2000 to the present, the fall in consumption and rise in savings has been dramatic.

China remains an outlier among other developing economies with a far lower level of consumption than Brazil, Russia, or India.



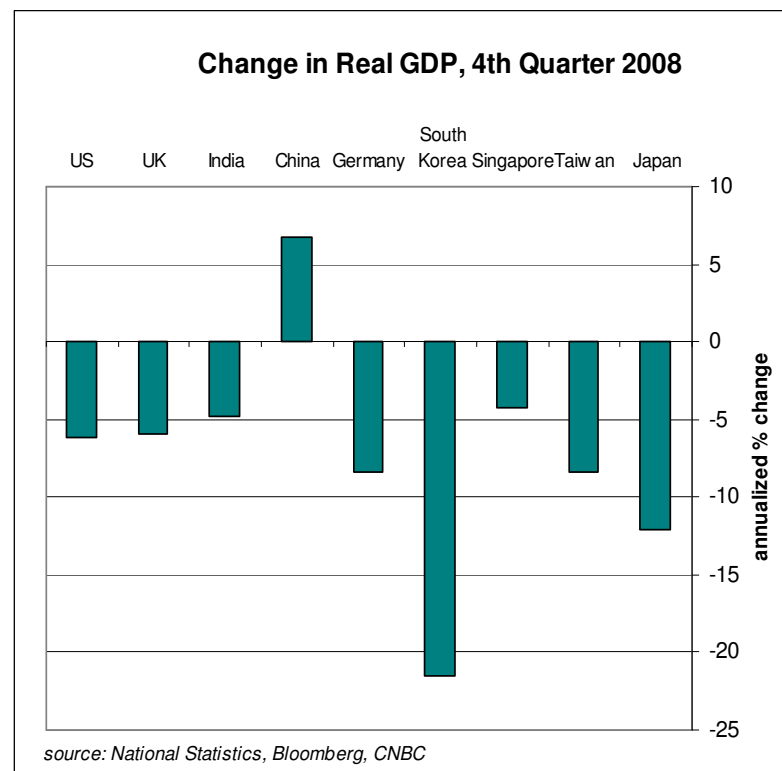
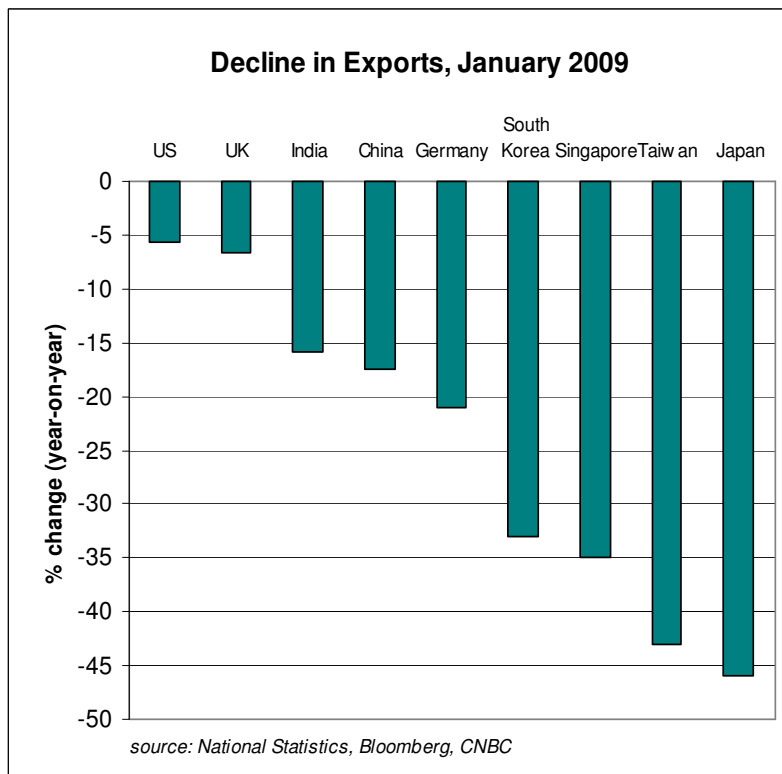
Collapse of Global Demand

Demand in the developed world has collapsed, as illustrated by U.S. final sales and imports.



Export Economies Have Fallen the Hardest

Falling global demand has caused a steep decline in exports.



Export dependent economies have suffered severe declines in GDP growth.

III. Potential Domestic Drivers of Growth

The leading candidates for a domestic economic recovery are:

1. Public infrastructure spending
2. A strengthened tradable goods sector
3. Green investment
4. Rising wages and incomes

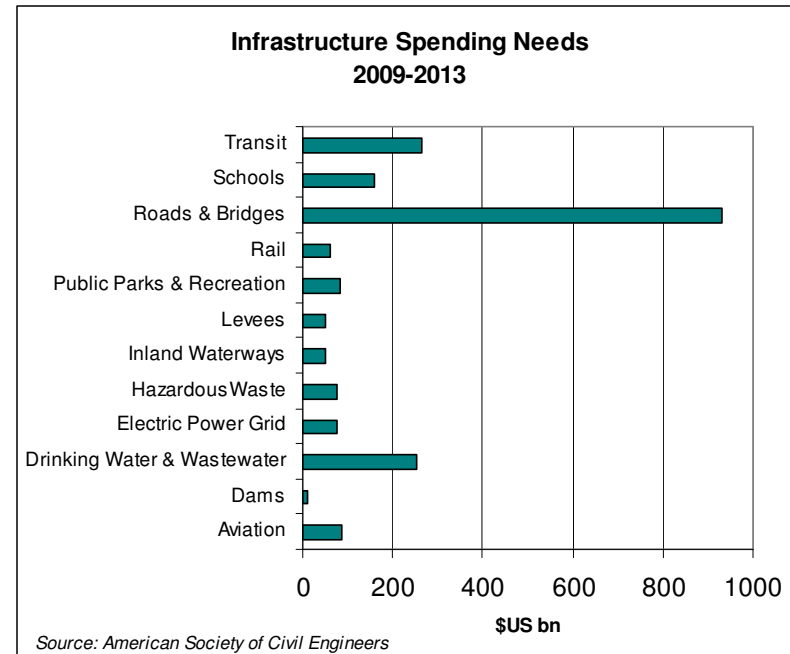
“The goal of a new recovery program therefore must not be to recreate this pattern with more short-term consumer-oriented stimulus but to steer the economy onto a more sustainable growth path. Future economic growth will need to be driven less by debt-financed consumption and more by investment that leads to the creation of good jobs and rising wages, and by exports to those economies that have underconsumed for much of the past decade.”

Bernard L. Schwartz
Chairman and CEO
BLS Investments LLC

Infrastructure

“The most important source for economic growth is the pent-up demand in the United States for public infrastructure improvements in everything from roads and bridges to broadband and air traffic control systems to new energy infrastructure. We need not only to repair large parts of our existing basic infrastructure but also to put in place the 21st-century infrastructure for a more energy-efficient and technologically advanced society. This project, entailing several trillion dollars in new government spending over the next decade, would provide millions of new jobs for American workers.”

Bernard L. Schwartz
Chairman and CEO
BLS Investments LLC



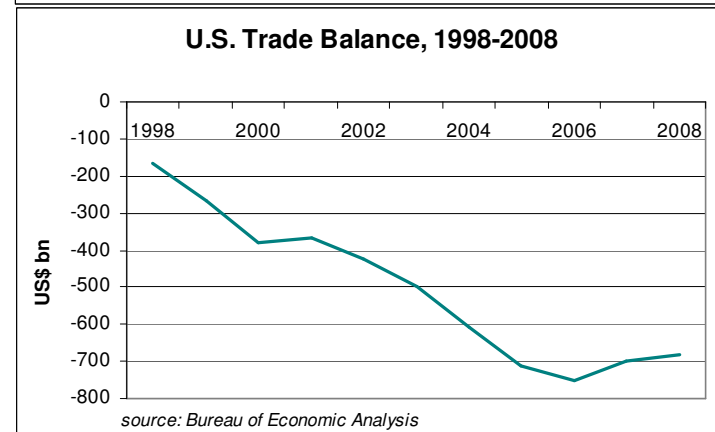
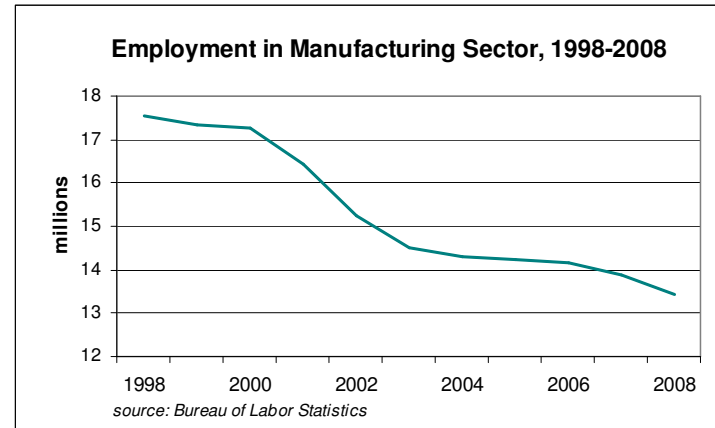
Total Spending Needed Over Next 5 years =

\$2.2 trillion

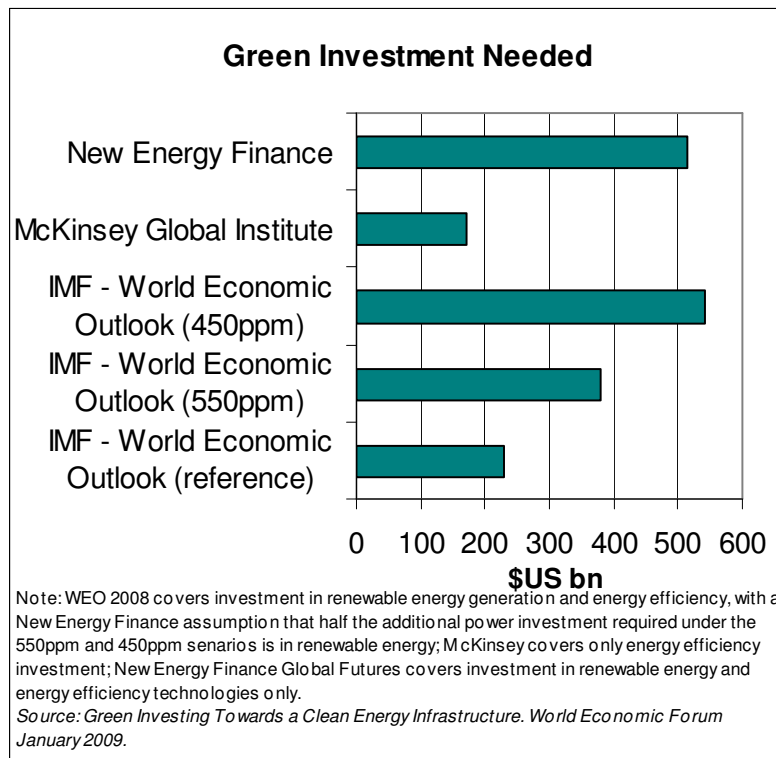
Tradable Goods Sector

“Rising exports must constitute a main pillar of an economic recovery and growth program... The Obama administration must therefore adopt an international strategy to encourage China and other large current account surplus economies to expand domestic demand to offset weaker U.S. consumer growth.”

Sherle R. Schwenninger
Director, Economic Growth
Program, New America
Foundation



Green Investment



“Energy conservation and the production of sustainable energy are areas with potential for great gains... if we do this job right, we can develop new industries which will set standards for efficient and sustainable energy production and use, and reduce our trade deficits, over time, both by curbing imports and by exporting these new products to the world.”

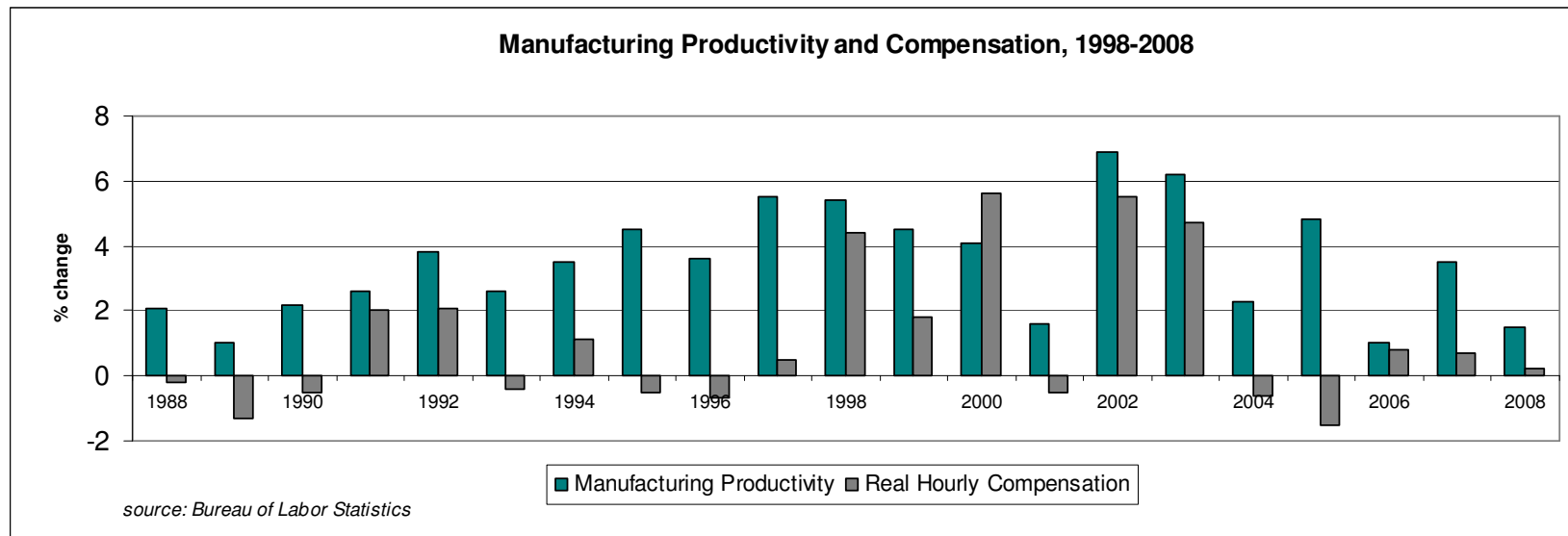
James K. Galbraith
University of Texas, Austin

Commitment to Rising Wages

“We need a different economic model to drive economic growth in the future: one that accepts that high wages can both enhance productivity and sustain demand, and thus are vital to healthy and sustainable growth.”

Jeff Madrick

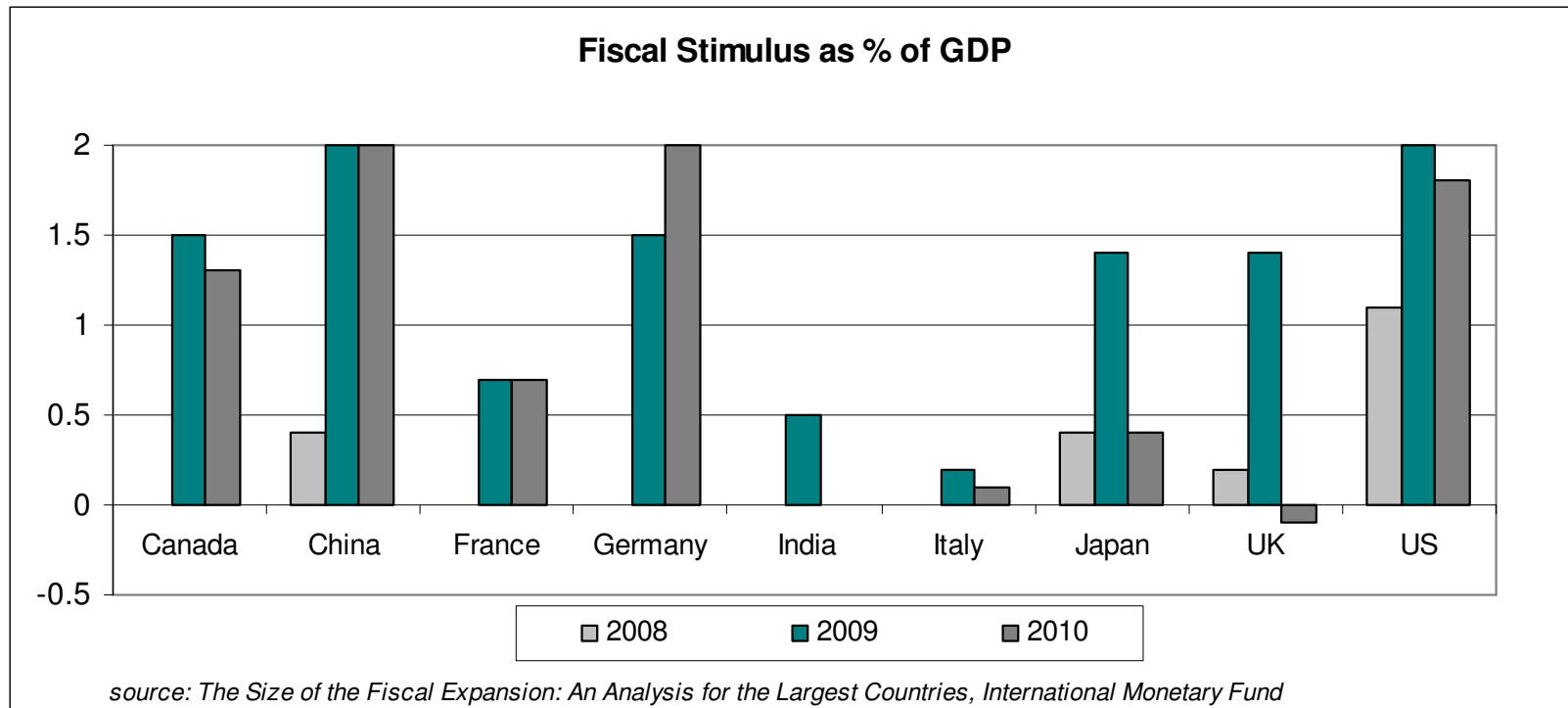
**Director of Policy Research, Schwartz Center for Economic Policy Analysis
The New School**



IV. Global Demand

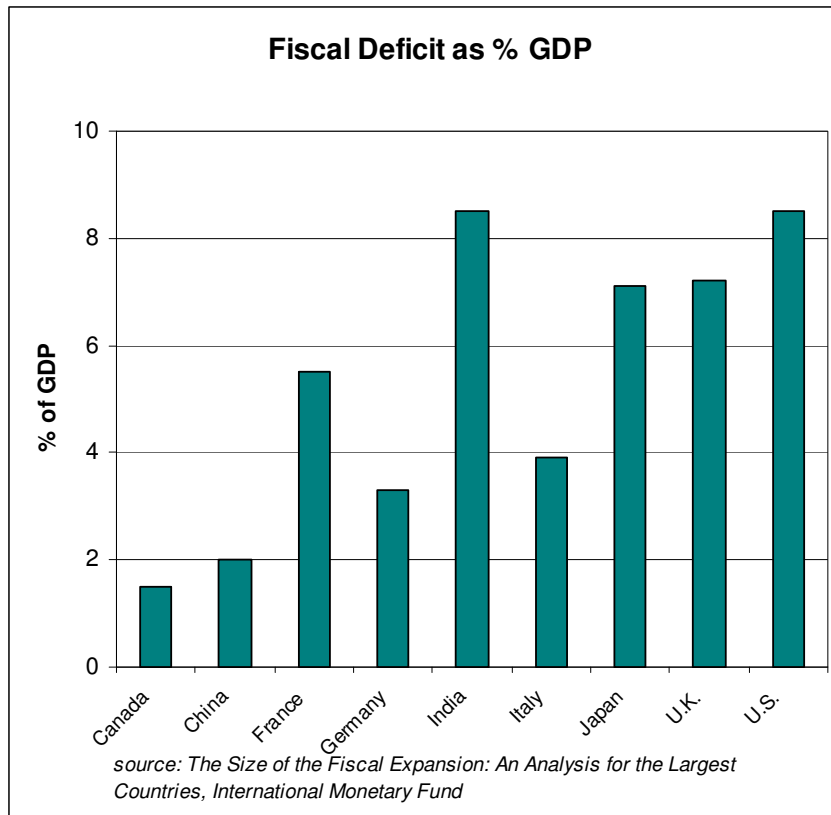
National Fiscal Stimulus Packages Fall Short

The IMF called for fiscal stimulus totaling 2 % of GDP. According to their analysis, the announced stimulus packages of major economies average 1.6% of GDP in 2009 and 1.3% of GDP in 2010.



Fiscal Policy in Surplus Countries

Current Account Surplus Nations have a Responsibility to Stimulate



Many nations with large current account surpluses have room to increase fiscal stimulus – by boosting consumer demand, increasing infrastructure spending, and providing a more robust social safety net.

“The [Obama] administration should lead the world towards an understanding of a point that concerned John Maynard Keynes: it is hard to accommodate countries with massive and persistent current account surpluses. The counterpart deficits, if prolonged, almost always lead to financial crises. The way out is for most surplus countries to spend more at home.”

Martin Wolf
Chief Economics Commentator
Financial Times

Tapping Pent-up Consumer Demand

In 2007, BRIC economies accounted for 16% of the world economy but consumption in these economies was only 7.6% of global GDP.

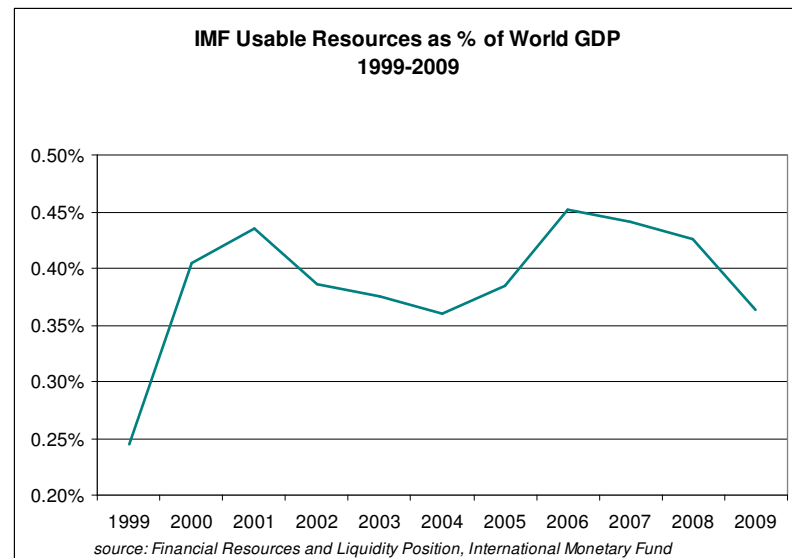
“BRIC countries will be the only source of domestic demand growth globally in 2009. In 2010, we forecast, domestic demand growth in advanced economies will recover to 1.2 per cent and in the BRIC economies will accelerate to 7.2 per cent, fuelled by China’s stimulus. So, coming on top of 2008, we project that for three consecutive years we will have seen global demand expansion led by the BRIC economies.”

Jim O’Neill
Head of Global Economic
Research, Goldman Sachs

Boosting the IMF

“The G-20 should support substantially increasing emergency IMF resources through a significant expansion of the New Arrangements to Borrow (NAB). The NAB could be increased by up to \$500 billion and membership could be enlarged to include more G-20 countries... In addition, we are prepared to explore additional actions to provide support for the poorest countries given the impact of the crisis and the need for global liquidity. The World Bank and other Multilateral Development Banks must more effectively leverage existing resources by flexible use of their balance sheets to help meet financing needs.”

Tim Geithner
U.S. Secretary of the Treasury



Adding \$500bn, as Secretary Geithner proposed, would increase the IMF's resources to 1.2% of world GDP.

World Economic Recovery Fund

“A world economic recovery fund would make it possible for the IMF and the World Bank, along with regional development banks, to carry out a globally applied macroeconomic stimulus program to supplement national fiscal expansion. The IMF could tap the recovery fund’s resources to carry out currency stabilization programs and help countries manage their way through balance of payments problems. The World Bank and regional development banks could tap the fund’s resources to accelerate lending for job-creating public works and social investment in developing countries. Money from this global fund could also be made available to specialized agencies of the United Nations to carry out social investment projects related to health care, education, and the environment. This increased

social and public spending would help stabilize consumption and investment in vulnerable developing and emerging economies.”

Sherle R. Schwenninger
Director, Economic Growth
Program, New America Foundation

