The Revitalization of Wealth Creation in the United States

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Introduction

The 20th century was perhaps the most influential inflection point in man's history. In the past century, the United States has implemented a permanent change in global society that will alter its course in unimaginable ways. America's grand contribution is not the new E-world that has allowed people to communicate from thousands of miles apart at the click of a mouse button; it is not the triumph of a society based on polarization: capitalism, over a society based on convergence: communism; and it is certainly not the result of man realizing his capability of destroying entire societies through a simple scientific formula: $E=MC^2$. Today's world is not different from the prior 2,000 years of life because of any one of these power coefficients. Today's world *is* different because the inherent source of power has radically changed or rather because the source of national strength has switched its balance of power. Prior to 1946, nations went through centuries of civilization concentrating on creating strength through the expansion of land. And it was through the expansion of territory with which strong nations found economic prowess. Ironically, for these strong nations of the past (i.e. Germany, Great Britain, France), what they believed to be their strength was in fact the very reason for their collapse. The more resources those nations dedicated to not only the expansion of territory but the maintenance of that territory, the less were available for the real core of a nation's strength, its domestic economy.

America's everlasting contribution to society is the way in which through her own success, she has manipulated and transformed the foundation of power from that of a nation with the ability to expand its land, to that of a nation with such domestic unity and economic vibrancy that others must bend to emulate her. From the outset, America was born on the words of Washington, "A nation is a slave to its animosity or to its affection, either of which is sufficient to lead it astray from its duty and its interests." In the first 150 years since independence in 1792, America has built itself on Adam Smith's theories of communal self-dependence which will through an *invisible hand* create communal prosperity. However, over the past 60 years, American corporations and industry has become ever-so increasingly dependant on the hands of workers and consumers outside the United States. Essentially, the current American economic policy is planting the roots for a general shift in focus in two ways: 1) it is a general shift in focus from an economic balance of labor and capital to one that is tilted towards the capital factor; 2) this will eventually become a net outflow of resources to foreign lands instead of an inflow of resources to continue developing the domestic economy.

In 1776, Adam Smith wrote in the *Wealth of Nations*, "In the lone houses and very small villages which are scattered about in so desert a country as the Highlands of Scotland, every farmer must be butcher, baker, and brewer for his own family." The year is now 2005, and while the number of very small villages has drastically decreased, the farmer still must be the butcher, baker, and brewer. However, it is not because of the lack of other butchers, bakers, and brewers but that there are too many of each. Though this phenomenon exemplifies the creation of wealth endured in the U.S, it also speaks volumes as to whether the nation's growth is supported by actual wealth creation or merely by cost-cutting measures. More importantly, this phenomenon zones in on the precise challenge that faces America going forward.

Before going in further depth with this challenge, it is important to note and recognize two inevitable realities. Firstly, the forces of globalization that America has put into play have embedded themselves into the world's economy and are irreversible. Globalized commerce is a strength of American business and if U.S companies are forced to follow isolationist policies, foreign companies will pick up where they left off. Secondly, over the next 50 years, the populous nations of China and India will be the major competition of the United States indicating that the American labor economy and policies will play a key role as these three nations compete.

This paper contends that how the U.S deals with the, "butcher, baker, brewer" phenomenon and labor mobility will be the deciding factor as to whether America will continue to foster new wealth and grow *with* its Asian counterparts or whether there will be a transferal of wealth from the U.S to China and India.

The mobility of labor in the United States has always been far superior to other Western societies and Japan. The ability to change careers and transfer skills has been extremely efficient in America. And so creating a sense of urgency and awareness of U.S labor mobility is an arduous case to make. However, the threat is there and it is real. And as the world becomes increasingly globalized and the American economy becomes increasingly dynamic with consistent birth and decay of industries, labor mobility will become an essential tool that the U.S can leverage to its advantage. To vindicate the importance of improving labor mobility in the U.S, this paper will parallel America's future relationship with China and India with that of the current relationship of the E.U and the U.S. By analyzing and comparing the U.S's economic dominance over the EU, it will illustrate the potential dominance that China and India may have in 50 years if the U.S does not continue to improve its labor market. Furthermore, it is very important to identify where exactly the strength in America's current mobility rests on. It predominantly extends only to white collar workers or the service sector as opposed to blue collar workers in the manufacturing sector. Also, there are two components to labor mobility: skill-related mobility and locational mobility. America's strength is in locational terms not for skill-related transfers.

America's biggest challenge going forward in the next 50 years, if she wishes to remain the world's largest and wealthiest economy is a renewed focus on the domestic economy and specifically domestic workers.

Laws of the Production Function

Inherently implied in the notion that wealth creation has ceased to exist in the U.S is that the traditional factors affecting a country's productivity are beginning to see their returns marginalized. The Cobb-Douglas Function uses these inputs to compute productivity: **Cobb-Douglas Function**

$$\mathbf{Y_t = L_t^{a} - K_t^{(1-a)} - TFP_t}$$

$L_{t=}$ Labor Input (e.g. hours worked)

$K_{t=}$ Capital Input (e.g. services from capital stock)

TFP= Overall Productivity (total factor productivity)

This function basically describes the various productivity levels with different weights of labor and capital. Implicit in this model is the law of diminishing returns on capital. This law states that up to a certain point, increasing the K-variable will no longer contribute to adding productivity. Furthermore, as more and more capital is applied, the returns on each increased level churn less and less productivity. Finally, the model implies that increasing the capital input can take any nation to its "steady state" until which the country can grow no more. Is this to say that no nation can increase its productivity passed the inflection point of capital? In fact, the only way to continue an increase in productivity is through other sources such as labor.

As evident in Exhibit 1, it is clear that the return on capital in terms of productivity has already visited its pinnacle and that clearly the law of diminishing returns is taking place. From the chart, it is clear that the percentage growth of GDP from year to year since 1960 began its climb up until the mid 70s where it then begins to tail off gradually up until the current timeframe. The important thing to recognize through this analysis is that while there are moments of economic growth spurts since the peak, overall the growth rates are stabilizing and ranging from 3% to 6% growth every year as opposed to the 6% to 12% growth rates that were seen in the 60s and 70s. Referring to Exhibit 2, I contend that the U.S finds herself a few economic cycles away from the inflection point where capital no longer contributes to productivity. Contrastingly, America's rising competitors find themselves at the early stages of productivity where there is still tremendous opportunity to grow.

Furthermore, I contend that the current underperforming economies of the EU-15 exemplify the potential state the U.S could find itself in the long term. This analysis will suggest that the EU-15 today as opposed to the United States 30 years ago is precisely the comparison that the United States must work to avoid with India and China. In Ruth Lea's study of the EU economy she states, "As Ian Milne points out, over the period 1996 to 2005, China will have grown by an estimated annual average of 8.25%, India by 6%, the USA by 3.5%, and the EU-15 by under 2.5%." While the U.S still has significantly more growth potential than the EU, it is slowly converging to the current European current state. In fact, there is overwhelming similarity to the growth potential of China and India today as opposed to the U.S economy in the 1970s. Referring back to Exhibit 1, the U.S GDP growth rate during the mid to late 70s fell into the same range of 6% to 9%.

Impact of Long-Term Unemployment

When discussing the U.S job market, I want to re-emphasize the point that the U.S is at an inflection point in its economic history. Taking previous years' statistics and the relative comparative advantage that the United States at face value could install a false sense of security and could inhibit the necessary changes to be made. Therefore, I will continue with the analogy that a complacent labor policy will simply plant the seeds for the United States to sink into a state of stabilizing productivity like that of the EU today. And the role of labor flexibility should be at the paramount of the required changes in policy. Labor flexibility is the cornerstone to preventing long-term unemployment. Furthermore, long term unemployment will become an increasingly important metric for economic growth as the forces of globalization cause further rise and decay of old and new industries in the United States.

The significance of long-term unemployment to this study is that it is the clearest signal of labor immobility in a country. In this analysis, long-term unemployment is taken as a percentage of total unemployment.

By running a regression of long-term unemployment as a percentage of total employment against GDP growth, the results were both indicative of a trend as well as the appearance of certain outliers which should be cause for concern. The regression ran the two statistics of eight countries (US, UK, Sweden, Japan, Germany, France, Finland, the EU-15, and Denmark. The results shown in Exhibit 3 show an interesting result for the United States. While all of the EU countries reflected relatively strong negative correlations between long-term unemployment and GDP growth (as predicted), the US, UK, and Japan, perhaps the three most industrialized of the set show positive correlation. The US is slightly tilted with positive correlation, however, the UK has a strong coefficient of 0.773 and Japan has a coefficient of 0.356. What do these results indicate? How can the US be growing their domestic product while having a growing long term unemployment figure? This question will be revisited later in this paper.

Alluding back to the Cobb-Douglas Production Function discussed earlier, once an economy has reached its maturity, a possible way to extract further returns from the inputs is through labor. "A nation with a flexible labor market able to shift workers from one economic activity to another quickly, smoothly, and without social disruption, would have a substantial competitive advantage over countries unable to adjust smoothly to today's quickly changing demands for various working skills as technology progresses and consumer tastes vary. The nation with labor market flexibility would be like an ideal baseball team on which all members could play any position with equal skill…(Douglas)" However, where I disagree with Douglas is his position on employee benefits. He states, "…that reducing employers' responsibility to provide job security inevitably ends up imposing new tasks on the state, which must provide stronger and wider social safety nets to take care of the unemployed workers." Where the argument comes into play is that the economic cost of long term unemployment is far greater than the cost of government support when a worker loses his job. Long term unemployment is an effect of extensive job security benefits provided by corporations. As shown in Exhibit 4, countries with large after-employment benefits have very high positive correlation to long-term unemployment. The lack of job security in the United States in fact plays a major role in its ability to remain flexible. While Douglas states that, "To just weaken or abolish such job-security provisions is not really creating labor *flexibility*, but rather just labor *expendability*…the U.S cannot afford to remain one of the industrialized nations in which employment for many workers is least secure." I disagree given the American diaspora. In a rapidly evolving economy like the U.S where constant growth and decay of industries take place, it is essential for workers to be incentivized to find new jobs as current industries decay. And the lack of job security serves as the incentivization. While government and corporate benefits may provide security for employees, it is only a short-term one. In the long run, American corporations and the government cannot infinitely supply benefits to the unemployed for both financial reasons as well as ethical ones. Our economy would not only go bankrupt but it would be sending out a very negative signal to the employees across the country and completely destroy motivation.

Essentially, this phenomenon is precisely the one that has taken place in the EU. Workers are less apt to actively pursue new career opportunities because the patriarchic relationship its workers have with corporations they are employed to. In Exhibit 4, it is evident that Germany, France, Spain, and Belgium, with some of the highest long-term unemployment figures also provide the enormous benefits to employees. So in a sense, responsibility gets shifted from the worker, the child, who is supposed to be actively pursuing new opportunities to the corporation, the parent, who now holds the burden of taking care of the child. This not only serves as an inhibitor to corporate development, but plays as a strong catalyst towards worker-apathy. And thus, exacerbating long-term unemployment. As Wasmer points out in *Interpreting Europe and US Labor Markets* Differences, "On one hand, mobility costs are high in Europe and transitions between steady-states has especially strong adverse effects. Jobs endogenously last longer in Europe than in the US, but when they are destroyed, the welfare loss for workers is higher." Some of the consequences of the European model are a lack of mobility because albeit jobs last longer, when workers do lose jobs, they have no preparation or awareness of changing job paths. Thus, the economy remains very static rather than dynamic.

The culture behind the U.S labor economy is the exact antithesis of the European model. The American model applies an entrepreneurial angle to the employee turnover issue. Corporations in the U.S promote what I call an "ownership mind frame" where employees are geared to think of their career as their own business. As Wasmer asserts, "US workers live permanently with the idea of mobility. They invest smaller amounts in firm's specific knowledge, and much more in recyclable skills, i.e. in general human capital. As a result, their outside options are high…Accordingly, workers do not really mind having low unemployment benefits, since they are trained to obtain new jobs at low investment costs." In doing so, the employee is well aware and prepared for what a corporation may have to do in times of recession or decay. As Wasmer infers, "…in the US context, workers tend to invest in general human capital especially since they face little employment protection and low unemployment benefits, while the European model (generous benefits and high duration of jobs) favors specific human capital investments." Employees recognize the potential reality of being "layed-off" as well as the lack of benefits after security. This plays an integral role in the reason why the U.S has one of the lowest long-term unemployment rates in the world. Not only are employees incentivized to pursue new career routes but corporations are able evolve and restructure according to consumer demand rather than artificially propelling a burden that only inhibits future growth.

At this juncture, it is important to recognize the source of this labor flexibility in the American market and how the situation is changing. Labor mobility is based on adjustment and adaptability. These components are broken down into locational based mobility as well skill-related mobility. The flexibility in the labor markets has always been a strong suit of the American economy. Unlike the cultural and lingual divides of the European Union and other large economies like India and China, America has limited cross regional cultural disparity and no language barriers. This refers to the locational aspect of mobility. In the U.S, workers with relative ease can move to other regions of the country without any significant barriers. Now looking at Exhibit 6, with the exception of Sweden, the U.S had the highest regional mobility as opposed to all other developed nations with a 2.9% of the population relocating between 1980 and 1997. In stark contrast, the more static labor markets of the EU's 3 biggest economies as "…mobility rates in terms of the fraction of the population moving from one region to another is between twice and five times lower in France, Germany, and Italy." But as the American economy in the 20th century progressed and evolved into service-oriented industry, it is the skill-related component that will be the crucial factor in terms of how mobile America can become. And legislatures must make a shift towards pre-emptive policy making rather than reactionary. The overlying issue is that America by nature is very apt to make changes when it sees trends coming. However, in the process of that change, the tangential issues at times get overlooked.

Problems with Skill-Related Mobility

Skill related mobility refers to the ability of a worker to move from one occupation to another. Why will skill-related mobility play a fundamental role in whether or not the US can continue to grow? For the past 50 years, the US has built an economy that has encouraged the world to privatize, open their trade doors, and compete on a global level. In the early stages of this process, the opportunities were endless for America because at the time, it was the largest developed economy in the world. As a result, no matter what the industry, it was almost certain that American firms could exploit economies of scale and achieve cost-advantages over any other nation in the world. However, as the economies of China and India began to privatize and grow, America's economies of scale in several industries began to diminish. And it is in reference to this phenomenon, that America's deficiency in skill-related mobility is overlooked.

When referring to white-collar jobs it is very easy to recognize that workers enjoy high levels of mobility between careers. Take for example an investment banker working on Wall Street. If she decides to switch careers to a marketing related field, or to work as an executive for a Fortune 500 corporation, or even to become teacher, she can do so with relative ease considering her broad discipline of education. In essence, skills that white collar workers invest in are versatile in application. This is symbolic of the American labor model which promotes the focus on general human capital rather than firm-specific capital.

In contrast, blue-collar workers in the U.S are more symbolic of the European model. Blue-collar skills are extremely defined and industry specific. For example, how easy would it be for a coal miner to switch to a career in auto-repair, or construction, or manufacturing? Practically impossible without training. This is a result of the education and skills that the blue-collar worker has invested in that give him a very specialized skill-set that cannot be easily transferred in its application to other careers. As Wasmer points out, "If someone invests in skills specific to a job in thinking that it will last forever, and forgets about investing in general human capital skills, its market productivity in and out of the firm will drastically differ…" So when certain industries fail to last forever, what do workers in those industries do? On the one hand, they cannot enter the service-sector without extensive training and education. On the other hand, there is no mobility to other firms in the industry because the entire industry as a whole has decayed. So inevitably the workers without broad-based skills become immobile and fall into the long-term unemployment statistics. And it is in this pool of workers where skill-related mobility is nonexistent. More importantly, however, it is important to understand that it is specifically those industries with specific human capital that have become decaying industries in the United States. This decaying process of blue-collar related fields is the product of a gradual transition of the American economy. Over the past 5 decades, the US has ultimately shifted its entire focus to service-oriented industries. And as this trend continues to expand, more and more blue-collar occupations will decay thus increasing the long-term unemployment rate.

From 1950 to 2000, the percentage of total output in the US economy from the service sector has risen from 56.4% to 77.4%. But it is important to note that this rise was in concurrence to any maturing economy. As a result of changes in demand, changes in technology and changes in labor supply, the U.S has gradually squeezed out the goods sector as real incomes rose over time. And this is all simply a reactive force that the US has recognized all along. Lee and Wolpin's analysis in "Intersectoral Labor Mobility and the Growth of the Service Sector" concludes that, "…if all else had remained the same at their 1960 levels except for supply side factors, there would have been no change in the service sector employment share over the period. On the other hand, had only demand factors, production technology and product and capital prices, changed since 1960, leaving the supply side factors at their 1960 levels, the service sector share of employment would have increased by 27 percentage points." So the rise of the American economy was due to demand side factors which were derivations of rises in the real income levels in the US. As millions of workers gradually shifted to the service sector, goods-related sectors slowly crumbled. However, this was justifiable to US policy makers because our economy was given ample time to spur on new industry and new revenue streams. Back then, the US was so far ahead of the global economy that they had the luxury of allowing industries to decay in expectation of new industries to arise before seeing any real losses. However, the landscape has severely changed from this obsolete view.

Today, the rate at which industries are decaying in the US is much faster and the real question is, can the economy originate as fast as it is decomposing. Clear evidence of this is that now, not only is their decay in existing manufacturing and traditional blue-collar occupations, but even now to the service sector and traditional white-collar jobs. And the outsourcing trend is hitting all aspects of the service industry from financial services, Fortune 500 corporations, and tech firms. According to a study by Deloitte & Touche, "…the top 100 financial-services firms [will] offshore more than $200 billion of their operating costs and save more than $700 million**."** According to Newsweek, one of America's largest companies, General Electric has introduced what it calls a "70-70-70" plan where it plans to outsource 70 percent of its headcount of which 70% will go offshore and 70% of those offshore workers will be in India. As for the information technology sector, according to the Associated Press, it has lost 403,000 jobs between March 2001 and April 2004 to outsourcing. And all these trends will continue to grow into new areas of the service economy as highly educated yet low-wage nations like India, Russia, and Ireland continue to develop. This should, at the very least install a sense of urgency to policy makers of the grave need for increased skill-related mobility as more and more workers will be displaced.

Technology

But it is not so much the numerical job loss that is of concern but it is the rapidity at which entire fields of the service economy have completely been exported away from the domestic economy. While this is partly a result of countries like India and China catching up, it is more so a natural effect of technology and specifically America's ability to swiftly incorporate technological advancements into business processes.

Technology has played a dual role in what some economists like to call America's "*new economy*". The role of information and communication technologies (ICT) plays a unique role in a country's production function. Referring back to our Cobb-Douglas Function, the argument is that ICT can increase a country's productivity by directly impacting the Total Factor Productivity (TFP) coefficient in two ways. It increases labor productivity growth by, "…increasing ICT capital relative to labor in ways that result in more output (capital deepening) and altering the way capital and labor interact (better techniques or organization) so that production is increased although the amount of capital and labor used stays the same"(Finance & Development, Masi). Exhibit 8 shows that during the years of 1990-1995, the contribution of ICT investment to GDP growth was greater than any other country in the world with .51% contribution. From the years 1996-2000, the US's ICT contribution jumped to .84% which was again one of highest contributions with the exception of Sweden with .94%. Furthermore, the impact that ICT investment has in the US is far more effective than in Western European states like France, UK, and Germany. While ICT investment growth is high in those economies also, the returns are not as high as those found in the US. This can be accounted for by structural characteristics of each nation's labor markets. Americans by contrast to Europeans are bred with the notion of job insecurity and so are more apt and receptive to advancements in technological process related to their industry. As a whole, America is an extremely dynamic economy with what Robert Rubin calls, "a historical embrace of change."

To further emphasize the impact of ICT on industry is found in that the most noticeable rise in labor productivity growth is specifically in those American industries where ICT investment is high. A 2001 study by the US Council of Economic Advisers that "…there is only a small cyclical component to the acceleration in labor productivity growth and that the acceleration can be attributed to faster capital deepening and a pickup in TFP growth in both the computer and the noncomputer sectors."

Clearly, investment into technology has enabled the US to increase labor productivity growth and to communicate and engage in commerce with the low-wage, highly educated labor markets of India and China. But this is only one side of the story. On the periphery, it is evident from Exhibit 8 that ICT investment has a positive impact on GDP growth but there are other effects that investment in technology has that are not represented in that chart. Furthermore, these effects are exacerbated in the American economy because of its aptitude to effectively embrace new technology.

While investment in ICT has greatly enhanced efficiencies of American corporations, it has also drastically stream-lined processes that previously required value-added human capital. In essence, as ICT grows, more and more white-collar jobs that were once high-value added functions become automated and thus commoditized. And because of this, more and more white collar jobs are being shipped abroad to places where the work can be done for less than one-tenth of the cost in the US. So then is labor productivity growth really a positive signal to our economy? By raising labor productivity, aren't corporations evading the costs of more employment by replacing it with technology? In Exhibit 7, there is a huge disparity between the EU and the way the US balances labor productivity to the employment rate. As the graph indicates, most of the EU countries have relatively high labor productivity coupled with extremely low employment rates. These countries would serve as evidence to the notion that increasing labor productivity does in fact indicate low employment. However, the US seems to defy this theory. While the US has one of the highest labor productivity figures, it also enjoys a relatively high employment rate. This divergence can be explained by the US's aptitude for innovation and its ability to craft new industries and its flexibility in labor markets. However, this paper serves to reconfirm the notion that these factors that have preserved America's growth statistics are gradually fading because of a complacent government position. As the US continues to engage itself in more trade with India and China (as it should), these synergies will gradually diminish.

Jeffrey M. Lacker, President of the Federal Reserve Bank of Richmond, goes as far as to argue that technology is one of the biggest culprits of the growing polarization of wages that has taken place over the last half of the century. While the technological advancements prior to information technology replaced low-skilled labor, IT has a clear biased towards a "skill premium". Basically, as American firms invest into new technologies, those technologies can create two outcomes. On the one hand, the new technology can serve to replicate the functions of several workers and thus replace them completely. On the other hand, new technology can provide a communication apparatus so that large firms can send their low-level white collar functions abroad; still leaving those domestic workers out of work. A McKinsey report, *Exploding the Myths of Offshoring,* contradicts however that, "The cost savings enjoyed by US companies are the most obvious source of value. For every dollar of corporate spending that moves offshore, US companies save 58 cents…" But then one should ask, where is that 58 cents going to? It is going to the higher levels of the corporation. And thus there has been a shift in revenue flows from an equal distribution over all levels of skill to a much tilted distribution to those only possessing high-level skill. Having said that, it is important to note however, that technology, like globalization is a force that neither can nor should be restrained. All this evidence is not to imply that investment in technology should be inhibited. But it is to show that the current US landscape is much different from eras of the past. Furthermore, elements like technology and trade liberalization are exerting new and never-before-seen effects on today's economy and their adverse effects should be recognized and dealt with in a forward-looking manner. As the McKinsey report notes, "The current debate is misplaced, however, because the problem is neither trade itself nor globalization more broadly but rather the question of how the country should allocate the benefits of global trade."

Increased Mobility rather than Protectionism

In fact, globalization and foreign revenue streams have been an intricate part of profitability for American corporations especially over the last 15 years. As former Treasury Secretary for the Clinton Administration, Robert Rubin, points out, "…if you look at outsourcing, it is a part of a larger phenomenon of trade liberalization. I think trade liberalization contributed substantially to our well-being in the 1990s, and I think it's the right path going forward." The problem is not globalization. Elements like globalization and investment in technology is a reality in today's economic times and inhibiting its natural forces would simply be prolonging the inevitable. The benefits of recent trends like offshoring in fact create net gains for the US. Despite predictions by Forrester Research that by 2015, nearly 3.3 million US business-processing jobs will be moved to foreign locations. While this figure may be alarming, the benefits to consumers, corporations, as well as tangential factors must also be taken into account. For consumers, the savings for firms that outsource are transferred into lower prices for consumers. Catherine Mann from the Institute of International Economics contends that, "…global sourcing of components has reduced the cost of IT hardware by up to 30 percent since 1995, boosting demand and adding as much as $230 billion to the US GDP in that period." Additionally, the workers that American firms are employing in China and India have become one of the fastest growing consumer segments in the world with a taste for foreign products. And the big winner is of course American corporations that save millions from outsourcing jobs. All in all, according to the McKinsey study, the US gains roughly $1.12 to $1.14 from every dollar that is sent abroad.

The assumption that most economists make to justify the offshoots of globalization is that, "…a flexible job market and the mobility of US workers, along with the entrepreneurial and innovative spirit of US businesses, will enable the United States to generate new jobs faster than offshoring eliminates them." I disagree with this because it simply makes too many empty notions. First, the labor markets will continue to become less and less mobile in the future. Second, while America does have a history of embracing change and an innovative culture, the rate at which American innovation is being asked to produce new higher-value added jobs is impossible given the rate at which jobs will be lost. While new innovation will surely be a major contributor, its impact is a long term one. Labor mobility, however, is something that can come to fruition relatively quickly. However, simply taking a *laissez-faire* approach to this issue is completely the wrong course of action. Policy makers cannot expect low-level white collar workers and blue-collar workers, whom for the most part have invested in specific human capital, to miraculously mobilize on their own. There are deeply rooted issues in today's economy that should be cause for grave concern to policy makers.

A False Sense of Security

In October of 2002, the Dow Jones Industrial Average reached a low of nearly 7500. Today, only 30 months later, the Dow is back up to over 10,000 in April of 2005. The source of this recovery is not so much the concern as what is missing from this recovery. Some call it the "jobless recovery", and rightfully so. Referring back to Exhibit 3, the US was one of only a few countries that actually had positive correlation between long term unemployment as a percentage of total employment and GDP growth. This positive correlation indicates that despite an increasing long-term unemployment figure, American GDP continued to grow. This trend alone should alarm policy makers. Albeit numerically our economic statistics are growing, our stock markets are appreciating, and corporations are meeting profit levels, are the people of the economy truly better off?

The case for economic instability does not end there. While our economy has successfully rebounded on the periphery over the past 4 years, this recovery was coupled with "…the first net job loss under any administration since 1932. You've had declining price-adjusted median incomes in the United States"(Rubin). Furthermore, we have a projected fiscal deficit of $11 trillion by the year 2011. And this is significant because it means less resources can be allocated to the necessary programs the government must put in place for our labor markets to stay competitive in the years ahead. Yet, despite all these negative indicators of the health of our economy, how are US firms meeting their profit levels? Why is the Dow above 10,000? Why are investment banks busy with deals in the pipeline?

The fact is the US is in the midst of a booming recovery. Immediate cost-cutting techniques (outsourcing, ICT, and global trade) and a weak dollar has allowed US firms to cut costs and broaden their scope in the global arena. While these are all conventional methods of bouncing back from a recession, there is something missing in this picture. Revisiting an earlier reference, "…a flexible job market and the mobility of US workers, along with the entrepreneurial and innovative spirit of US businesses, will enable the United States to generate new jobs faster than offshoring eliminates them." In order for the mechanisms of labor flexibility and innovation in US businesses to take place, there must be reinvestment into the economy in the form of things like new hiring and R&D. However, this investment is absent in the economic recovery. As Robert Rubin notes, "Companies have an abundance of cash but they're not spending it on investment or hiring." Instead, corporations are simply keeping this cash on their balance sheet. Essentially, we arrive back to the same conclusion. New wealth is not being created in America's current landscape. Instead, those who have invested in general human capital, essentially those at higher-value added occupations are inheriting all the profits. Meanwhile, those with specific human capital and at the low-value added functions are either losing their job or are remaining stagnant. And as long as those profits remain on a company's balance sheet rather directed towards new jobs and investment, wealth will continue to be transferred from the low-value added functions to high-value added functions.

The heart of the problem lies in the complacency of the American government. The US is dealing with economic threats in the *laissez-faire* approach that has always worked in the past: let the old industries decay and let innovation replace it with higher-value added jobs. The only difference between the past and the present is that in the past, this process could have and in fact did take place naturally because the US virtually controlled the global arena. Throughout the 60s and 70s, there was no other nation that could even come close to competing with the efficiencies and economies of scale that US industry could sustain. In the 80s, there was concern that Japan could take the place of US, however, this perception was inherently flawed. Japan is a small country (population wise) that could, perhaps, excel and surpass the US's efficiencies in certain industries but never on a broad scale. And in true American character, the economy adapted and innovated. "Consider the way the US semiconductor industry reinvented itself after losing out to Japanese competitors, in the late 1980s…The big US players-Intel, Motorola, and Texas Instruments-abandoned the dynamic-random-access-memory (DRAM) business…[and invested] more heavily in the production of microprocessors and logic products…Throughout this shift toward higher-value-added activities, the total number of US jobs in semiconductors and closely related electronics fields held constant…(McKinsey Report). And this strategy worked, then. But there is flawed sense of security with this approach going forward. However, the circumstances are different and more importantly the competitors are different. In order to sustain growth on all levels for the US economy in the future, the government must play a much more proactive role in not only increasing labor mobility but also the allocation of corporate profits derived from cost-cutting and layoffs.

Solutions for the Future

This paper has attempted to prove that enhanced flexibility in American labor markets is the recipe to sustaining economic growth. Furthermore, the movement to stimulate labor mobility must be set in motion immediately in order for the US to not only be prepared but to in fact excel 30 to 50 years from now. So as established, the source of this stimulus must come from the government. Policy makers must take a much more proactive role in the labor markets in order to augment labor mobility. The underlying issue that the US must engage with head-on is the condition of displaced workers. It is not enough to merely suggest that these workers will find education and training and mobilize on their own. In a country where unemployment compensation is low, the burden of tax rests more on the shoulder of employees, and the effects of globalization is immense; it is unfathomable to expect blue-collar workers, and low-value-added white collar workers to be able to muster up the funding and the energy to do this on their own. One thing is certain. Globalization and technology are here to stay. In addition, this nation is unavoidably progressing up the food chain and towards higher-value-added job functions. To try to prevent this process would be a grave mistake. But what would be even a bigger mistake would be to ignore those that have lost their link on the food chain and expect for them to get back on without any help. As Robert Rubin puts it, "…Trade liberalization has to be intertwined with programs that will deal with those that are dislocated by trade. And we must have a much more effective program to promote competitiveness in our economy." The following recommendations are what I believe will make the difference in the future between a weakening labor market and strengthening one.

Shifting the Tax Burden

Currently, a U.S employee carries more of the tax burden than his employer. Referring to Exhibit 9, which breaks down the percentage of total tax and Social Security paid by the employee and employer, it is evident that in the United States, the employee clearly carries a majority of the weight by paying over 50% of the taxes. While the United States, falls approximately at the median compared to the other countries in the analysis, it is important to recognize the drastic distinctions in American culture from the other countries. As stated earlier, US workers are instilled with the concept of job mobility and treating your career as if it were your own business. In that sense, all Americans understand the uncertainty of their employment status. This is not the case in countries like Germany and Japan where the people are infused with the idea of one company for life. The question now is, how can the government alter the tax burden to both protect employees while simultaneously incentivizing workers to become more mobile.

One plausible solution that I believe can achieve this is a two-prong approach. First, the government should reduce taxes on labor input and increasing the tax on corporate profits, thus shifting the burden to corporations rather than on employees. In doing so, employees will have gained more of their salary to put away when recessionary trends come and their job becomes insecure. If and when an employee loses his/her job, this additional income will serve two purposes. It will provide strong support during the duration of the time the employee remains unemployed. And it can also be a source of funding for investment in new education or training to mobilize into either a higher-value-added function or a different industry. The shift in tax burden must be complemented with a saving to the corporation as well.

In exchange for corporations taking a higher percentage of the tax burden, unemployment benefits and compensation should be reduced by an equivocal amount. This will in turn put two effects in circulation. First, the reduction in unemployment benefits and compensation will lessen corporate apprehension of new hiring because if in case a recession hits, their will be minimal costs to the firm to let workers go. Thus, a reduction in benefits will serve to motivate companies to be more proactive in hiring new workers. Second, the reduction in benefits will serve as a psychological effect on employees. It will encourage employees to save the additional income they receive in the event they do lost their job. Employees will also become more cognizant and prepared for a situation in which their job is lost. And in knowing that they will not be taken care of sufficiently after employment, employees will invest more in general human capital that is easily transferable through out industries. Furthermore, there is evidence that reduced unemployment benefits has a positive effect on the overall economy. Referring to Exhibit 10, it is clear that countries with higher unemployment benefits show slower GDP growth rates. In fact, through a regression, it was found that Unemployment benefits have a negative Pearson coefficient (correlation) of -.823. This serves as strong evidence that as employment benefits increase, GDP growth slows down because not only does it cut into corporate profits but serves to immobilize workers. By shifting the tax burden and reducing employee benefits, employees will be more psychologically and intellectually prepared and apt to mobilize into new industries. And thus the market will inherently become more flexible.

Emphasis on Secondary Schooling and Higher Learning

We have established that the forces of globalization and technology are unstoppable and in fact beneficial to our economy. The latter part of that statement lays contingent on whether our government prepares its people for the economic transitions that will come to fruition. And as America and its *new economy* travel up the food chain, it must make sure that all of its citizens are ready to make that journey. Given the current infrastructure of the American education system, there is a large sum of our population that is not ready.

Throughout the 20th century, American policy makers successfully established one of the strongest primary schooling systems in the world. However, now the same government intervention is required in the secondary schooling system. A stronger public secondary schooling system is essential if America plans to find growth as a higher-value-added economy. The fact is, many in this country neither have the preparation nor the access to gaining the necessary general human capital that the America's future labor market will demand. And the reason for this lag is because for so many years America ignored the lack of availability of secondary schooling to a good portion of the country.

But even more important than secondary schooling is the improvement of public universities. As the tuition costs in private schooling continue to rise, it is crucial that America's state universities are not only improved but more accessible to low income families like those of workers who have been displaced. The government must make higher education more accessible if it plans for America to become a high-value-added society. Furthermore, as our economy continues to progress into a dominantly service-oriented economy, investment in general human capital for the mainstream of America is the only element that can facilitate such a transition. As Lee and Wolpin point out, "An additional year of schooling increases white-collar skill by 1.80 percent more in the service sector than in the goods sector." It is evident that the economy that US policy makers and the effects of globalization are shaping for America's future will be highly dependent on versatile skill that will serve as a support system for displaced workers. Specifically, the government should play an active role in not only promoting but in fact infusing fiscal revenues into the development of public universities' liberal arts departments. I believe this is absolutely essential in diverting students who may be keener on pursuing more specific and narrow disciplines. What is currently occurring is that state schools are notoriously known for having what I call "pockets of genius." By this I mean, there are many public universities in the country that are exceedingly reputable for very specific and narrow fields. For example, the state school of New Jersey, Rutgers University, is one of the most acclaimed schools in the country for its pharmacy program. What this creates is a handful of students from those universities who ultimately thrive while those who invested in more general human capital in the liberal arts curriculum lose out because their degrees are not highly regarded. By investing more to improve liberal arts education in the US, this will breed a generation of students that are well prepared for any field they choose to focus on. So if a student decides to focus on accounting, they can do so. But if by chance, the accounting industry evolves into a low-value added function that can be cheaply outsourced to India (which is already occurring), then that student will have the support of very broad-based skills that are applicable in many different industries. This support will enable him/her to mobilize into a different industry like for example, marketing. Thus, the labor market will further enhance its flexibility and its mobility and workers will not only gain a more thorough education but this education will sufficiently support them in the very dynamic economy they are about to enter.

Training

While education is a solution for the long term and for the next generation of entrants into tomorrow's labor market, steps must be taken to support those displaced workers already a part of the current labor market. If something is not done, it will create an endless cycle of uneducated laborers. To illustrate, if the displaced workers in the short term are unable to mobilize and find new work, their children will be unable to receive higher learning education and will thus continue in the path of their parents. This is a very dangerous cycle that must be avoided at all costs. Exhibit 11 shows the extreme differences in how the US supports its unemployed workers and how many other industrialized nations do so. The exhibit portrays the amount of funding dedicated to training the unemployed as a percentage of total GDP. The figures indicate that the US contributes a meager .02% of the total GDP towards training displaced workers. This amount is well below almost every other industrialized nation with the exception of the United Kingdom.

This figure must change and the US government must proactively support newly displaced workers with the required training in general human capital. This training will provide invaluable support to the discouraged workers. It will serve as a plug for the short term until the longer term solutions like improved secondary and collegiate education kick in. Although government funding of training the unemployed is not in line with conventional American policy that takes a more *laissez-faire* approach, unchartered waters call for nouveau thinking. A subsidized training initiative is simply one example of a broader overall theme that the US must adopt. As Wall Street analysts like to say, the past means nothing. The policies and fiscal techniques that have been successful for America in the past no longer apply in this new age. Unlike any other time since World War II, the US will have real competitors. And with this change, US policy makers must also change.

Conclusion

There is an underlying Catch-22 effect in for any type of success that a nation achieves. In this case, the more economic success a nation enjoys, the more complacent it becomes to adapting to new changes in the environment. The inherent misconception that the United States must come to terms with is the fact that our economy can be over taken and that the threats that are posed 30-50 years from now must be dealt with today. In the years after the 9/11 terrorist bombings, the United States adopted a proactive and pre-emptive mode of thinking; a mind set that looked beyond present circumstances and envisioned what course of action to take now in order to prevent a forecasted future threat. It is now upon policy makers to embrace the same pre-emptive mentality and apply it to our economy.

Above all, the US government must redefine its current perspective on real economic growth. The random jumps in the Dow in corporate earnings are not indicative of genuine economic growth and wealth creation. Furthermore, these signs tell nothing of our labor markets and the nation's overall competitiveness. The positive signals in today's economy serve as nothing more than short-term vindicators of current economic policy that fails to attack the real long-term adversities to our nation. This paper has used the declining condition of US labor markets as a platform to suggest that despite the endorsed and publicized victories on Wall Street, Main Street is headed for troubled times in uncharted waters. And as long as Main Street continues to lose jobs, Wall Street's successes will be merely a short term affair.

The recommendations I have suggested earlier is a two prong approach that can keep America competitive for the long-term while supporting the unemployed for the short-term. With subsidized training and a more advantageous tax policy to the worker current unemployed workers and prospective unemployed workers will have a scaffold which they can protect themselves with for the short term until the labor market improves. And these short term measures are crucial because long-term solutions like education can take many years to come to fruition by which point thousands can go jobless for long durations. This will not only cause a slow down in growth but create a huge burden on the government for years to come. Education reform, however, is the most effective answer to America's long-term competitiveness. This two prong approach of support for the short term and improved education for the long term is a solution that views America's future progressively rather than in a protectionist manner. The days of Washington's plea for America to remain isolated are long gone. Globalization has enabled American corporations to sustain profitability over the past two decades. In addition, the entries of foreign competitors like Japan has forced the US to up its own performance to levels that some would have never imagined. Competition is a healthy phenomenon but a nation must make sure her people are ready to face that competition.

As Robert Rubin notes, "…trade liberalization has to be intertwined with programs that will deal with those that are dislocated by trade. And we must have a much more effective program to promote competitiveness in our economy. We have got to invest far more substantially and effectively in basic research." As the world grows ever closer and America makes its attempt to climb up the food chain, she must revisit her old fortes of fueling innovation and industry creation through R&D, increasing skill-related mobility in the labor markets, and simply embracing change as it heads her way. America has invented the most popular game in town, and now she must play it: her own way.

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