

Zero Interest Rates Do Not Help Growth

WASHINGTON – After a mediocre 4th quarter of 2014, the US economy came to a virtual stop in the first quarter of 2015. In part this is due to the substantial slowdown within America's oil patch, (think Texas, Oklahoma, and North Dakota).

End of the oil boom

Yes, excessive global oil supply and falling prices (minus 50%) have forced many US energy companies to scale back investments, or drastically cut down production. This has had and will continue to have a negative impact on the overall economy. Indeed, lower oil prices mean less demand for rigs, supplies, rail cars designed to transport oil, pipes, valves, and what not. And this translates into declining business volumes for all, not to mention fewer people employed by the energy companies, their suppliers and vendors.

A mediocre economy

That said, there is no question that this worrisome first quarter of 2015 took place within a feeble recovery. Yes, the US economy keeps growing. But at a rate that is well below the post war average of 3%. Last year we did 2.4%. This year it is unlikely to get much better, given this most disappointing beginning.

It is all about ZIRP

And why is that? Why is it that we cannot shake off what some are calling our "secular stagnation"? Well, here is an explanation. What if the Fed "cure" –zero percent interest rates, or ZIRP– may be in fact the cause of the disease? In case you forgot, we are going through the longest period of

Fed-mandated zero interest rates in US history.

Theoretically speaking, zero interest rates should be stimulative. Cheap money should make it easier to borrow for productive activities, this way acting as a tonic for the overall economy. Well, that did not happen. The economy grows, but very modestly. In other words, the designated stimulus does not stimulate.

A Wall Street bubble

The real beneficiary is Wall Street. With zero interest rates, for investors the only way to make money is to buy stocks. And so, largely because of ZIRP, we have a Fed-induced Wall Street boom. In fact, it is a bubble, completely out of sync with a slow growth, mediocre economy. Yes, many valuations do not even remotely match actual performance. And yet investors stay in stocks in large part “because there is nowhere else to go”.

Lunatics in charge?

If we take all this together, the only thing that we can conclude is that the Federal Reserve is run by lunatics who, whatever their intentions, have in fact created a dangerous asset bubble. Or, worse, the Fed is run by snake oil vendors who have started to believe that their junk really cures people. And so, despite ample evidence to the contrary, they keep ladling it out.

Slow economy good for stocks

And the perversion of this addiction to zero percent interest is that when the economy slows down, as it happened in the first quarter, Wall Street actually feels better, because this means that the Fed will not raise interest rates any time soon.

You see, the Fed people have said time and again that they cannot raise interest rates (remember that zero rates are the

main cause of high stock valuations) until they are satisfied that the economy is chugging along nicely. With zero growth in the first quarter, no chance that the FOMC will raise interest rates any time soon.

A crazy world

So, think of this craziness. ***Stocks stay high because the economy is actually in bad shape.*** Stock would instead take a dive if the economy went into high gear, because with a healthy economy the Fed would feel compelled to raise interest rates, this way ending the Wall Street bubble.

In the old world now gone people would buy stocks in a growing economy. Now they would rush to sell them, knowing that their stock portfolios over valuation would be exposed by interest rates going back to “normal”, on account of...a growing economy.

The sad thing is that we have tacitly accepted this perversion as the “new normal”.

The Killing Of Freddie Gray Reveals A Huge National Tragedy

WASHINGTON – In Baltimore, on April 19 Freddie Gray, a 25 year old African American, died of a spinal injury that occurred while he was in police custody. We do not know all the facts. But what we know invites the worst possible speculations.

Killed by the police

It is not clear what Gray did that justified his arrest. Still, whatever the charges against him, it looks that he was severely beaten by the Baltimore police. In fact, he died because of the severity of the beating.

This is positively awful. This is the United States of America, a country of laws and due process. A country founded on the proposition that the government's main purpose is to secure and protect individual rights. And yes, people under arrest have the right to be treated properly by the police.

Killing Blacks OK?

The notion that a young African American can be arrested and killed while in police custody, and that this criminal tragedy may be explained away as "an unfortunate accident" makes the whole country look like we are still in Alabama circa 1950. In the bad old days, a policeman killing a Black person, intentionally or unintentionally, would not be in any serious trouble.

The broader picture

That said, if we look at the context in which the killing and its aftermath took place, the picture gets a lot darker. What happened in Baltimore in the aftermath of Gray's killing shows a racially divided American society.

It also shows how within this divided society we have a large underclass of disaffected young African Americans who (in this case, as in many other cases) have used the legitimate protests as an opportunity to loot, steal and destroy almost everything in sight.

So, here is the thing. There are some plain racists within the ranks of at least some police forces. For them using excessive force and brutality is perfectly OK when it comes to young African Americans. This pattern of gratuitous police violence justifies strong anti-police feelings among a majority of

American Blacks.

To all of this we have to add the toxic mix of extreme poverty, broken families and crime that plagues so many urban Black communities. A lot of crime invites more police interventions. And repeated police interventions may result in tragedies like Gray's killing.

Easy to ignore the larger problem

As President Obama said, it is easy to ignore this social tragedy of young African Americans trapped in perpetual poverty, until something like the Baltimore riots happens. But then, after making some noises about the need to "do something", when quiet returns we simply go back ignoring the root causes of crime and gang violence.

Sure enough, we can and should deal with the bad policing issues. It must be possible to identify, weed out and prosecute bad cops. But, as the President said, this is just the beginning.

The urban underclass

The broader issue is that in America we have a large urban underclass living in poverty and ignorance. For many of its members crime seems to be the only possible career.

Given this horrible mix, when something really outrageous happens, like the Gray killing in Baltimore, all restraint disappears. When criminal gangs take over, it takes minutes to transform a peaceful protest into mayhem, with stealing, looting and arson.

Again, this is a lot more than a law and order issue, with the police called upon to do the dirty work of arresting gang members.

We have a big problem

Given all this, it is clear that we have a big problem. A really big problem that goes way beyond a few bad cops who engage in criminal behavior. If we are serious about getting to the bottom of this, we have to educate millions of disaffected young people. We have to show them that there are credible and viable alternatives to crime and violence.

And yes, we also have to prosecute racist, violent cops who somehow believe that beating a Black prisoner to death is OK.

As I said, this is a really big problem.

Is China Cooking the Books On Economic Growth?

WASHINGTON – We all know that China's economy is slowing down. No more 10% growth, year after year. Still, the official 7% growth is more than impressive, especially if compared with trends among western countries. In the US we have may be 2.5%, while sorry-looking Europe is shooting for 1%.

Real data?

In this context of sluggish global growth, China's 7%, although much lower than what it used to be, is still exceptionally good. Except for one thing. Not only we are not sure that this data about growth is accurate, the truth is that most experts believe that it is a complete fabrication.

Of course, the issue of the reliability of official economic growth figures coming from a country in which the political leadership has a vested interest in "looking good" as steward of the economy is not new.

Official figures probably not real

What is new is that the WSJ, the newspaper of record for the US and the world economy, now says it openly. (Please read: *Experts Weigh Clues to Chinese Growth Puzzle*, April 27, 2015).

I must say the article reporting on the huge discrepancy between Beijing's numbers and what is estimated by several forecasting firms is polite and somewhat circumspect. The WSJ does not overtly say that the Chinese government routinely engages in fraudulent reporting when it comes to economic data. But it gets close to this by quoting others who openly state this very point, (There is an "atrocious lack of transparency" about GDP growth data, in the words of one academic).

A huge gap

And let's be clear. Here we are not talking about rounding errors, or discrepancies due to imperfect or conflicting data collection methodologies. Here is the gap between what is stated and what is probably true. China says its economy grew by 7%. Capital Economics estimates the true figure to be 4.9%, Citibank says 4.6%, the Conference Board puts it at 4.0% and Lombard Street says 3.8%. Got that? As a minimum, we are talking about 2% magically added to GDP growth. Worst case scenario, 3%.

No more deference

Well, I am glad that finally we are willing to say that this Emperor has no clothes. For some reasons China until now has been treated with an unusual degree of deference. We have been told by China watchers that the wise technocrats operating behind the scenes in Beijing and across China had everything under control. Unlike what we do here at home, with messy, *ad hoc* measures and no long term strategies, the Chinese always have a plan. We focus on the next quarter, while they see well below the horizon.

Bad choices and the end of the old model

Well, it turns out that their well crafted plans did not work out so well. China's gigantic stimulus, its own "wise" response to the 2008 global financial crisis, created growth. But it did so at an extraordinary cost in terms of massive non recoverable loans, and the creation of absurd levels of over capacity in practically every sector of the manufacturing economy.

Huge levels of debt and too many bad loans now haunt Beijing's technocrats. Of course, China has plenty of cash to fix the consequences of all this malinvestment. But it will cost tens of billions of dollars.

Meanwhile, the magic growth formula that guaranteed the exceptional growth of the past 30 years does not work anymore. It is impossible to rely on forever growing export markets, and a never ending construction boom at home.

Why low growth is unacceptable

To put all this in perspective, the end of the old growth model does not spell disaster for China. But It means getting back to normal. However, if "normal" is a 5% or 4% rate of growth (as estimated by the economic forecasting firms quoted above) this may create huge political problems.

The legitimacy of the unelected Chinese political leadership rests in large part on the claim that it knows how to guarantee growing prosperity for every one in China. *"Stick with us, we know what we are doing"*.

Cooking the books

Hence the need to cook the books when the real data no longer matches the political message. Beijing is willing to admit that China has entered an era in which the "new normal" is lower growth. But the Chinese Communist Party leaders

running the show are not willing to tell the whole truth about the extent of declining growth, for fear that mediocre economic results would stir up an unwanted debate down the line on possible alternatives to the Communist Party.

It is not our business to stir up political trouble in China, or anywhere else for that matter. But credible economic reporting has to be based on facts, and not on reproducing propaganda. Therefore, I welcome the WSJ's effort to tell the truth.

Is Hillary Clinton An Ethical Politician?

WASHINGTON – So, there you are working hard as the globe-trotting US Secretary of State, talking to heads of state and promoting US economic interests, including deals involving major US corporations.

Husband asking for money

At the same, your husband, who happens to be a still very popular former President of the United States, is busy working the same international circuits, drumming up major contributions on behalf of his foundation from some of the governments you are working with, along with major corporations or wealthy individuals within them. In fact, while you are Secretary of State, he also gets fabulous fees for speaking engagements abroad, (we are talking \$ 500,000 or more per event).

Then, upon leaving public office –with a mile long contacts list that includes every head of state you met with– you also

join the foundation. But then you decide that you want to get back into politics and so you announce that you will seek the presidency.

No evidence of any wrongdoing

In extreme brevity, this is Hillary Clinton for you. Look, whatever the recent allegations and innuendos about impropriety, so far nobody has come out with any evidence of any criminal wrongdoing. Nobody can claim that, while US Secretary of State, Hillary Clinton made policy decisions with the goal of benefiting the Clinton Foundation or Bill Clinton personally.

A convenient setup

But critics cannot be blamed when they question the ethics of this rather convenient set up of a wife in high office while the husband travels in the same circles, soliciting and getting huge amounts of money for his foundation in the process.

If you hate the Clinton family, you can conclude that they abused public office in order to enrich and/or benefit themselves.

The Clinton defenders reply to this assertion is that there is not even a shred of evidence to prove any of this. And this may very well true. Therefore: no evidence, no crime, case closed.

There is no evidence

Yes, except that here we are talking about the public image of a person running for the highest office in the land. And here the bar is not what may or may not stick in a court of law. Here we are not talking about being innocent until proven guilty. Here the bar, fairly or unfairly, is much higher. Here we are talking about not doing anything while in office that

may create even a slight appearance of impropriety.

To say to America that *"I am OK because you have no hard evidence against me"* is not the right message coming from someone who wants to be the next President of the United States.

I am ethical

The message should be: *"I am an honorable person who is totally above reproach. While in public office, I adhered to the highest ethical standards. No, I did not work with my husband to set a clever system that would prove to be advantageous to us, personally or politically. I did not work with him so that we could cover our tracks and make it impossible for anybody to accuse us of any wrong doing. I am an ethical person. I went into public office and I am now seeking the presidency because I want to serve the American people."*

Yes, in America every citizen is innocent until proven guilty. In this particular case of the Clinton couple there is not even the beginning of any criminal case against either of them. Most likely there will never be one.

Appearance of impropriety

But they have created the appearance of impropriety. And, fairly or unfairly, the American voters will decide on Hillary Clinton's viability as President in part on the basis of what they assume (even without any evidence whatsoever) she did while Secretary of State. Of course, the American voters may assume a lot of fictitious wrongdoing that never happened.

But when voters see a somewhat questionable setup –Hillary Clinton in high government office while the Clinton Foundation goes around asking and getting hundreds of millions of dollars, often from the same people she engages with– and then a careful clean up process, (remember all those e-mails that

have been destroyed without any third party review?), they may conclude that there is something fishy in all this.

Untrustworthy

So far, the immediate impact of all these allegations has been that a majority of US voters now believes that Hillary Clinton is not trustworthy. Of course, all of this can and will change. The presidential elections are still very far, (November 2016). And people change their mind.

In the meantime, there are plenty of opportunities to dig up stuff that may make any Republican would-be President look bad.

And we know that in politics anything goes. If any Republican did anything wrong or can be portrayed as having done anything wrong, you can rest assured that the Clinton people and their proxies will let us know.

We should be able to assume that all who seek high office are moral persons

Of course, in an ideal world it would be nice if we could limit any political debate on the merit of policy positions.

The very fact that we spend an inordinate amount of time trying to determine whether candidates for high office are or are not moral persons is an indication of a deep problem.

More Jobs in Italy? Not

really

WASHINGTON – The Italian government just released figures related to new jobs created most likely on account of new legislation that simplified certain labor market rules. The data indicate that some 90,000 new jobs were added.

A new trend?

Italy's President Sergio Mattarella said that this net jobs creation is an encouraging sign, possibly indicating a new trend in the perennially depressed Italian economy.

Well, this optimism is not unanimous. Susanna Camusso, head of the powerful CGIL trade union, stated that these are meaningless numbers coming from a propaganda office. An opposition leader argued that the government picked the figures from some astrologer, or that may be these are lottery numbers.

A more serious critique points out that the numbers were released without any explanation as to how they have been calculated, and what methodology has been used.

Staggering unemployment

However, even assuming that the numbers are genuine, and that there has been a modest increase in the number of Italian who now have some kind of job, the big statistics (that no one disputes) are truly frightening.

Italy's total unemployment is 12.7%. Yes, this is more than double the US rate deemed to be too high by most American economists. Youth unemployment is 42%. If you look at young people without a job in the south of Italy, the percentage climbs to 60%.

Besides, Italy's GDP has to yet to get out of the hole it fell into after the 2008 global recession.

These are the facts. In this disastrous context expressing any optimism about small changes based on data apparently not properly vetted is sheer lunacy.

Asia's Slowdown Will Affect America's Growth

WASHINGTON – Can America count on buoyant global demand to drive more US exports, and therefore more sustained growth at home? Not really. Here is an item from the WSJ, (April 22, 2015): *“Growth across Asia is slowing despite rate cuts as consumers and businesses focus on repaying heavy debts”*.

Yes, you got it. Led by China, Asia until yesterday was touted as the world's economy locomotive. But it seems that the Asians are also maxed out: too much debt impedes more investments and more consumption.

Indeed, another related headline is about Ford motor company trying to keep its market share of the once exploding Chinese automotive market while facing the headwinds of slower demand for new cars. Sure enough, the Chinese car market is still growing. But it has lost altitude. Forget about 16% rates of growth. Therefore Ford and GM are facing fewer sales in China.

Tough times for America

What does all this mean for America? It means that our unimpressive recovery (2.4%) may soon come to an end. US domestic demand is not growing, in part due to high levels of consumer debt that inhibit more purchases, and in part due to income stagnation.

If we add to this uninspiring scenario an Asian economic slowdown, it is really hard to see where the new growth will be coming from.

Tough times ahead.

If The US Economy Slows Down, Hillary Clinton Will Not Be Elected

WASHINGTON – If we go back to the 2012 presidential campaign, the brilliance of the Obama team was in its ability to turn the tables on Romney. Republican challenger Mitt Romney believed that *“he had to win”* because of the relatively poor state of the US economy. He honestly believed that the elections would turn into a national referendum on Obama’s manifestly mediocre skills as an economic policy manager.

How Romney was defeated

Well, it did not work that way. The Obama people counter attacked by successfully painting Romney as a heartless “vulture capitalist”, a predator who stripped assets from the companies he bought, tossed the scraps away, and enriched himself in the process. This was and is a ridiculous caricature of a successful business person. But the demonization strategy worked, very well.

From that point on, contrary to all predictions and plans, Romney was on the defensive. Add to this a number of egregious self-inflicted wounds, (such as comments about 50% of America being dependent on public largesse), and we can see

how Romney, for a long moment the inevitable 2012 winner, was sunk.

Difficult to use the same script in 2016

Now, as we approach the 2016 elections, it is my contention that Hillary Clinton's main political vulnerability is also going to be a very soft US economy, or worse an economy in recession. However, contrary to 2012, I am not sure that she will have another Mitt Romney who could be just as easily demonized. This trick would not work with former Florida Governor Jeb Bush or Ohio Governor John Kasich.

The US economy is getting weaker

Of course, predictions about what may happen more than a year from now are likely to be wrong. But this is the way I see it. The US economy right now is performing in a mediocre but semi-acceptable way only because of the compounded effects of the longest zero interest rates policy (ZIRP) period in modern history. We know that the Federal Reserve will have to stop this insanity at some point. It may be later than we think. But it will have to be done. We also know that rising interest rates will cause the end of the current Wall Street bubble, with unknown, but mostly negative ripple effects.

Over stretched consumers

In the meantime, the US consumer –the traditional engine of US GDP growth– is once again over leveraged and over stretched. Do not count on the average Joe to pull the American economy forward on the basis of his willingness to keep spending more and more by getting deeper into debt. The average Joe is maxed out. He has already used up all his credit, while his disposable income is flat. And the consequences of high debt and income stagnation are huge. Flat or lower consumer spending will act as an enormous brake on an economy that is mostly driven by it.

No new exports

More broadly, the international economic scene is not that promising. Countries that buy from America, (think of Europe and Japan), are in serious trouble. If they are lucky they will stay out of recession. Any new growth will be very modest, (may be 1%). Therefore they will buy less from Caterpillar, IBM, General Electric, or United Technologies. Add to weak export markets the parallel phenomenon of a rising dollar and you see that growing or even keeping traditional export markets will be an impossible challenge for US producers.

Time is everything

All these trends indicate a weakening, not a strengthening, US economy, possibly a recession coming soon. Of course, here timing is everything. If (with luck) things continue along present trends, (modest economic growth, low unemployment), right up to the elections, then Hillary Clinton has almost nothing to fear.

But if we have a real slow down, or may be a recession, right before the elections, Hillary Clinton's chances to get to the White House will diminish, may be they will vanish altogether. Whatever her customized "new" message may be, after all she is another establishment Democrat who served under Barack Obama. Really hard for her to distance herself from his legacy when it comes to economic policies.

US economy chugging along, Hillary Clinton wins

If none of this will happen, if, come September-October 2016, the economy is alright or on the upswing, then beating Clinton will be very, very difficult. She would be able to claim that more of the same economic recipe, with a twist here and there, works well.

Unfortunately, America has gotten used to mediocre economic

performance softened by subsidies and public assistance here and there. The Republican basic message focused on relaunching private enterprise while cutting down suffocating regulations will resonate with some, but not with a majority of Americans. Most of them, assuming no sudden crisis hitting them, are likely to choose the devil they know.

It is a sad commentary on America that the Republicans should hope on a recession as the lucky development that will increase the chances of their nominee to gain the White House.

In China The Economy Is Still Run By The State

WASHINGTON – The highly regarded The Economist weekly magazine has a Leader (we call it Editorial in America) about economic reforms in China, (*The quiet revolution*, April 18th, 2015). Leaving aside the analysis on recent and announced changes, what is most extraordinary is what the Leader does not say.

Is China a capitalist country?

I do not know whether this is due to a deliberate attempt at obfuscation, sudden amnesia, or stupidity. But the fact is that The Economist never mentions in its Leader “China’s Communist Party”, “state controlled economy”, “state-owned enterprises”, or “party’s control over economic policy”.

In other words, if you did not know anything about China’s

post war history and current politics, by reading this Leader you could very well think that China is just another capitalistic country now undergoing some reforms aimed at creating a more sustainable foundation for future economic growth.

And yet we know that this is not the case. China is not another capitalistic country. And it can be argued that China's current economic problems are in large part due to its unwillingness to become a "normal" capitalistic country.

The party controls the economy

And why is China reluctant to "go all the way"? Because true capitalism is founded on real economic and political freedoms. There is no doubt that China changed a lot during the last 30 years. There has been immense liberalization. The previously non-existent private sector has been allowed, and it has become an impressive force for wealth creation and modernization.

But none of this occurred spontaneously. This transformation happened because the Communist Party permitted it. It has been clear from day one that the entire economic change process, while broad, was not and is not open-ended. It has taken place and it will continue under the direction and within the limits imposed by the ruling Communist Party.

The political role of State Owned Enterprises

And here is one gigantic limit. Whatever some honest reformers in China may say, for the time being, the state will continue to control the economy, while running directly some of its most strategic sectors via its own State Owned Enterprises.

For the time being, the party-state will not privatize the public sector. And here is the clear political reason. Despite well documented malinvestment and inefficiencies, the publicly owned strategic sectors, (banking, insurance,

telecoms, energy, steel and more), allow the party to retain control over the rest of the Chinese economy, and therefore over China.

Deliberate obfuscation?

All this is to say that any analysis about “reforms” in China that does not refer to the broader political and policy context outlined above, (a one party state, not another capitalistic country), is either meaningless, or a deliberate attempt to obfuscate.

Either way, given its reputation, The Economist could and should do better.

Europe Sliding Into Irrelevance

WASHINGTON – Here is today’s Europe. Stagnating economies, non-existent innovation, high debt caused by unaffordable pensions and other entitlements, and educated young people going away in search of opportunity.

Old societies

And there is more: high unemployment, especially for young people, and declining birth rates. Combined with the slow but steady drain of the most ambitious within the new generations, declining birth rates (below replacement levels in all of Europe, with the exception of France), mean frail societies dominated by senior citizens whose main preoccupation is not investment in the future but collecting pensions.

Generous pensions and other entitlements were pledged by politicians who over promised, thinking that the money to pay for future benefits somehow would materialize.

Immigration from Africa

If you think this is bad enough, sorry to say that there is more. Yes, add to this depressing mix the steady inflow of desperate illegal immigrants from North Africa, Sub-Saharan Africa and the Middle East. They escape from poverty, wars and political chaos, hoping to find something better in Europe. This is not a massive wave, but a steady, daily *drip-drip*. Tens of thousands arrive every month, and this has been going on for years, with no end in sight.

Now picture this. Italy has zero growth and high unemployment (above 10%). Youth unemployment is about 40%, and around 60% in the South. And yet now the same tired, over stretched and impoverished Italian state has to provide for thousands of new illegal immigrants who sail daily from North Africa, landing in Sicily. (So far, 20,000 new arrivals in 2015).

And what can these poor migrants, (many of them women and children), add to a semi-comatose Italian economy? Nothing. Absolutely nothing. In fact, they represent a new cost. They are poor, illiterate, and unskilled. On top of that, a majority of them are Muslim, this way adding another layer of complexity to the already impossible task of integrating millions of aliens into a new society.

We have a strategy

In all this, there is an amazing degree of wishful thinking in Europe that has now passed the threshold of collective insanity. Here is the plan, the smart (and painless) strategy to get out of all this.

“No worries. Mario Draghi and the European Central Bank, (ECB), have got this thing under control. You see, they have

launched Quantitative Easing, (QE). And this clever remedy works practically like a (free of charge, mind you!) Elixir of Long Life.

All of a sudden –Puff!– interest rates are down to zero, And this magic remedy means that (essentially broke) governments now and going forward can keep borrowing, since the cost of servicing new debt is down to nothing.

Therefore, this QE Elixir means that we can keep on ignoring the fiscal disasters caused by monstrous and totally unaffordable welfare states. As long as we can issue more bonds, all is well. We shall pay pensions by issuing more bonds. This is a really smart policy, and it will work wonders.

Yes, we may concede that Greece overdid this a little bit. But everybody else will be fine. Italy's national debt is now 130% of GDP? Totally manageable. France's economy is semi-comatose? Wait for QE to work its magic."

No reforms

While delivering his monetary cocaine, Draghi did also say to the EU policy-makers that they should get serious about realistic new fiscal policies, and pro-growth legislation. But the policy-makers have gladly taken the QE cocaine dished out by the ECB and ignored the warnings.

In all this, Europe is not going to go down in flames, in the midst of financial chaos and political unrest. No, just like on old person afflicted by a variety of serious, but not lethal, chronic diseases, Europe will shrivel, and slowly slide into irrelevance.

America Needs Structural Reforms

WASHINGTON – There is no doubt that millions of Americans are economically worse off because of the negative impact of a couple of global trends. First of all there has been the Asian awakening.

The impact of cheap labor

This translated into hundreds of millions of able-bodied Asian workers who almost suddenly joined the global labor pool, while offering their services at a fraction of the cost of their US and European counterparts. A lot of additional cheap labor supply, with no significant additional global demand for more goods, simply depressed the wages of US workers, while causing many US businesses to literally shut down, or move to low wage Asian countries.

Technology kills jobs

This is bad enough. But there is more. In the past, the effect of new technology was the creation of new sectors. The introduction of mass industrial production at the beginning of the 20th Century created millions of factory jobs, just as modern farming allowed food production with very few farmers, this way creating labor redundancies in the country side.

But now it is different. Now, advanced industrial technology means mostly automation. And this means that robots rather than humans make stuff. The factory of the future will be run by machines with only a few highly specialized humans at the

controls.

This means fewer and future factory workers, regardless of demand increases.

Pressure on the US middle class

All this is enough to describe the plight of a huge portion of the American middle class. Jobs disappeared or pay a lot less, because US wages have to compete with the lower wages of Asian workers willing to do pretty much the same jobs at a fraction of the labor cost. At the same time technological progress killed other functions that now can be performed by machines.

Regain competitiveness

The only possible –but by no means certain– way out this is to regain global competitiveness by redoubling our efforts in innovation. We have to create new technologies, new systems, new products that will allow our corporations to lead.

This is not at all simple. Still, as a minimum, let us stipulate that public policy needs to be aligned with this paramount strategic objective of fostering innovation. But let me be clear on this. Good public policy is no guarantee of an economic renaissance. However, for sure bad public policy will hinder it, or prevent it altogether.

So, what is good public policy for America?

Here is my list.

The to do list

1) We need a vastly simplified federal tax code that will eliminate all tax loopholes, while reducing tax rates. What we want is a pro-growth tax code that encourages easy compliance, without discouraging business formation and new business investments.

2) We need a dramatic reform of all entitlement programs. We simply can no longer ignore the fact that all major entitlement programs (Social Security, Medicare, and Medicaid) were designed in another era, with vastly different demographics, and significantly lower costs.

3) We need a dramatic reform of the entire US public education system. The facts are known. US public schools, often at a very high cost, deliver a mediocre and at times horrible product. The impact of bad public education is immense. First of all, it creates an almost insurmountable obstacle to social mobility. The poor disproportionately depend on public education to get the skills that will allow them to advance in the American society. And, secondly, a smaller pool of educated people will make it a lot more difficult for America to become once again an innovation leader. Functionally illiterate high school drop-outs rarely turn into leading inventors.

4) And, yes, we should have sensible immigration reform. Make the borders secure. Create a path to legalization for most of the illegals who are here, and make it a lot easier for ambitious, smart people to come here and start a business. Let's start with the capable people who are already here as graduate students in leading American universities. We educate them. Let's give them a chance to stay and work here, if they so wish.

Health care is a mess

To this agenda we should also add serious health care reform. But this is so complicated that I hesitate to place it on my wish list. Simply stated, by creating a system that is a horrible hybrid between private and public, with perverse incentives for doctors to over treat, and no financial reward for teaching prevention and "wellness", we have created a real monster. And so, we got the worst of everything: astronomic costs, (the US spends 17.5% of GDP on health),

millions of Americans affected by (preventable) chronic diseases, and mediocre health care.

Plenty to do

Anyway, there is plenty to do. However, it will be difficult to hear clear calls for true reforms coming from the crowded field of would-be presidents. And this is a real shame. What I outlined above should be a pretty straightforward, non-partisan, to do list.

And yet our politics have become so ideological and vicious that we have done essentially nothing to advance on any of these issues for more than a decade. Between Bush's foolish wars and Obama's sterile populism, we have wasted precious time, not to mention trillions of dollars.

Focus groups policies

And now the risk is that the next president will be elected on the basis of what focus groups want to hear, (usually more benefits and lower taxes), as opposed to what needs to be done.