Speech by Richard W. Fisher, President and CEO (2005–2015)

The United States: Still the Growth Engine for the World Economy?

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I am honored to be here today. The Fishers trace their roots to Surrey, our familial home until British authorities "encouraged" the more, shall we say, entrepreneurial side of the family to relocate to Australia. With the passing of time, we were welcomed back—to the Middle Common Room at Oxford's Hertford College, where as a graduate student I met my wife and cemented a special affection for any and all things British.

I have been asked to speak on the U.S. economy and will do so shortly. As you might expect from the president of the Federal Reserve Bank of Dallas, I will dispense a little "Texas brag." But no one who tills the fields of economics, not least a central banker, can stand in a British forum without a sense of humility and gratitude. You invented the "dismal science" that my Fed colleagues and I do our level best to put into constructive practice.

Smith, Mill, Hume, Malthus, Ricardo, Keynes—even Marx—derived their economic theories on British soil, giving us principles and disciplines we have sought to perfect in the American economic machine. As you know, we Americans do love debt! And it is to the great economic intellects of England that we are most profoundly indebted.

My kind hosts, who had no idea that this event would follow so closely on the heels of the meager growth estimate reported for last year's fourth quarter, have asked me to address the question: Is the United States still the growth engine for the world?

The answer is yes.

Let me explain why.

The American economy has been on an upswing for more than four years. Growth advanced briskly at 4.2 percent in 2004. It slowed to a still solid 3.5 percent in 2005, although I would not be surprised if GDP were revised upward when we take a more definitive look at the fourth quarter. In January, the U.S. economy employed 134.6 million people, up 2.2 million in a year. Unemployment stood at a four-year low of 4.7 percent, which compares with the latest reading of 8.4 percent for Europe and even higher rates for some of the continent's major economies.

We have weathered hurricanes' fury and record-high energy prices while continuing to grow and keep inflation under control. The statement the Federal Open Market Committee released Tuesday quite summed up our current situation succinctly: “Although recent economic data have been uneven, the expansion in economic activity appears solid.”

This is especially true in what I call the “growth rim”—an arc of population centers with favorable demographics that begins in Virginia, runs down the southeastern seaboard through Georgia to Florida, then through the megastate of Texas and on to the uberstate of California and up to Seattle. I use “mega” and “uber” to describe the two largest states for a reason: to illustrate the depth and breadth of our economy. In dollar terms, Texas produces 20 percent more than India, and California produces roughly the same output as China. To the extent there is weakness in the U.S. economy, it is in the Northeast and North Central states.

Netting all this out, the consensus of most economic forecasters is that growth in the first quarter will rebound to a rate well above 4 percent.

To understand what this kind of growth means, we need only follow Margaret Thatcher’s wise hectoring to “do the math.” The United States produces $12.6 trillion a year in goods and services. Be conservative—once again, Lady Thatcher would like it—and assume that in 2006 we grow at last year’s preliminary rate of 3.5 percent. The math tells us we would add $440 billion in incremental activity—in a single year.

That is a big number. What we add in new economic activity in a given year exceeds the entire output of all but 15 other countries. Every year, we create the economic equivalent of a Sweden—or two Irelands or three Argentinas. In dollar terms, a growth rate of 3.5 percent in the U.S. is equivalent to surges of 16 percent in Germany, 20 percent in the U.K., 26 percent in China and 70 percent in India.

Of course, our growth is driven by consumption, a significant portion of which is fed by imports, which totaled $2 trillion last year. Again, do the math: Our annual import volume—what we buy in a single year from abroad—exceeds the GDP of all but four other countries—Japan, Germany, Britain and France.

So, yes, the United States is the growth engine for the world economy. And it is important that it remain so because no other country appears poised to pick up the torch if the U.S. economy stumbles or tires.

Are there reasons to worry it might do so? In fashionable circles and at various “chat shows” like Davos, you certainly hear many.

Of immediate concern is the potential bursting of the so-called housing bubble. Some parts of the United States have experienced uncommon acceleration of housing prices. We are all familiar with what occurred in the U.K., Australia and the Netherlands, where a deceleration of housing prices hit consumption hard. As a result, many a jaundiced eye is being cast on the U.S., where mortgage debt service as a percentage of disposable income has risen in recent years and consumption has been partly financed by equity aggressively “extracted” from the housing stock through ever more novel financial products.

Again, it is important to do the math.

Currently, 80 percent of U.S. homeowners have fixed-rate mortgages. Just one in five has a variable-rate mortgage. The majority of the latter are so-called hybrids, carrying a fixed rate for a few years before converting to a floating rate. Roughly 80 percent of these mortgages are scheduled to have their rates reset; however, the impact will not occur all at once but will be stretched out over the next several years.

It is true that homeowners with variable-rate loans borrow larger amounts. It is also true that they have higher incomes. The median borrower with a variable-rate mortgage devotes a smaller portion of household income to debt payments than those with fixed-rate loans.

In recent years, the analytically nettlesome Interest-Only—or IO—mortgages have become a significant percentage of housing loans in some markets. Unlike other mortgages, payments on IOs increase when the interest-only term expires and borrowers are required to make principal as well as interest payments. These mortgages pack a double whammy when rates reset after the IO period expires. Many of these mortgages, however, have long periods during which the interest rate and IO period are locked up. Given that the average mortgage is held only six or seven years, many houses will be sold or refinanced before the amortization period ever kicks in.

Given this, I will let you draw your own conclusions about whether the housing market's financial dynamics will strain the U.S. economy as interest rates rise in response to Federal Reserve tightening. It is not unreasonable to think the situation is manageable, albeit worth watching closely. And this so-called cloud may even have a silver lining, as noted recently by Scott Burns, the astute American syndicated columnist. When people have to make money from their jobs, rather than from their homes, perhaps they will focus more on their work and what they produce. Not an altogether bad set of priorities!

The other preoccupation is the U.S. current account deficit, a subject second only in popularity to the ongoing saga of Brad Pitt and Angelina Jolie. America's large trade deficits have been discussed for so long by so many eminent analysts that I have little to add—except to remind you that it takes two to tango. Those urging the United States to rein in its spending should be equally full-throated in prodding countries with excess savings and trade surpluses to create conditions for growing their domestic demand. If they fail to do so, and the U.S. suddenly becomes virtuous on its own, the global economy would sink into a deep funk.

So if there is a ready substitute for the United States as the consumer of first and last resort for many developing economies, I would like someone to tell me which country, or group of countries, might fill the bill. As our new Fed Chairman, Ben Bernanke, made clear in a speech last April, this issue entails a lot of moving parts, but the counterpart to scant saving in the United States is excess savings by other countries and/or underinvestment in their own countries.

I want to spend the remainder of my time at the podium talking about the long-run position of the United States. One of my favorite recollections from my days at Oxford is the story of John Maynard Keynes at the Bretton Woods conferences. He grew terrifically frustrated at the arrogance of the Americans and complained bitterly to Lord Halifax, the British ambassador. Halifax, who no doubt bore in mind the British legacy of intellectual thought that I cited earlier, sought to comfort him. Thus it was written:

> "In Washington," Lord Halifax
> Whispered to Lord Keynes,
> "The Yanks may have the money,
> But we have got the brains."

The key to the American economy's success in recent years—the wellspring of our growth—has been a unique combining of money and brains to enhance productivity, the ability to turn out more goods and services from our labor and other factors of production. This, I submit immodestly, we have done well. During the great post–World War II boom, productivity grew 2.7 percent a year from 1950 to 1973. It then slowed to an anemic 1.5 percent from 1974 to 1995, leading the denizens of Davos and other salons during the 1980s to extrapolate dark thoughts from then-fashionable titles like Ezra Vogel's Japan as Number One, published in 1979, and Paul Kennedy's The Rise and Fall of the Great Powers, published in 1988. But just when it appeared Japan would pass America, we took a turn for the better. U.S. productivity ramped up to growth rates of 2.9 percent a year from 1996 to 1999 and 3.2 percent a year from 2000 to 2005.

New technology fed the productivity surge. The microprocessor led to a host of productivity-enhancing tools—increasingly miniaturized yet more powerful computers, cell phones, the Internet, bar-code scanners, fiber-optic cables—countless innovations that enhanced business managers' ability to automate operations, rationalize inventories, enhance customer service, process data, move information and cut costs.

The Information Age technologies were available in nearly all countries, but few reaped the same productivity gains as the United States. Over the past decade, productivity growth in the European Union's 15 core countries, for example, has averaged 1 percent a year, far less than the United States.

The key to wringing more from the new technologies lies in the American economy's adaptability. We let the economy change. We provide a healthy environment to nurture entrepreneurs. Starting a business takes five days in the United States, compared with 45 days in Germany and 108 in Spain. We have not saddled the private sector with regulations that interfere with hiring and firing or dictate outmoded methods of production. We let labor, capital and companies compete—within the country and with the rest of the world. Our economy continually reorganizes itself to take advantage of new technologies, freeing labor from old jobs so it can move to new, higher-value uses.

The Lex Column in Friday's Financial Times noted that Joseph Schumpeter called the capitalist process "creative destruction," a marvelous phrase that captures the two-sided nature of economic progress. I like Schumpeter—despite the fact he never spent significant time in England—because his writings focus the mind on the process of change and adaptation. They are particularly relevant today. Listen carefully to these three quotes from two of his seminal works.

In his book Capitalism, Socialism, and Democracy, Schumpeter wrote: "The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates."

From that same page: "The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory … illustrate the same process of industrial mutation … that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is … what every capitalist concern has got to live in."

And from volume 1 of Schumpeter's Business Cycles: "A railroad through new country, i.e., country not yet served by railroads, as soon as it gets into working order upsets all conditions of location, all cost calculations, all production functions within its radius of influence; and hardly any 'ways of doing things' which have been optimal before remain so afterward."

String the key phrases of those three citations together and you get the bottom-line plot of capitalism's process of creative destruction: "The opening up of new markets, foreign or domestic ... revolutionizes the economic structure, ... destroying the old one, . . . creating a new one .... [It] upsets all conditions of location, all cost calculations, all production functions, ... and hardly any ways of doing things which have been optimal before remain so afterward."

Here is where China and India and all the bristling new economic entrants come in. They are today's equivalent of Schumpeter's railroads. They and the phenomenon of globalization are agents of creative destruction writ large. From now on, hardly any way of doing things which used to be optimal will ever be the same.

I posit that China and India and the new players will enhance American productivity and abet U.S. growth, not threaten it. These rising economies will provide sources of inputs American companies can use to drive down costs and increase variety for consumers. They will increase competition—which is good. Competition sharpens the wits and improves muscle tone. Facing foreign competition head-on will keep us at the forefront of the global economy by encouraging businesses to do what they should do: create jobs and profits in a virtuous cycle that, properly nurtured by monetary and fiscal policy, goes on indefinitely.

Note that I mentioned monetary policy. I would like to think that America's greatest asset is the wisdom and steady hand of its central bank. But truth be told, wise and temperate monetary policy is a necessary but insufficient condition for America's success. Our greatest asset is our inherent flexibility and the private sector's ability to capitalize on the ever-changing economic landscape. Our comparative advantage lies in the millions of managers in our business community who serve as the nerve endings in Adam Smith's invisible hand, stretching capitalism's fingers into every corner of the world to extract value at the lowest cost—to enhance productivity. They adapt to economic change with breathtaking alacrity. I am not talking just about CEOs but also about middle managers who operate supply chains, control inventories and fine-tune operations. As long as the Federal Reserve does its job of holding inflation at bay, and as long as our political leaders resist protectionism and other forms of interference with creative destruction, we will remain a productive economic machine.

At the Dallas Fed, we refer to the process of creative destruction as "the churn." I mentioned Ezra Vogel's and Paul Kennedy's works, which provide bookends of a sort for the 1980s. In preparing for this speech, I asked my staff to look at what has happened to the U.S. economy since that period, when it was fashionable to talk of America's demise.

Therein is the math of the churn.

From 1980 to 2005, American workers filed 118 million claims for unemployment insurance. Many others lost their jobs, of course, but either didn't qualify for benefits, were not unemployed long enough to file a claim, or quickly transitioned to new jobs. It is hard to find a figure that would include all the job losses, but it would be more than 150 million, surely. That is the destructive and painful side of the churn.

Yet, despite all these job losses:

Total employment over the period rose by 44 million—net. At annual rates, unemployment fell from 7.2 percent to today's 4.7 percent. Productivity increased by 72 percent. Per capita real GDP shot up from $26,113 to $42,760. The average workweek fell by nearly two hours to 33.7 hours, and average household real net worth more than doubled to $431,000. That is the creative and restorative side of the churn. All this was accomplished, by the way, with less economic downtime. Since the beginning of 1982, the United States has had just 16 months of recession, compared with 43 in France, 70 in Germany and 82 in Japan.

In short, the churn works. If we allow the market system to recycle our labor to new, higher-value-added jobs, it will keep us working, productive, well paid and richer, with better jobs and more time to enjoy life.

Mervyn King was spot-on in his speech in Kent just three weeks ago when he noted that "a willingness to adapt and embrace, rather than resist, change is the key to greater prosperity. That road may at times be hard going...but it leads ultimately to a more prosperous destination."

P. G. Wodehouse, who wasn't an economist or a central banker but who sprouted in British soil, would have put it this way: In a globalized, Shumpeterian world, it is simply not true that *plus ça change* results in the *même chose*. America's business managers get it. The British business community gets it. Continental Europe's private-sector managers are equally up to the task of adapting to compete. It is up to the continent's political leaders to create conditions that liberate the private sector to reignite the combined mass of Europe's economies as an engine of growth while the ECB ensures that business remains undistracted by inflation.

Until then, the task of being the world's economic engine falls to the United States.

About the Author

Richard W. Fisher served as president and CEO of the Federal Reserve Bank of Dallas from April 2005 until his retirement in March 2015.