



Commodity Outlook 2003: The U.S. Economy¹

P.J. van Blokland²

According to Karl Poehl, "Americans are always worried about economic trends, suggesting that it is something of a national neurosis" (Poehl, 2002). This brief article attempts to address that neurosis.

Perhaps the most significant concept to grasp here is that the world currently recognizes the United States as the only superpower around—a situation unique in world history (Zakaharia, 2002). Throughout history, one power has almost always been held in check by another: the power of the British Empire was usually curbed by the French, Dutch, and Spanish empires, and they by Britain. The most recent example of countervailing powers was the United States and the Soviet Union, a balance upset with the end of the cold war. Therefore, the recent terrorist attacks against the United States may not be directed so much at American values as "scoring one off the big kid on the block." Much the same resentment might have been directed against the Soviet Union, were it still a superpower. Americans should realize our overwhelming influence on world events and recognize that the rest of the world is reacting to that influence.

For example, in July 2002, Morocco and Spain almost went to war over Leila, a small island in the Straits of Gibraltar mostly inhabited by goats. The Moroccans landed 12 soldiers and hoisted their flag.

A fortnight later, Spain sent 75 soldiers and hoisted two flags. The two fulminating and growling countries did not consult the European Union or the United Nations, but instead consulted U.S. Secretary of State Colin Powell to stop a potential war (Zakaharia, 2002).

Americans are usually considered the wealthiest people in the world. In fact, the U.S. gross domestic product (U.S. GDP) per capita is \$36,200, second only to Luxembourg and a shade more than Bermuda and San Marino (World Facts and Figures, 2002). But these numbers, of course, do not tell the whole story. For example, the U.S. GDP is now around \$10.5 trillion, about equal to the GDPs of Japan (\$4.8 trillion), Germany (\$2.2 trillion), France, and the United Kingdom (both at \$1.5 trillion) combined (PGMM, 2000). Interestingly, Iraq's GDP is \$19 billion, whereas Florida's GDP is \$466 billion. The U.S. GDP's annually adjusted real growth is, from third quarter numbers, around four percent, which is greater than any European country, except Ireland, and twice Japan's rate (*The Wall Street Journal*, 2002b). So while the U.S. economy may not be doing well at this time, it is doing considerably better than its rivals.

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2. P.J. van Blokland, Professor, Department of Food and Resource Economics, Florida Cooperative Extension Service, Institute of Food and Agricultural Sciences, University of Florida, Gainesville, FL.

For most people, the stock market is a major indicator of economic strength/health. That is one of the reasons why 55 percent of us have savings, pensions, and insurance policies, either actively or passively, in the market today compared with 20 percent 15 years ago. The last three years have provided around \$2.5 trillion in stock market losses, though there are some signs that the worst may be over. October and early November 2002 produced a Dow gain of over 1,000 points, and the market could show a five percent growth over the next three years. This would be welcome to a gradually aging society—not as satisfactory as the halcyon 20 percent growths of the late 1990s, but still better than equivalent risk bonds and handsomely above inflation.

There are some indicators that offset this good news. The U.S. economy is uniquely driven by consumer spending, which supplies some two-thirds of the U.S. GDP. Even the recent recession has not materially dampened consumer purchases due, in part, to astute short-term encouragement from car companies and the lowest interest rates in living memory. The consequence of exuberant—perhaps irrational—spending has been three years of negative savings, meaning that we spend more than we receive. No other major country comes close to this trend and it obviously cannot continue indefinitely. Average U.S. household debt is now, for the first time, larger than personal disposable income (PDI), which is what we have left after paying taxes. We owe \$103 for every \$100 of PDI (about two-thirds of this is mortgage debt). For example, Americans owed \$85 per \$100 PDI in 1989 compared to \$72 in 1979 (Ismail-Beigi, 2002). Again, this trend is not sustainable, and there is little experience on what public policies should be used to curb debt-financed spending without starting another recession with its inevitable increased unemployment. Credit card debt now averages \$3,250 per person compared with \$2,800 in 2000. Even worse, the 55-64 age group averages just under \$7,000 per head (*Miami Herald*, 2002).

The U.S. unemployment level is now about 5.2 percent, compared with 7.5 percent in 1992 (Bureau of Labor Statistics, 2002). This seems manageable but inevitably hides those who are getting laid off and those who cannot find entry-level jobs. Despite some

well-publicized layoffs of white-collar workers, the relatively undereducated are always the first to be affected. This, in America, means minorities. Resentment by minorities is increasing, meaning that we may face more racial problems than we think if education does not become more desirable as a poverty escape.

Education, in general, is a problem in the United States. Worldwide, American adolescents trail all but a few developing countries on test scores in mathematics and science (Peterson, 2002). According to the International Adult Literacy Survey, “Americans barely reach the international literacy average set by advanced democracies” (Peterson, 2002). Because human capital is more important than physical capital in a country's economy, the average American may be unable to compete in the future as a product from the typical American public school.

Another area of concern has been consumer confidence in the U.S. economy. Fall 2002 surprised everyone when the consumer confidence index dropped to its lowest level in years at 79.6 in October 2002 (the September reading had been 86.1). However, the index rose back up to 84.1 in November. Most economists have forecasted the October drop as minor (in that drops are historically rarely more than a point), but consumer confidence is still a concern. The market is more volatile than it has been since the 1960s. Retail sales are weak. Although Wal-Mart had a Thanksgiving record and sales were good for the whole 2002 holiday period, these sales did not forecast the Christmas spending that retailers often rely on for 40 percent of their annual sales. Manufacturing is stagnant, there have been huge price hikes in health care, and the index of leading economic indicators has fallen or stayed flat for five months in a row. Profits from current production fell 1.3 percent in the third quarter of 2002, and prices received by U.S. corporations are down for the last five quarters, the longest string in 50 years (*The Wall Street Journal*, 2002c). All these factors have produced an increased nervousness and uncertainty in a country famous for its optimism. But possibly the biggest shock was the realization that erstwhile reputable companies (Enron, Tyco, Worldcom) blatantly lied to the public. This started a media frenzy that uncovered a track of dishonesty by

financial institutions (Merrill Lynch, Citigroup, Anderson) and dubious behavior by trusted figureheads (Jesse Jackson, Jack Welch, Martha Stewart). The U.S. government has also failed the people. For example, the Environmental Protection Agency (EPA) is allowing Washington, D.C. to dump highly contaminated water into the Potomac River. When all is said and done, there is little to imbue the average American with confidence in either the public or private sectors at a time when we want confidence more than anything else (*The Wall Street Journal*, 2002a).

So where does all this lead? First, we need to briefly review where we have been. The nine years of economic growth that began in 1991 were the longest in U.S. history. The economy grew over four percent annually and unemployment was low. The stock market enjoyed historically high returns and corporate high-tech investments changed the face of business, increased productivity, and elevated growth and income expectations. Business investment surged with easily available financing from the financial markets (DNP Select Income Fund, Inc., 2002). In fact, the stock market still shows a two percent annual gain over the past five years.

All the events mentioned in this paper essentially mean that we will have to face more uncertainty and market volatility, both domestically and internationally, than most of us have experienced in our lifetime. This uncertainty, driven by lack of trust, will continue for some time. However, the United States' economy is too big and its people too optimistic not to succeed. The United States, political and corporate, may be temporarily "ill", but it can cope, though it will be decidedly uncomfortable while the "illness" lasts.

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