

Mitchell's Musings 2-6-12: Hearsay Evidence

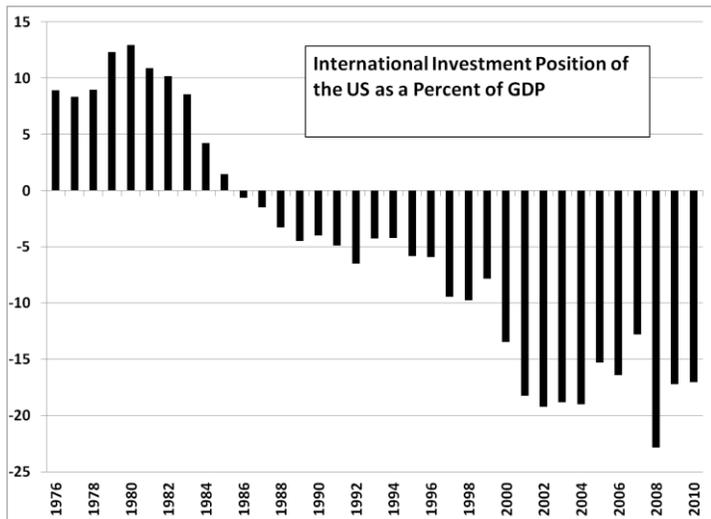
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Thomas Friedman, the New York Times columnist, noted the following in a recent op ed:

...There is today an enormous gap between the way many C.E.O.'s in America — not Wall Street-types, but the people who lead premier companies that make things and create real jobs — look at the world and how the average congressmen, senator or president looks at the world. They are literally looking at two different worlds — and this applies to both parties.

Consider the meeting that this paper reported on from last February between President Obama and the Apple co-founder Steve Jobs, who died in October. The president, understandably, asked Jobs why almost all of the 70 million iPhones, 30 million iPads and 59 million other products Apple sold last year were made overseas. Obama inquired, couldn't that work come back home? "Those jobs aren't coming back," Jobs replied...¹

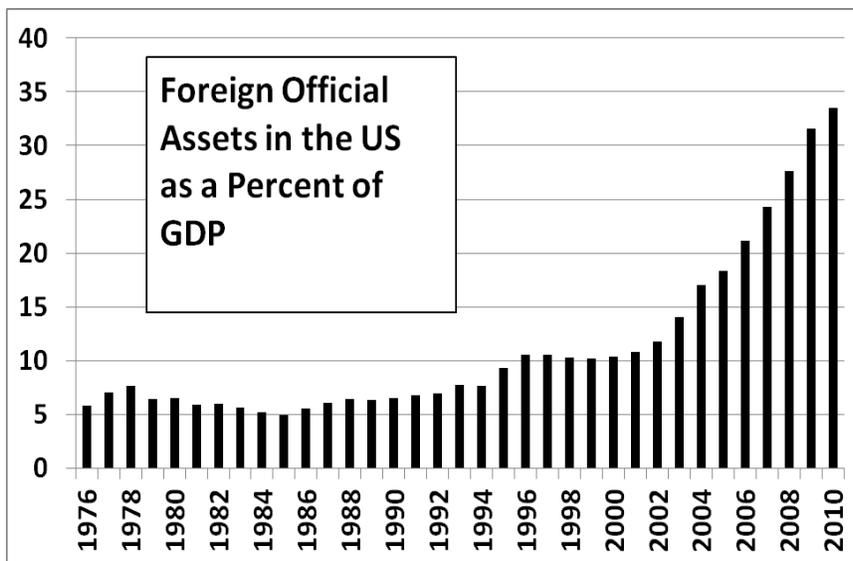
So what do we make of this excerpt? CEOs and politicians do inhabit different worlds. Neither world makes them especially acute analysts of macroeconomic trends. Nonetheless, CEOs are expert in the practice of microeconomics, which often used to be called the "theory of the firm," at least on the supply side of the supply/demand equation. In this case, the President – whose charge is more on the macro side - was asking a legitimate question. And Steve Jobs was simply telling him that at today's exchange rates, it was cheaper for his firm to produce iPhones in China. As long as the world cost structure remains as it is, the Apples of the world will continue to make their current production location decisions and "those jobs (won't) come back."



¹ <http://www.nytimes.com/2012/01/29/opinion/sunday/friedman-made-in-the-world.html>

But there is more to be said about the issue as the chart on the previous page suggests. The U.S. has net borrowed from the world to import iPhones and other goods. Can that process – borrowing for internal consumption - continue indefinitely? It shows up on the chart as a large net debt to the world that built up over a long period, but became especially pronounced in the 2000s. Although the value of the net debt fluctuates with exchange rates, simply to keep the debt from growing over the long term would require a switch from the present net export deficit to a situation in which the value of exports equals the value of imports.

To begin to *lower* the net debt would require an ongoing export surplus. That consideration is something about which Steve Jobs did not have to concern himself. It wasn't Apple's problem. But it is something that a president should be pondering. Indeed, a president might also want to concern himself with the chart below.



Foreign central banks, especially in the last decade, have been increasing their holdings (their reserves) of U.S. dollars. When they do so, they tend to keep the dollar's value high relative to their currencies. So production decisions – such as Apple's - tend to go abroad. Will foreign central banks continue to pile up their dollar reserves indefinitely? Again, that issue was not a question for Steve Jobs to worry about, but it is one which presidents and other politicians should be asking.

If you ponder these two charts and begin to think that a) ongoing borrowing to finance a U.S. trade deficit is ultimately unsustainable and b) there is some limit to how many dollars foreign central banks will want to pile up, then you will have to come to the conclusion that, one way or another, the U.S. net export balance will have to improve. Such a development will mean more export production in the U.S. and/or more import-substitution production, i.e., domestic production of goods once made abroad will move back toward the U.S. So jobs are coming back. How can you produce more exports and/or substitute more domestic production for imports without using workers? Whether those jobs are iPhone-producing jobs or jobs producing other products is yet to be determined. Also to be determined

is whether the adjustment will go smoothly or whether some new financial crisis will be triggered. For politicians looking for advice on such matters, Steve Jobs – were he still alive – and the other CEOs referenced by Friedman are not the obvious go-to persons .