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In Search of a New U.S. Economic Path in the Aftermath of the Global Financial Crisis

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A Reevaluation of the Financial and Industrial Crisis

The global financial crisis that began in 2008 was, outwardly, a result of the bankruptcy of American financial institutions. The crisis, however, has alerted us to the deeper crisis underlying not only the American financial market, but also the American economy as a whole. Multiple scholars have pointed out that the recent financial crisis stems not only from the financial sector, but also from the larger structural factors. In light of this claim, this report seeks to reevaluate whether and how the U.S. federal economic policy has been addressing and remedying the structural factors that have led to the current financial crisis.

Our research shows that, while the post-financial crisis federal policy on the economy does evince features that are divergent from those of the past policy, it is yet too early to conclude that a new policy paradigm or a fundamental shift has taken place.

In the period between the 1980s and the outbreak of the latest financial crisis, the U.S. federal government's basic approach to the economy was deregulation, especially centered on the financial sector. There was a consensus that increasing the proportion of the service sector—including the financial industry—in the overall economy was only natural in the interest of the United States' comparative advantage. Little attention has been paid to the declining competitiveness of conventional manufacturing, even though information-based and innovation-led manufacturing gained a greater public profile. While the United States has signed numerous free trade agreements during this period, these deals were more intended to open up the partner countries and therefore to secure the United States' strategic benefits than to promote the United States' economic interests. Hence, after concluding the North American Free Trade Agreement (NAFTA) in response to the economic integration of the European Union, the United States has gone on to conclude free trade agreements with other strategically important countries around the world, including some in the Middle East, South America, and South Korea. The United States' trade policy, in other words, was motivated as much by strategic interests as by economic needs. Even in promoting the United States' economic interests, the federal government went after indirect and more comprehensive benefits, such as the expansion of American financial or service companies and the improvement in the welfare of American consumers through lowered prices on imported goods.

Since the outbreak of the financial crisis in 2008, however, a noticeable change has begun to take place in the federal government's economic policy. The two-fold change involves a shift from deregulation to regulation in the domestic economy, and another shift from strategic focus to economic focus in trade. The pursuit of financial innovation and liberalization that has led to the current crisis has had to give way to the increasing regulation of the financial sector, and especially high-risk financial transactions. While this significant shift did, in part, arise in response to the onset of the financial crisis, it may also reflect the change of the U.S. administration, with the election of President Barack Obama in 2009, from the Republican Party to the Democratic Party.

Evaluation of the New Manufacturing Policy

The fact that the U.S. economic policy took a turn to manufacturing, instead of continuing to promote the financial industry as the major source of growth, may be more than a mere reaction to the financial crisis. President Obama's reaffirmation of the resolve to increase governmental funding for auto manufacturing settled the controversial debate between the Democrats and the Republicans in Congress concerning the declining American auto industry. President Obama's move was mainly a result of the recognition that manufacturing is indispensable to create reliable quality jobs for the future generations of Americans. Refusing to accept the decline of the manufacturing sector as inevitable, Congress also enacted the Manufacturing Enhancement Act in 2010, providing a wide range of measures in support for American manufacturing. Furthermore, the Obama administration also released the National Export Initiative as part of promoting the exports of American goods overseas. The federal government continues to increase its efforts to improve the price competitiveness of American companies, including support for corporate research and development and subsidies for the energy sector with a focus on the expansion of shale gas production. It is too early to tell how effective these governmental measures have been in promoting the growth of the U.S. manufacturing sector. Nevertheless, comparing the United States to other countries and regions in terms of the rates at which the exports of manufactured goods increase suggests the revitalization of the U.S. manufacturing sector. As of 2011, the exports of American goods (in terms of quantity) grew at a rate of 7.2%, and are expected to continue the upward trajectory at an annual rate of 5.3% in 2012 as well. These figures are considerably higher than the world average or the rates of other regions. More specifically, these figures are 1.5 percent points and 3.0 percent points higher than the averages of advanced countries, and are even higher than the average of emerging economies.

Table 1. Quantitative Growth of the Exports of Manufactured Goods

(Unit: %)

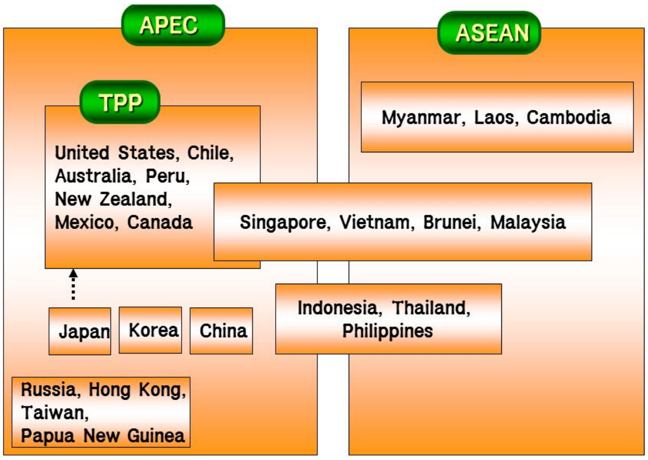
	2005	2006	2007	2008	2009	2010	2011	2012
World average (A)	7.4	9.2	6.9	2.4	-11.3	14.0	6.0	3.1
Advanced countries (B)	5.8	8.6	5.8	1.7	-13.2	14.1	5.7	2.4
Eurozone (C)	5.3	8.7	6.6	1.0	-14.2	13.0	6.9	2.5
Emerging Economies (D)	11.2	10.5	9.0	3.8	-8.0	14.0	6.6	4.0
United States (E)	7.5	9.4	9.7	6.3	-12.0	14.3	7.2	5.3
(E) – (A)	0.1	0.2	2.9	3.9	-0.7	0.3	1.2	2.3
(E) – (B)	1.7	0.8	4.0	4.7	1.2	0.2	1.5	3.0
(E) – (C)	2.2	0.7	3.1	5.3	2.2	1.3	0.3	2.9
(E) – (D)	-3.6	-1.0	0.7	2.6	-3.9	0.3	0.6	1.3

Source: International Monetary Fund, World Economic Outlook Database.

Evaluation of the New Trade Policy

The stable growth of American exports may reflect the active and pragmatic turn in the new U.S. trade policy. The Obama administration that came to power after the outbreak of the financial crisis has sought to distance itself from the past administrations by adopting a new approach to trade. In total, the new trade policy has a much stronger pragmatic emphasis, focusing as it does on expanding markets for American goods and creating more jobs domestically. Whereas the Republican Party has traditionally pursued trade liberalization as a way of ensuring American interests in general through increased trade, the Democratic Party has tended to focus on the specific benefits of trade deals, such as increases in exports and jobs. The new trade policy, however, also diverges from the conventional Democratic emphasis on strengthening environment and labor-related regulations as part of conditions for free trade agreements. The Obama administration will support the strengthening of these regulations in trading partners not to promote the causes of environmental protection and labor. Rather, the Obama administration will support these regulations only if and when pushing for such regulations will benefit the American economy by reducing imports from emerging economies. This pragmatic turn from strategic interests to economic benefits explains the increasing shift in focus from the Middle East to Asia. The Obama administration also identified the execution of the National Exports Initiative, designed to promote the domestic economic growth and the creation of jobs, as the highest-priority trade issue in 2011. A good example of the new trade policy is the increasing efforts the U.S. government is making to conclude ongoing FTA negotiations and to promote the Trans-Pacific Partnership (TPP) with the countries in the Asia-Pacific region instead.

Figure 1. Membership in the Trans-Pacific Partnership (TPP)



Source: Compiled from various sources by the authors.

Evaluation of the Financial Reform and Regulation

A similar shift has been noted in the financial policy as well. Having outgrown the traditional pursuit of financial innovation through deregulation, the U.S. federal government is increasing its regulation of the financial market. This trend is especially evident in the increasing regulation on major financial institutions that play major roles in the overall financial system; the limits on the transactions of derivatives; and the increasing demand for the transparency of credit rating agencies. Nevertheless, the post-2008 changes in the financial policy are in no way comparable to the shift of paradigm that took place during the Great Depression in the 1930s. Whereas an ideological consensus emerged, in the aftermath of the Great Depression, regarding the government's role to regulate and supervise the market, no such paradigmatic shift or consensus has emerged in the aftermath of the latest financial crisis. While the regulation on the behavior of financial institutions has increased, no major reform has been made on the structure of the financial market itself.

Political Stalemate and Legislative Efficiency

One reason for the absence of a fundamental paradigmatic shift in the U.S. economic policy after the recent financial crisis may be that this latest crisis is not as severe and far-reaching in effect as the Great Depression. Another reason, however, has to do with the persistent ideological antagonism marking the current U.S. politics. The Great Depression served to narrow down the ideological gap between the two American parties in a radical manner. The situation is reverse today, casting serious obstacles to the reforms that the Obama administration seeks to implement. Recent legislative victims to the increasing political hostility between the two parties include the Dodd-Frank financial reform bill thwarted by the opposition from the Wall Street, and the reform of the medical insurance system that was harshly criticized by the Republicans in spite or because of the reform's goal to mitigate the growing income disparity among American households.

Implications

The foregoing analysis supports the following conclusions on policy implications. First, the efforts by developed countries to enhance governmental support for domestic manufacturing sectors and limit the imports from emerging economies may seriously compromise the prospects for Korea's exports. The Korean government needs thus to develop a proper strategy to counter such prospects. President Obama's reelection is likely to increase the U.S. government's support for American manufacturing further, resulting in increased pressures on trading partners motivated by the need to protect domestic industries. These may include increasing antidumping investigations concerning automobiles, steel, home appliances, and other such goods the United States has traditionally imported. The growing competitiveness of the U.S. manufacturing sector also means increasing competition for Korea, whose manufacturing industries are already competing against those of other advanced economies.

Second, the Korean government needs to act proactively in response to the growing protectionist trend in the United States and elsewhere around the world. As the recession that was set off by the subprime mortgage crisis in the United States continues to last worldwide due to the Euro crisis, the governments of numerous countries are increasingly taking to a protectionist stance. Accordingly, the Korean government needs to minimize risks on both the domestic and external fronts, and also to diversify the markets for its exports to include emerging economies so as minimize the effect of the developed countries' increasing restrictions on foreign imports. In particular, the Korean government may need to sign free trade agreements with Canada and Mexico earlier than planned in order to strengthen the position of Korean goods in the U.S. market.

Third, the financial crisis that started off in the United States indicates the repercussions of relying solely on the integrity of individual financial institutions now that institutional investors play major roles in the economy and the transactions of derivatives among financial institutions are growing active. The Korean government needs to learn from this example and reform its supervisory system on the financial industry by extending its scope of supervision, enhancing the capability for systemic risk management, and increasing financial security. In the absence of a proper method for measuring systemic risks, however, the efforts to reform the supervisory system may backfire by inviting and increasing arbitrary government interventions with the market.

Fourth, political and ideological antagonisms decrease the efficiency of the legislature. The continuing confrontation between the two parties in the United States thus presents significant obstacles to the speedy and efficient legislation and enforcement of economic reforms. South Korea resembles the United States in that the growing ideological conflict in the legislature is feeding the widening income disparities and the growing government spending. If left unmitigated, income disparities are likely to divide up the voters along class lines. Such a division in the electorate will support neither social integration nor legislative efficiency. Great efforts are thus required to reform the Korean economic structure and market competition so that a measure of fairness is restored to the distribution of wealth and income. KIEP