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Building a Better Economy
An Interview with Lester Thurow

With downsizing the subject of major media inquiries, economic security is on everyone's lips. Jobs everywhere seem to be in jeopardy.

As economist Lester Thurow points out, reports of continual layoffs only underscore the antiquated nature of our present system. Capitalism, he says, arose when a timely ideology—a stress on maximizing individual welfare—fortuitously merged with the new technology of the steam engine, which could drive an industrial system. Yet today, such technologies as computing, which rely on human brain power rather than on rich natural resources, require an ideology that fosters collaboration on such crucial social investments as education and research and development.

Thurow has never been shy about cutting to the heart of economic issues, whether in revealing the fundamental causes of problems or in prescribing strong medicine for solving them. In magazine columns, in television interviews, and in such bestsellers as the Zero-Sum Society (1980) and Head to Head (1992), he has called for systematic public efforts to guarantee full employment and develop industries on the cutting edge of the high-tech global economy. His book The Future of Capitalism, published in March 1996, analyzes the challenges posed by "tectonic forces" sculpting a

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new economic landscape, such as the infusion of millions of workers from formerly communist countries and the advent of an unprecedented elderly population.

Formerly dean of MIT's Sloan School of Management and vice president of the American Economics Association, Thurow is currently Lemelson Professor of Management and Economics at the Sloan School. In an interview with the managing editor of *Technology Review*, Sandra Hackman, Thurow talked about the need for the United States to reject self-defeating moves toward "survival-of-the-fittest capitalism" and to embrace a thoughtful mixture of public commitment and private initiative essential to creating an economy that works.

> **Americans have the quaint belief that if your life goes to hell, nobody should come to your rescue, and if somebody does, it means you are a lesser human being.**

Technology Review (TR): Every week, we hear of another company laying off thousands of people, yet the unemployment rate is not at its historical high. How can this be?

Thurow: The United States nominally has one of the lowest rates of unemployment in the industrialized world because we don't count a lot of people as unemployed. About 7.5 million people are officially out of work, but we have another 5 or 6 million people who say they want to work but who don't meet any of the technical criteria for being unemployed in the previous week. We've also got about 4.5 million people who work part-time but want to work full-time, and we've got 8 million people who are temporary workers. We have another million people who are self-employed "consultants," many of them professionals affected by downsizing who may even have one or two customers but who would be glad to take a regular job. We also have about 2 million people who work on call and don't work if their employers don't call them. And then we have, between the ages of 20 and 60, 6 million missing men. They're not in school, not at work, not unemployed, not in jail, not retired—they're dropouts.

Overall, about a third of the labor force would like to work more than they're now working. If you have that many unemployed, you shouldn't be surprised if the law of supply and demand kicks in and wages drop. Unfortunately, instead of focusing on how to create more and better jobs, the people in Washington are spending all their energy trying to cut the social safety net, arguing that somehow everyone will hold tight and remain in the system. But we know that isn't true—even if some do hang on tight, others will fall off. We also know that people are more likely to succumb to disaster if we take away the safety net, just as when people climb mountains without a rope, they are more likely to fall. The fear ratio goes up, and as the fear ratio goes up, coordination goes down.

TR: Do you foresee serious political and social upheavals resulting from significant unemployment and falling wages?

Thurow: Not necessarily. If you reduce wages three-quarters of 1 percent a year, everybody effectively thinks, "Hey, I'm to blame." It has to do with American ideology. You see this most clearly if you compare this country with France. When the French government recently proposed making what were, by American standards, small cuts in the social welfare state, the French took to the streets. If you look at the United States, in contrast, Reagan fires all the air traffic controllers, and there's no response. AT&T gets rid of 48,000 workers, no response. The guys in Washington make rather large cuts in programs such as Medicaid and student loans, no response. Americans really do believe that if your life goes to hell, nobody should come to your rescue, and if somebody does come to your rescue, it means you are a lesser human being. We tend to give the system no credit when we do well, so we don't blame the system when we do badly.

TR: Where does this belief come from?

Thurow: It stems partly from the fact that the United States is the only country with founding fathers whom we think of as demigods. Europe evolved out of a system of feudalism that everybody understood was wrong and had to change. The interesting thing is how little the U.S. political system has changed in 200 years. For example, everyone knows that American high schools are the worst in the developed world, but we don't do anything about them because Thomas Jefferson invented local school boards, and they're deeply embedded in what we think of as a perfect system. Unfortunately, local school boards have conflicts of interest—how do you flunk your neighbors' kids and get elected?—and in any case are uniquely unqualified to run school systems. In general, school boards have no knowledge of what kids are going to need 20 years from now and no interest in the long-run success of the nation. The result is that few Americans could pass the French baccalaureate or the Japanese or German equivalent. Americans who go to college catch up with their European and Japanese counterparts, but those who don't, fall permanently behind.

To address this and other long-term problems at the heart of our economic crisis, we need to realize that people's success or failure is due not only to their own initiative but also to how well the social system works. Success is certainly not a function of the "market" alone.

TR: But, in your opinion, does the United States have to cut back on the social welfare state if we are to create more well-paying jobs?

Thurow: The social welfare state is mostly the elderly, and if you project the number of retired people we will have in 2020, we can't afford to give them what we're giving them today. We're allowing Social Security and Medicare to drive all the investment items out of the budget. So we cut research and development, we cut education, we cut infrastructure, and pretty soon—over a 20- or 30-year period—we have a budget that is all pensions and health care, and nothing is left for the investment items that every society needs.

TR: Isn't health care a major economic driver?

Thurow: If you do something for the health care of 20-year-olds, you're investing in the economy because if you can keep them healthy, they will in fact have long working lifetimes. If you do something for the health care of 70-year-olds, you're not investing in the economy—a 70-year-old's health is pure consumption.

TR: That sounds pretty hard-hearted. Are you proposing to relegate older Americans to the poverty levels common before Social Security and Medicare?

Thurow: The issue is not poverty. The average elderly person in America has a per capita income substantially above that of the average person under the age of 65. And of course, a lot of people now are retiring earlier. We're subsidizing this income heavily—retired individuals get back all the money they paid into the Social Security system plus interest in less than four years. After that, they're essentially on welfare. That means we're basically taxing poorer people to give money to richer people.

We should set up a system under which no Social Security recipient gets less than the poverty line but nobody gets more than the median income. If individuals want to do better than that, they have to rely on personal savings and private pensions. Unfortunately, politicians don't want to face up to this problem because there are so many elderly voters. The issue is particularly difficult because it is a new one for humanity; the first society in history dominated by elderly voters will occur around the year 2025. But sooner or later, we will have to devise an alternative approach because society has to have resources to invest in research and development, infrastructure, and education.

TR: What about cutting the military budget—the other major piece of the pie—to finance pensions and a range of social needs?

Thurow: The military is already down to about 4 percent of GDP. Since Vietnam, we've paid for a lot of the expansion of support for the elderly by cutting military expenditures. If you cut those expenditures by another quarter, you get a little breathing room but don't solve the fundamental problem.

TR: Why are long-term investments so important in maintaining a successful economy?

Thurow: Take what everybody says is the most exciting economic phenomenon at the moment—the Internet. Where did the Internet come from? It was paid for by the Department of Defense and the National Science Foundation 30 years before it became economically viable. Government basically kept that technology going until it could attract private investment. The same thing happened in biotechnology—the government invested for 30 years before private companies got to the point where they could make profitable biotech products. If we don't make similar investments today, we won't have new industries coming along later that can provide jobs, income, and productivity.

TR: How do we know that, if we make those investments, they won't pay off more for China, say, than the United States?

Thurow: The problem is you don't. But China is not really competing with Route 128 [Massachusetts] and other areas that develop high technology. To have a successful economy, you've got to have world-class infrastructure, you've got to have world-class skills, and you've got to do world-class research and development, and China simply isn't rich enough to do all those things. So there's room for everyone.

There are some industries—textiles is one of them—where low-wage countries have a tremendous advantage, but there are lots of other industries where low wages don't provide an advantage. The automobile industry is a good example because in the best automobile plants these days, we assemble a car with about 11 hours of labor. If you're building a $30,000 machine with 11 hours of labor, it doesn't make much difference whether you pay the workers $40 an hour or $4 an hour. And you don't do it with labor-intensive methods because you can't build a high-quality car with thousands of people swarming over it.

TR: How do we decide which projects to invest in, as well as which ones government should pursue and which ones should be left to private industry?

Thurow: With R&D, there's kind of a natural division of authority. If a project should pay off within six years, then that's something private industry can and will finance. If you're talking about something that's not going to pay off in terms of a marketable product within 10 years, it is clearly something government should finance. For between six and 10 years, there needs to be a mixture. In Europe, the government says: If you come through the door with a good medium-term project and half the money, I'll provide the other half. So what they're doing is lengthening time horizons and cutting risks, but the firm has to put up some money.

TR: The Clinton administration hasn't fared well in its efforts to secure funding for joint public/private R&D projects.

Thurow: They talked about doing that in the beginning, and then it all got buried under health care. I think the administration made a big mistake: Its three possibilities for major initiatives included a big infrastructure project, reskilling and upgrading the education of those Americans who graduate from high school but don't go to college, and health care. But that was a poor choice. Reforming health care was never something that was going to happen within two years—it would more likely take eight years. Americans don't like paying for health care, but they're also reluctant to change an existing system. Plus, health care is a consumption item.

I think the choice should have been infrastructure because it is an investment item and because projects such as building bridges are visible and can be accomplished within a reasonable period of time. Also, the great thing about infrastructure is that we know how to do it.

TR: What kinds of projects should we fund?

Thurow: One area clearly is high-speed rail transportation between major cities within 200 miles of each other. We could also speed up the process of wiring the country with fiber optics. And we could improve our roads and bridges, which we have basically let rust. Those efforts not only stimulate the economy but they provide a lot of jobs, and they're generally well-paying jobs.

But the most important "infrastructure" investment is education. No private company would ever pay for producing a college graduate. Sixteen years of money in before you get any money out? It doesn't meet capitalist criteria. Yet producing college-educated adults is terribly important in terms of maintaining a successful economy. And no society in the world has ever become literate without being willing to invest substantial funds in public schools.

Basically, we have to understand that

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we live in a different world than we did in the 1950s and '60s. It's now a world that depends much more on knowledge industries than on natural resources, which you either inherit or you don't inherit (and nobody inherited more than we Americans). And those industries, just like the people who work in them, have to be incubated over a long period of time.

TR: Even if we educate Americans better and boost funding for research and development and infrastructure, will enough well-paying jobs result?

Thurow: They will if we allow the economy to expand. The Federal Reserve Board is using high interest rates to hold economic growth to 2.5 percent. To generate good jobs for most people, you have to be willing to forgo the war on inflation that's already been won and let interest rates drop further. You also need a global economy that's growing faster, which means putting pressure on other countries to let their interest rates fall and their economies expand.

TR: Do we also have to use trade negotiations to open up other countries to what we are selling?

Thurow: The problem is not other economies—it's Japan. At some point, the United States and the world have to solve the Japanese problem, which is that nobody has been successful at selling products in Japan. The Japanese have been running a $140 billion trade surplus with the world, about half of that with the United States.

Unfortunately, President Clinton hasn't been willing to threaten the Japanese so they will take seriously his demands that they buy more U.S. goods. What we've been doing thus far doesn't work. Talking doesn't work. Negotiating doesn't work. Yelling and screaming don't work.

We have to give up the idea of intervening directly in the Japanese economy while also finding a way to correct today's serious trade imbalance. Rather than trying to force the Japanese to open up specific sectors such as automobiles and rice, we ought to insist simply that they buy roughly as many goods from us as they sell to us. If, for example, the Japanese buy $100 billion worth of our products in any given year, we should allow them to sell $110 billion worth of products to us the following year. That way, the ball is in their court—they can decide what they want to import, or even *whether* they want to import.

TR: What do you think of Patrick Buchanan's suggestion that we impose high tariffs on Japanese goods?

Thurow: I'd rather give the Japanese an incentive to expand their imports than prevent them from continuing to export to our economy.

TR: In any case, shouldn't our first concern be to get our own house in order?

Thurow: Yes. At the moment, we're selling the idea of survival-of-the-fittest capitalism while forgetting about the community itself. If you don't make the basic infrastructural and social investments, you gradually see a stagnant economy. If you remember your high school history, teachers used to talk about all these wealthy societies that fell apart because people quit investing in their irrigation canals. The Moors had elaborate irrigation systems in southern Spain, and the Incas had comparable systems in Peru. When the Spanish conquered those two societies, they didn't make the social investment in the canals, and half a century later those once-rich places were poor.

TR: Are we capable of learning such lessons?

Thurow: That depends. When something dramatic happens—for example, the 1929 stock market crash—societies usually reorganize themselves to prevent it from happening again. What people find much harder to deal with is a slow decline—say, of one-half of 1 percent per year—that we look back on 25 years later and say, "Hey, that was a big deal."

TR: How can we snap out of our lethargy?

Thurow: We have to follow Chairman Mao's dictum that a journey of a thousand miles starts with the first step, and the first step is to choose some highly visible project that evokes national pride the way the moon project did—for example, a world-class high-speed rail line between San Diego and San Francisco or between Boston and New York. Such projects would not only provide a more efficient transportation system and local jobs but excite people about American technological prowess, underscore the government's commitment to serving its citizens, and awaken us to the possibilities for building a better economic future.

Sandra Hackman is managing editor of Technology Review, *Massachusetts Institute of Technology (MIT), Cambridge, Massachusetts. Lester Thurow, a professor of management and economics at MIT and the coordinator of the school's Asia-Pacific Initiatives, will be a keynote speaker at ICMA's 83rd Annual Conference in Vancouver, British Columbia, Canada, September 14–17.*

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