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The Director of Central Intelligence
Washington, D.C. 20505

National Intelligence Council

NIC #01530-88
29 April 1988

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

VIA: Chairman, National Intelligence Council

FROM: David D. Gries
Vice Chairman

SUBJECT: NIC Research Study Entitled "The United States in the
Global Economy in the Early 21st Century"

Last January I mentioned my plan to start a research project on how the US economy would compare to other key economies in the early 21st century. The outline for this project (attached) is now out for comment to elements of the CIA, the Intelligence Community and outside consultants. Relying primarily on charts and graphs to convey findings, the project will examine where the US economy is today in relation to the global economy, where current trends are leading the US economy in relation to the global economy and what factors could change this scenario. Ken Brown of the NIC Analytic Group is helping me.

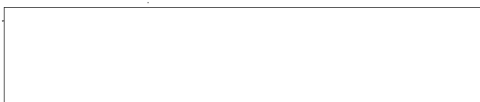
Although this is an unusual kind of project--and hence will probably be called a research study rather than an Estimate--I believe there is a policy-level audience for it. Secretary Shultz has shown interest in analyses that examine the future of the world economy, and a new administration could find some of the conclusions relevant to policy issues.

The project should be completed by July.



David D. Gries

Attachment: As Stated



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SUBJECT: NIC Research Study Entitled "The United States in the Global Economy in the Early 21st Century"

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THE UNITED STATES IN THE GLOBAL ECONOMY IN THE EARLY
21ST CENTURY

The purpose of this project is to present data that shed light on these basic questions:

- Where does the US economy stand in relation to the rest of the world, and what changes are currently taking place?
- Where will likely trends take the US economy (again, in relation to the rest of the world) by the early 21st century?
- What factors would alter these scenarios and lead to improvements in the ostensible outcomes of these trends?

The following is an outline of the paper that is planned. It will consist mainly of graphs and tables, identified below in brackets [], most of which will pertain to the United States, Japan, and major European nations; in some cases data for the East Asian NICs will be included. The text is meant to give a brief, objective interpretation of the data.

I. The United States in relation to the world

The US standard of living is still the highest, by most measures, though not far above that of the major industrial nations.

[GNP, measured in terms of purchasing power parity, US et al.]

[Home ownership, auto ownership, telephones per capita, US et al.]

The US economy is changing. The shift to service industries continues, as it does in all industrial countries, though the share of output originating in manufacturing is fairly stable. US share of manufacturing jobs is also stable.

[Share of output in services, US et al. This would show service share of each country's output, for several years.]

[Share of jobs in manufacturing, US et al. This would show each country's share of the total number of manufacturing jobs, for several years.]

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Despite these shifts, the number of jobs continues to rise, and at a much faster pace than in other industrial countries.

[Trends in number of employed, US et al.]

The US economy continues to "internationalize," which is in accord with worldwide trends. Internationalization has many dimensions. Exports as a portion of GNP have risen steadily for most major countries. Capital flows have increased greatly, and stock ownership by foreigners has increased. Linkups among technology producers have multiplied.

[Trends in Exports/GNP, US et al.]

[Trends in gross trade surpluses and deficits, world totals, as tabulated in unclassified data in OGI report.]

[Foreign ownership of US equities and Japanese equities.]

[Trends in international linkups in technology, as tabulated in unclassified data in CIA report.]

By several measures, the United States' share of the world economy is diminishing somewhat. The US share of world GDP and exports is declining slowly. While it is hard to measure industrial "competitiveness," the United States is a leader in fewer industries than in the past. In international finance, the Japanese dominate the list of the largest financial institutions. The dollar, though still the key currency, is relatively less widely held than in years past. It must be emphasized, however, that the changes have been gradual, and that the United States remains economically preeminent by most measures.

[Trends in shares of world GDP, US et al.]

[Trends in shares of world exports, US et al.]

[For selected years, the number of industries in which countries (US, Japan, Germany, UK, France, and "all others") have a 20 percent or greater share in world exports.] This chart also illustrates increasing internationalization, since progressively fewer industries are dominated by any one country.

[Ranking of top ten financial institutions, with national affiliations.]

[Trend in share of world monetary reserves held in dollars.]

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The military balance, measured in terms of resources devoted to the military, has not changed much. The burden of defense varies significantly from country to country.

[Military spending as percent of GNP, several years, US et al.]

[Military personnel per capita, US et al.]

While change in the global economy is to be expected, some trends are disturbing. Productivity growth in the United States seems to be chronically slower than in other industrial countries. Consequently, growth in real hourly earnings has been relatively slow. The low rate of savings in the United States requires capital inflows in order to maintain investment in factories and equipment. Worldwide, debt has grown rapidly during the past decade, and this reduces the stability of the world economy.

[Trends in output per worker, US et al.]

[Trends in hourly earnings, US et al.]

[Savings as percent of GDP, US et al.]

[Trends in private and public debt, US et al., world totals.]

II. Where are current trends leading?

Judging strictly from the numbers, the United States will have a smaller role in the world economy at the turn of the century. Its share of the world's gross domestic product and industrial production will be somewhat smaller. Its share of population will decline somewhat too, though not nearly as much as that of Western Europe.

[Forecast of shares of world gross domestic product, US et al.]

[Forecast of industrial production, US et al.]

[Forecast of shares of world exports, US et al.]

[Forecast of shares of world population, US et al.]

(Note: The above forecasts are by Data Resources, Inc.).

The United States' smaller economic share is not merely a consequence of a smaller share of the world's population. Because of slow productivity growth, US living standards will not improve as rapidly as those in Japan and some other industrial countries. A decline in the portion of the

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population that is in the labor force will also contribute somewhat to lagging living standards.

[Forecast of GDP per capita, US et al.]

[Forecast of dependency ratios, US et al.]

Technology will be perhaps the most enduring advantage that the United States has. The United States will continue to be the major center of scientific research, though other nations--particularly Japan--will catch up in some aspects. The United States will maintain its lead in many significant technologies and will probably show the greatest growth in the use of computers and other high-tech products. The US will continue to be a magnet for graduate students in science from all over the world.

[Forecast of use of high-tech equipment, US et al.]

[Forecast of technology leadership areas (?)]

[Foreign student enrollment (?)]

Though the US share of the world economy will be smaller than it is now, no other nation will become a clear leader. Much of the international growth will take place in Asia, where only Japan is in any position to challenge the United States for economic leadership. Thus, economic power will be spread more widely without the United States necessarily falling behind any particular country.

III. Sources of possible change in this scenario

Declining relative economic power has unattractive implications, particularly for foreign policy. Can anything be done to change the outlook presented? This report makes no policy recommendations, but merely tries to list the sources from which change could come. The data that follow are intended to show how well the United States currently compares with other nations with respect to these sources of economic growth.

Technological progress has been identified by virtually every economist who has studied the subject as the most important source of economic growth during this century. The United States will continue to spend more money than any other nation on R&D, though Japan is catching up rapidly. Other nations are taking advantage of US universities and laboratories in order to advance their own scientific capabilities. About half of US R&D goes to military applications (far more than in Japan or Europe), which have much less commercial payoff than private R&D. Basic research as a portion of all R&D is somewhat lower in the United States than in Europe, though about the same as in Japan.

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[Trends in spending on research and development (government and private), US et al.]

[Trends in spending on basic research, US et al.]

[Trends in the number of foreign science students in the United States.]

[Number of researchers: Japanese in US, US in Japan]

[Trends in the number of US patents issued to residents of foreign countries.]

The share of GDP invested in new plant and equipment is smaller in the United States than in other major industrial countries, an ominous sign for future economic growth. Some research has concluded that the cost of capital is higher in the United States than in Japan.

[Forecast of fixed investment as share of GDP, US et al.]

[Hatsopoulos data on the high cost of capital, US vs Japan]

Workers' skills are an important ingredient in economic growth. Skills are reflected somewhat in productivity measures (which also are influenced by the quality of plant and equipment that workers are given to use), and it has already been shown that productivity growth is lagging. The skills of the labor force in the year 2000 are foreshadowed by the quality of education now being imparted; by that measure the United States lags badly, particularly in science and mathematics.

[Comparisons of general scholastic achievement, US et al.]

[Comparisons of scholastic science achievement, US et al.]

Much has been written about the superiority of certain Japanese management techniques. In recent years, US companies have tried to copy some of these methods, though no data are available to measure the extent of such changes, much less their effects. US business has, according to a variety of reports, made progress in reducing the number of levels of management and in pruning away excessive corporate staff.

[Ratio of managers to production workers, for selected industries, US et al.]

[Other comparisons, yet to be documented, that will illustrate differences in managerial techniques, mobility, remuneration.]

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Entrepreneurship and the dynamism of small firms: the United States appears to have an advantage stemming from the vigor of its small-business sector. New, small high-technology firms have made many product innovations. Venture capital is much more plentiful in the United States than in Europe or Japan.

[Venture capital funds, US et al.]

Government actions can help or hinder growth. High taxes, interference with market prices, and and over-regulation are generally regarded as negatives. Government spending as a portion of GDP has been drifting upwards in most industrial nations. Japan has the highest taxes on income (though on a relatively narrow base of taxed income). Several nations do not tax capital gains, though the United States does. The United States has the highest degree of private ownership of major sectors of the economy. Agriculture (one of the few areas where comparable data on subsidies are available) is generally highly protected and subsidized.

[Government spending as percent of GDP, US et al.]

[Social spending as percent of GDP, US et al.]

[Budget deficits as percent of GDP, US et al.]

[Tax rates on personal income, corporate income, capital gains, US et al.]

[Degree of privatization of key sectors, US et al.]

[Subsidies to agriculture, US et al.]

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