

How a Regional Economy Works, Economic Development Strategies, and the Economic Threat from 'Free Trade'

Bob Powell, exponentialimprovement.com, 8/21/06

The purpose of this short paper is to illustrate how an economy works, from a regional economy within the U.S. to the U.S. economy as a whole. Then "how it works" is linked to the U.S. trade deficit and its associated threat to the U.S. economy. The threat is serious; the U.S. faces economic collapse within a 2 – 3 years.

The Basic Structure

The diagram at right portrays a model of "How Does the Colorado Springs Area Economy Work" from a 2003 Economic Development Corporation presentation. Rocky Scott, then president of the Colorado Springs EDC, regularly included this slide in his PowerPoint presentations to educate his audience on the importance of the EDC's emphasis on attracting what are known as "primary" employers.

It's an important model.

It shows that employers that sell to outside the region bring dollars into the community that are circulated and recirculated many times. The model shows that these dollars are eventually used to purchase goods and services from outside the region.

Most people seem to understand that this model conveys an important understanding of the Colorado Springs economy and policies needed to improve it. I never heard anyone challenge it.

This model is as valid for a state or national economy as it is for Colorado Springs.

However, I encounter many, even economists, who appear to not truly comprehend its implications as they are not all that concerned about the U.S. trade deficit. A large and growing U.S. trade deficit is a threat to the U.S. economy just as a similar deficit would be to the Colorado Springs economy.

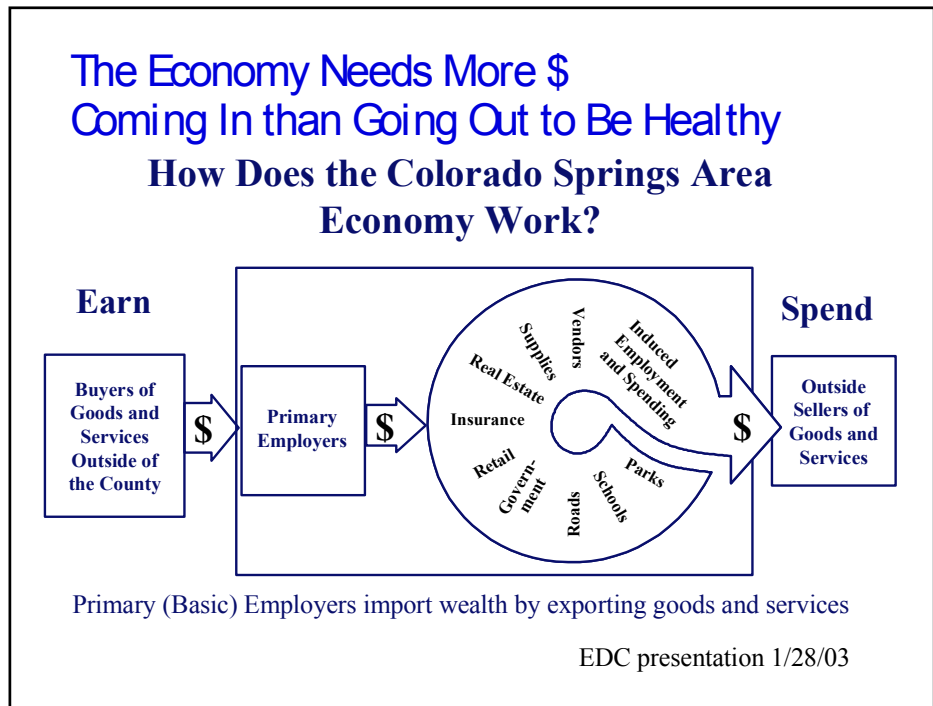
The loss of manufacturing companies and jobs and the accompanying decline in the production of exportable goods is the national equivalent of the loss of primary employers. The increasing gap between imports and exports is a result of a lack of primary employers nationally and not "earning" enough dollars from outside the country.

The need for these "primary employers" is, I submit, critical for a healthy U.S. economy and even critical if the U.S. is to maintain national sovereignty.

This paper uses this diagram to consider the

- basic structure of a local economy like Colorado Springs.
- impact of Wal-Mart-like stores.
- U.S. economy and the trade deficit

It also includes data on how the Colorado economy is faring.



Showing the Exchange of Goods and Services for Dollars

The modified diagram below shows the exchange whereby “Primary Employers import wealth by exporting goods and services”: goods and services are created and sold in exchange for dollars brought into the region.

Why Primary Employers Are Important

“Primary” employers” are employers that bring more dollars into a region than they spend outside a region, making dollars available to be spent at local businesses, dollars that are circulated and re-circulated within the community.

Primary employers are important because dollars coming into a region must exceed dollars going out for an economy to grow. For a stable economy, dollars coming in must equal dollars going out. An economy will be in decline if dollars coming in are less than dollars going out. This is basic arithmetic.

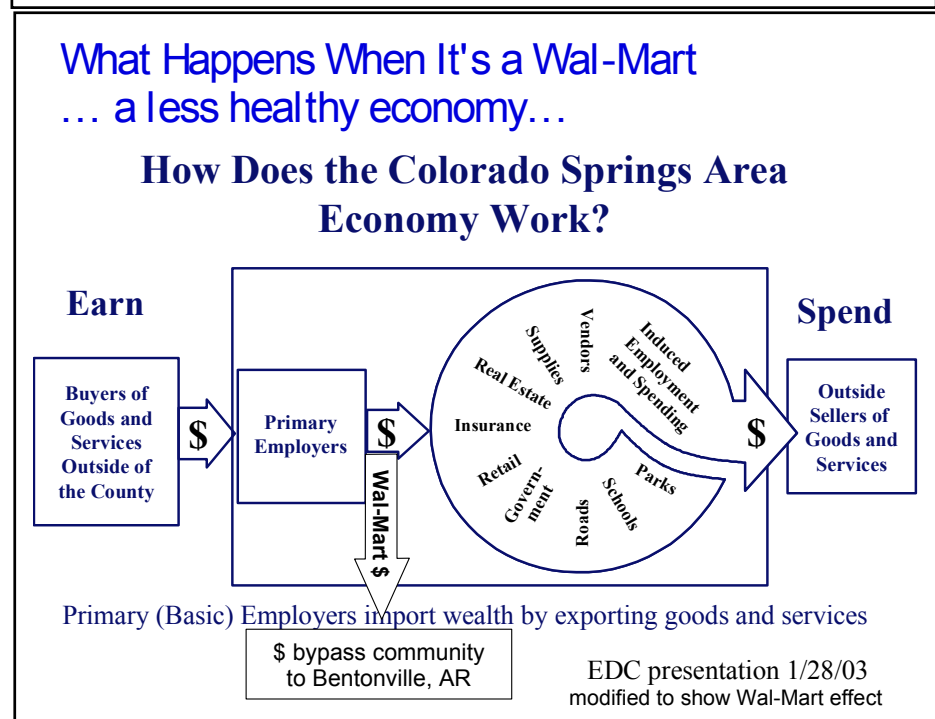
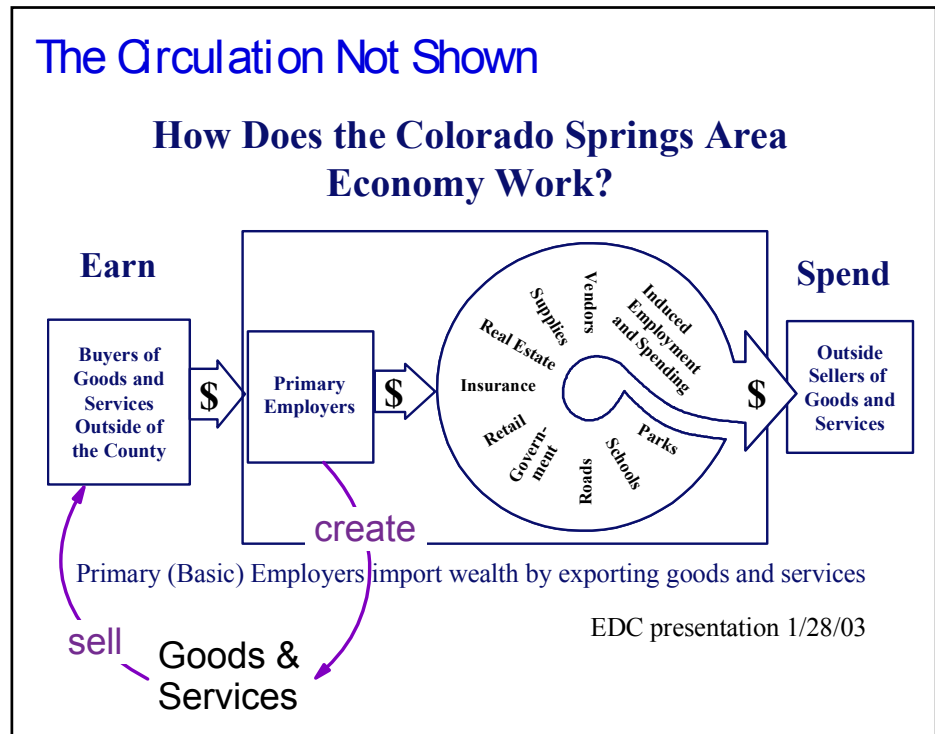
“Primary employers” are generally thought of as the “big corporations.” They are the ones usually targeted for attraction. But any company, small or large, that has more dollar sales to the outside than dollar costs going to the outside will fit the bill. They are beneficial to encourage and attract as long as those incoming dollars are allowed to circulate within the community.

A problem has been that Colorado Springs typically doesn’t get company headquarters and loses them during a business downturn.

Therefore, focused initiatives to attract small, as well as large, primary employers would benefit the economy. It would also help to diversify the economy.

The Impact of Wal-Mart-like Companies

Making dollars available to be



spent locally does not mean they *will* be spent locally, as this Wal-Mart example illustrates. Every night Wal-Mart ships dollars out to Bentonville, AR, as shown in the diagram above. Those dollars don't circulate in the local economy.

Wal-Mart-like companies are therefore somewhat the polar opposite of "primary employers." They do not produce exports. They displace local businesses that would be more likely to spend dollars locally. *And* they send dollars that might otherwise be available for circulation to outside the region. While some of Wal-Mart employee wages will be spent within the community, many of these employees also shop at Wal-Mart, so many employee-spending dollars also immediately leave the community.

What to do to Grow the Colorado Springs Economy

For a secure Colorado Springs economy, one would be advised to adopt policies to:

- Increase the amount companies sell to the outside by attracting small & large primary employers.

An initiative that promotes industry that exports goods from the region is the Colorado Springs Manufacturing Task Force, initially formed by the EDC, to promote the growth of higher-paying manufacturing jobs, primarily now through four initiatives: Knowledge Distribution / Sharing, Innovation Support, Increased Manufacturing Excellence, & Cooperative Area Marketing.

To attract primary employers, Colorado must invest in education for their families and in infrastructure to support their ability to do business. Opposing Colorado's ability to do this is a very real and troublesome danger to the economy.

- Not attract companies that don't circulate dollars from sales within the region.

Don't provide incentives to attract Wal-Mart-like companies to Colorado. Encourage them to leave if they do not change their purchasing practices.

- Attract companies committed to circulating dollars within the region.

An example that encourages this circulation is the Pikes Peak Regional Portal website: [Urban Embers](#), a Colorado Springs Online Business Directory start-up promoting local business connections that recently presented to the [Peak Venture Group](#), a local organization that supports entrepreneurial activity. Campaigns like "Always Buy Colorado" exploit this.

Attract companies committed to keeping jobs in Colorado.

The same kind of thinking would apply to the state and national economies.

The Tabor, Gallagher and Amendment 23 Growth Dilemma.

Tabor, Gallagher and Amendment 23 are symptoms, not causes, of Colorado's budget problems. While Referenda C and D were worthy of support to address immediate budget shortfalls, they also addressed symptoms, not causes.

While growth provides short-term economic benefits in that taxes associated with new development covers short-term costs and provides a short-term stimulus to the economy, we must eventually face the reality that those taxes do not cover the long-term costs of growth that appear years after initial development approvals as population expands. The growing infrastructure backlogs in Colorado Springs and the nation make this evident. The national 5-year infrastructure backlog is \$1.6 trillion ([ASCE](#)). Also, see the August 23, 2006 New York Times article [Things Fall Apart: Fixing Americas Crumbling Infrastructure](#) By NICHOLAS KULISH (also posted at [America's Crumbling Infrastructure](#)).

Attempts to pass those costs on to the public in higher property & sales taxes provoked public opposition that led to the passage of Gallagher and TABOR (similar to the earlier Amendment 13 in California). As additional growth put ever greater strain on funding of public education, education funding lagged; citizens responded by passing Amendment 23 to reverse the trend. Long-term costs include fire and police protection, courts, schools, libraries, and other public services. Traffic congestion increases, prompting demand for more road

building. More road building encourages even more growth and the cycle continues. The structure driving this is the same as addiction to drugs: get a short-term benefit at the cost of long-term degradation in quality of life.

While Referendum C passed statewide, it did not pass in El Paso County, even though it was not a tax rate increase, because the public here has an especially low tolerance for taxes. "Conservatives" tend to deny the need for taxes to support the commons necessary to support commerce. I contend that not funding infrastructure to support commerce is not a conservative policy.

It would be a wise move on the part of industries benefiting from new development to support impact fees to cover those long-term costs and maintain quality of life, the primary contributor to Colorado Springs attractiveness, to avoid "killing the goose that laid the golden egg." For those who believe in market forces, it's important that both the short- and long-term costs associated with a product be covered in the price of a product for the market to properly value and determine economic choices.

Given the current mix of policies, there will never be enough state and local funding to deal with ever-increasing infrastructure requirements. These costs must be dealt with as noted above. If this is done, there should be sufficient funding for infrastructure maintenance and other needed government services without overly burdening the public with property and sales taxes.

This Diagram is Also Relevant to the U.S. Economy

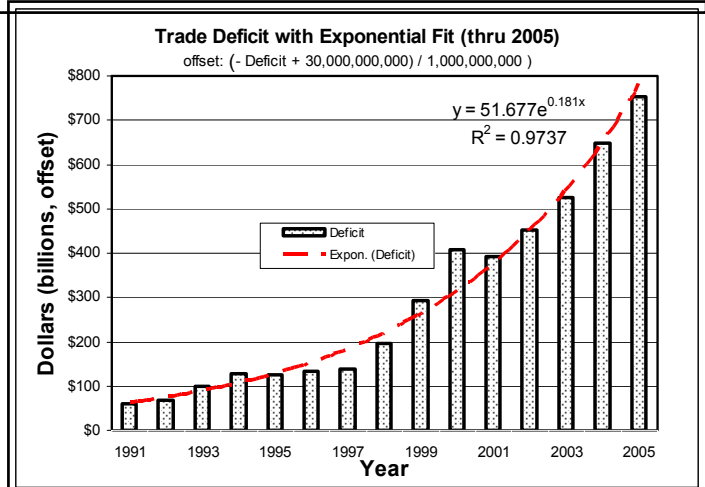
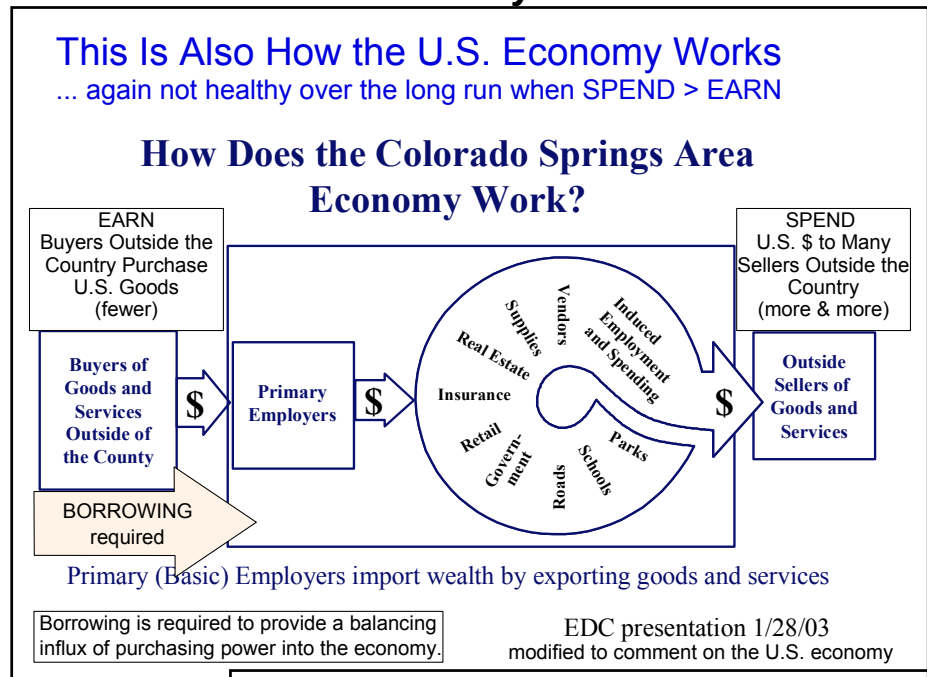
It's disturbing that many who understand how the model accurately depicts the situation for the Colorado Springs economy do not appreciate that the situation is the same for the U.S. economy.

When I expressed concern about the rising trade deficit and the increasing borrowing required, one economist said, "Well, if China wants to lend the U.S. money at low interest rates, it seems like a good deal to me." Sorry, but this is a myopic response that misses a major threat.

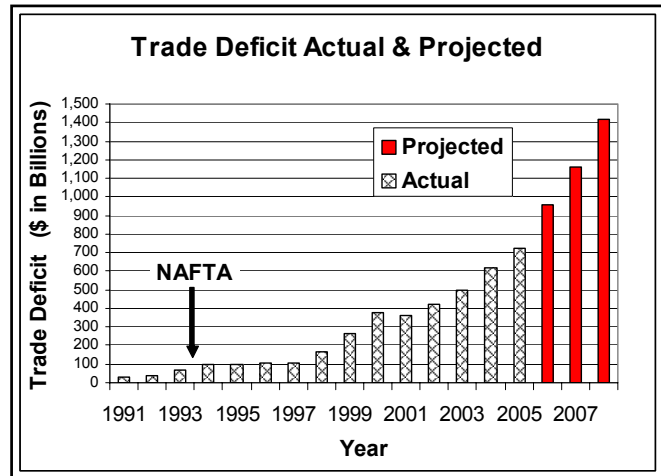
Deficit = Imports – Exports = Dollars Borrowed.

The 2005 trade deficit was ~\$723.6B, which was ~6.5% of 2005 GDP (\$11,135B). This borrowing is literally unsustainable. The chart at right shows that since 1991 the fit to an exponential curve is almost perfect [... with the best vertical axis offset, $R^2 = 0.9737$ for 1991 thru 2005 ... an $R^2 = 1.0$ is a perfect fit].

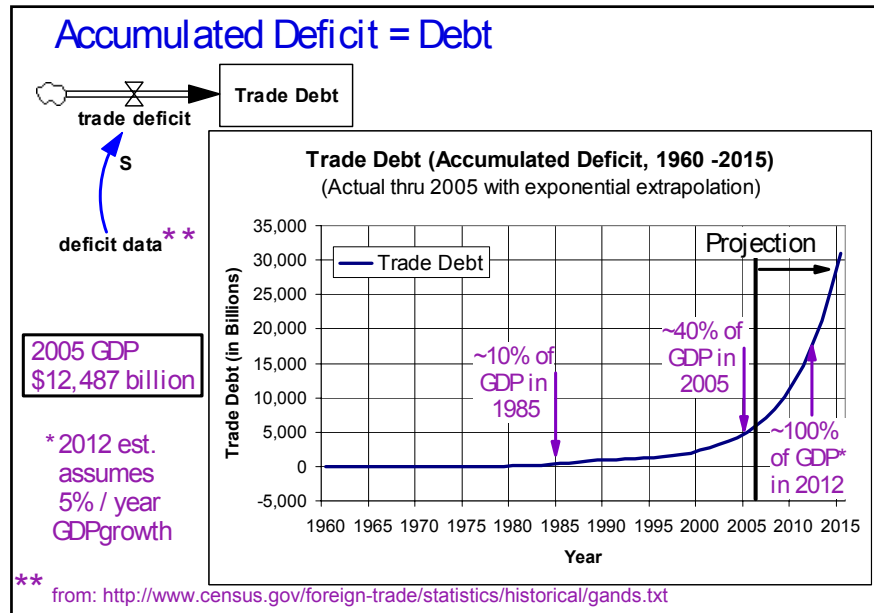
As shown in the diagram above, trade deficit dollars must be borrowed to make up for the shortfall. The national economic situation is serious because no exponential increase can continue forever. Period!



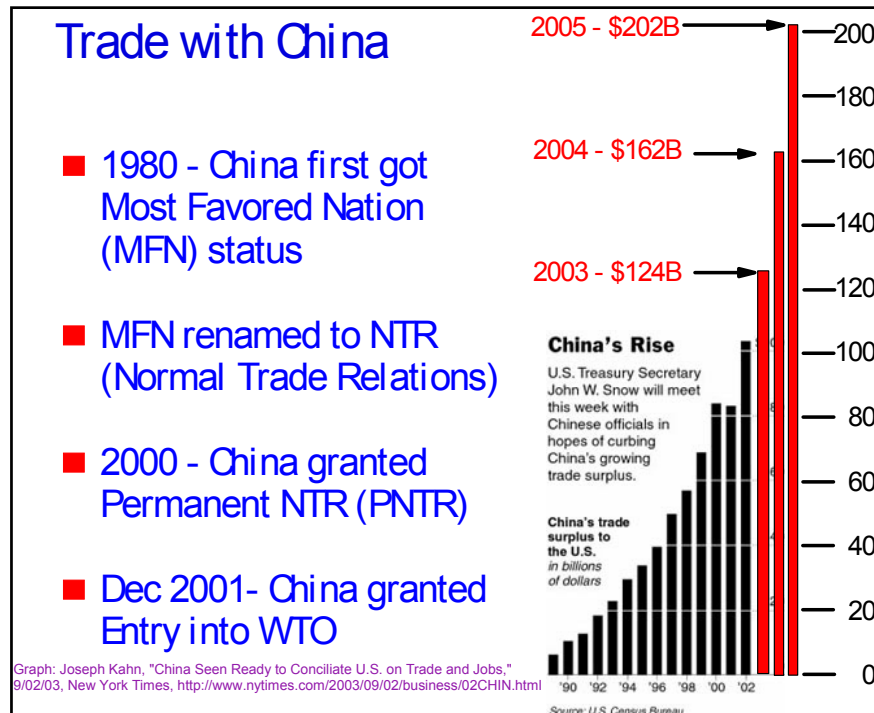
Given the current trend, the projected 2007 trade deficit is \$1,164B or ~10% of GDP.



Given the current trend, assuming a 5% per year growth of GDP, the projected 2012 trade debt (accumulated trade deficit) will equal ~100% of GDP.



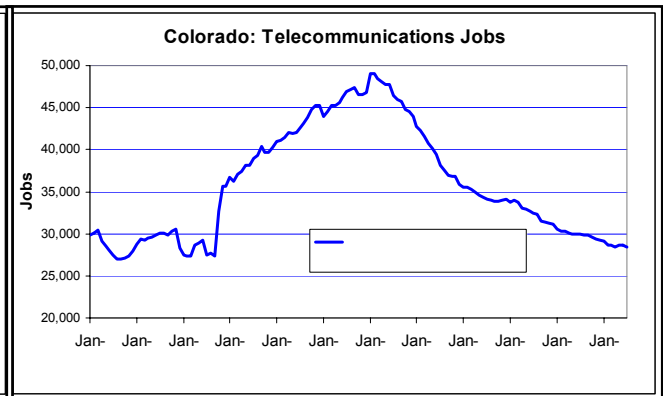
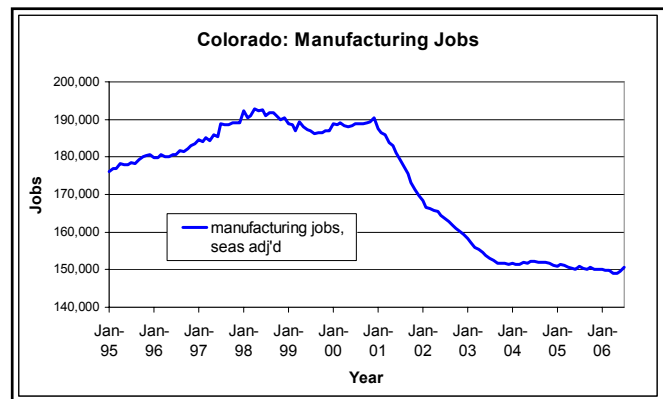
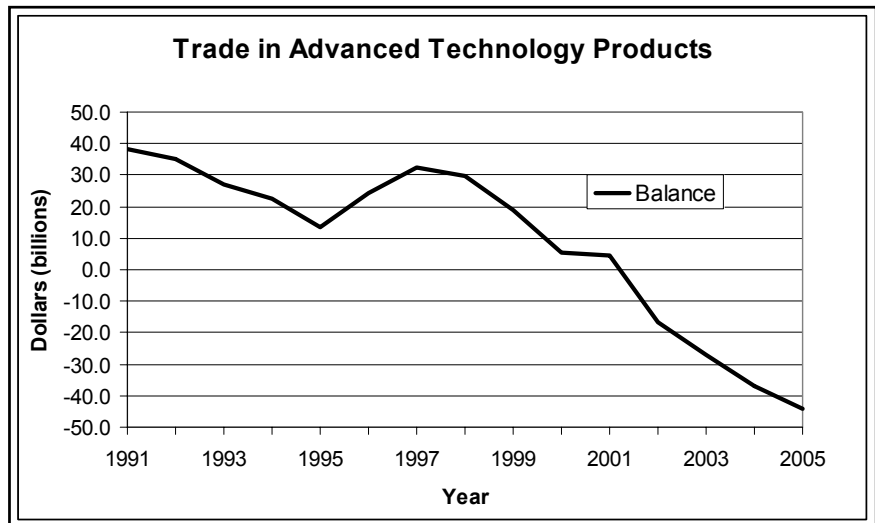
The trade deficit with China alone has doubled to \$200B from 2002 to 2005. This chart adds later data to a 2002 NY Times chart.



Many say that “trade” is good, just “get with the program.” The U.S. must simply move up the technology ladder to do high-tech work and leave the lower-skilled work to low labor cost countries.

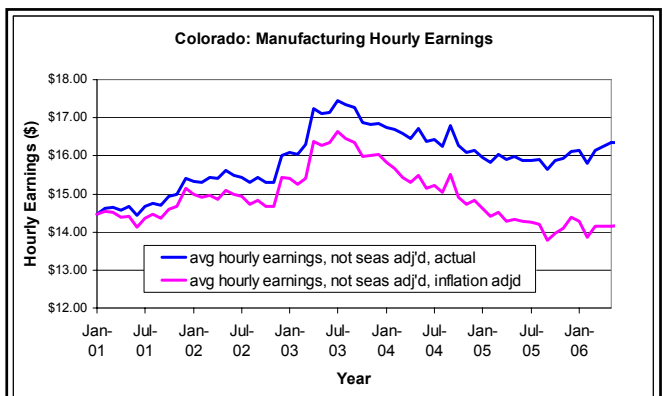
But looking at the facts dispels this myth. Over a period of 14 years, U.S. “trade” in Advanced Technology Products went from a \$40B surplus to an over \$40B deficit. ([ATP trade data link](#) ... one has to go into 15 different files to get the data for each of the 15 years ... it’s almost as if some don’t want this known). The data shows that the U.S. is losing high technology jobs as well as manufacturing jobs. The U.S. is moving down the technology ladder, not up.

This chart and other data also point to the fallacy of the, “if you’re displaced, just get retraining” myth. Since Jan 2001 Colorado has lost about 40,000 (39,900) manufacturing jobs. And from Jan 2001 to Jul 06 Colorado lost 20,700 telecom jobs and 37,100 information technology jobs. These were the jobs for which many retrained when they lost a manufacturing job.



In these three categories alone, that’s a loss of 97,700 good-paying jobs. Replacement jobs are at a considerably lower pay in hospital work, prison guards, and casinos. No jobs, except low-level service jobs, are safe from offshoring.

The result is that wages are falling. Manufacturing hourly earnings are up \$2.01 from \$14.45 in Jan 2001 to \$16.46 in Jul 2006, but they’re not keeping up with inflation – adjusted for inflation the hourly wage is down \$0.19.

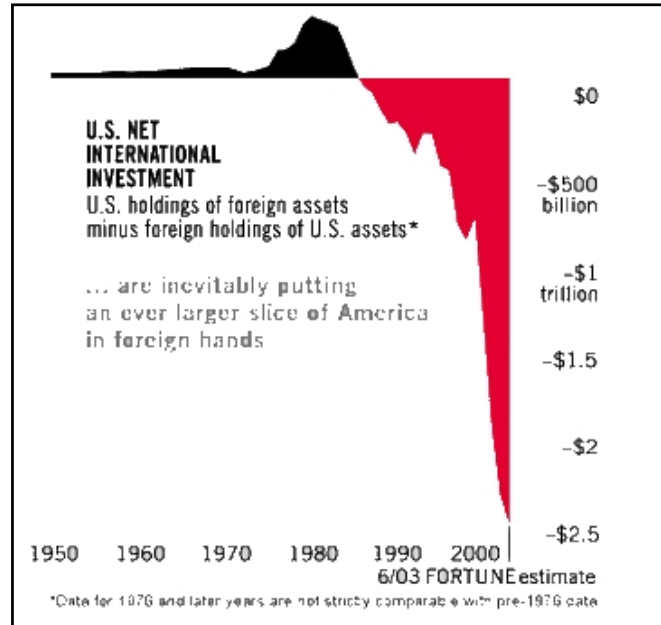


In addition, more and more of America is being sold to countries from which the U.S. is borrowing. The chart below is from Warren Buffett’s [October 2003 Fortune Magazine article](#). Because an exponentially-

increasing trade deficit is unsustainable -- borrowing will not be able to keep pace indefinitely -- he predicts a dollar crash. He advises investing in foreign currencies and foreign enterprises to protect investments -- and he's following his own advice.

Another important issue is that much of what we're talking about is not "trade" in the ordinary sense. Trade is when I sell you something and you sell me something. Corporations build components in foreign countries, or ship components to foreign countries for assembly, and ship them back to the U.S. for sale. That's "transfer of the factors of production," specifically it's labor arbitrage, not "trade."

As long as offshore pay is lower than in the U.S. and there's a global glut of production capacity that forces competition based on price, offshoring will continue. It will continue until U.S. wages and Chinese wages equalize. Given that Chinese wages are a tiny fraction of U.S. wages and there are an order of magnitude more Chinese workers than U.S. workers, this means U.S. wages will fall a lot and Chinese wages will increase very little.



For an explanation of the dynamics of "trade," see [The Trade Deficit and the Fallacy of Composition](#) and other links on that page. For an explanation of the flaws inherent in the arguments for "free trade," from "it's valid due to comparative advantage" to "don't include labor and environmental standards," see [A Systems Thinking Perspective on Manufacturing & Trade Policy](#); it also describes needed policies to avoid catastrophe.

The outcry from "free traders" is that we must not become "protectionist" (except of course for protection of intellectual capital like patent and copyright protections). But what's more worthy of protection than the U.S. economy? A strong military won't be possible without a strong economy -- that's what sank the Soviet Union.

In brief, here's what must be done.

The first thing to do is to immediately stop "reverse protectionism." That is, halt the U.S. subsidies for offshoring. There are many ... here are a few:

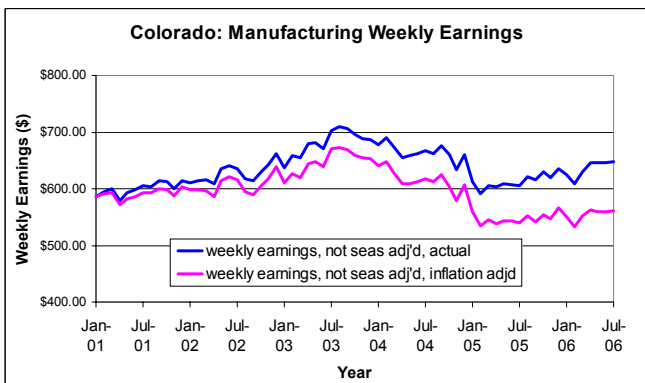
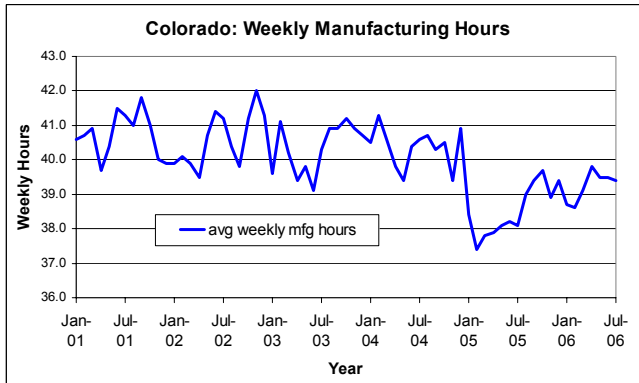
- Tax deferments: Companies can defer paying taxes on income from foreign subsidiaries ... indefinitely.
- Tax loopholes: such as moving headquarters to a tax haven.
- Investment tax credits: Providing R&D and other investment tax credits for companies that offshore manufacturing, where the U.S. doesn't fully benefit from the investment.
- Transfer pricing schemes: Corporations engage in transfer pricing schemes to avoid U.S. taxes, e.g., they sell components to foreign subsidiary with very low profit markup, and buy back product after manufacture with a very high foreign profit markup.
- Tax deductions for plant shut down for offshoring: Corporations are allowed to write-off the cost of domestic plant shut-down when they transfer the work to a factory in a foreign country.
- Tax deductions for training foreign employee replacements: Deducting the cost of bringing new foreign employees to the U.S. and requiring its U.S. employees, as their last duties before being fired, to train the foreign employees to do their jobs.

But because there are so many factors affecting offshoring (currency manipulation, tariffs, labor & environmental standards, tax loopholes, etc.), the only viable way to reverse economic decline is to adopt Warren Buffett's outcome-based approach for balanced trade (see his [October 2003 Fortune Magazine article](#)). He proposes a market for Import Certificates: You buy from the U.S. and you can sell an equal amount to the U.S.; if you don't want to sell to the U.S., you can sell your Import Certificates to someone who does. We can't live with "free trade." And even fair trade won't do it. What we need is mutually-beneficial, balanced trade.

The next section contains more data on how Colorado is faring.

The Impacts on Colorado

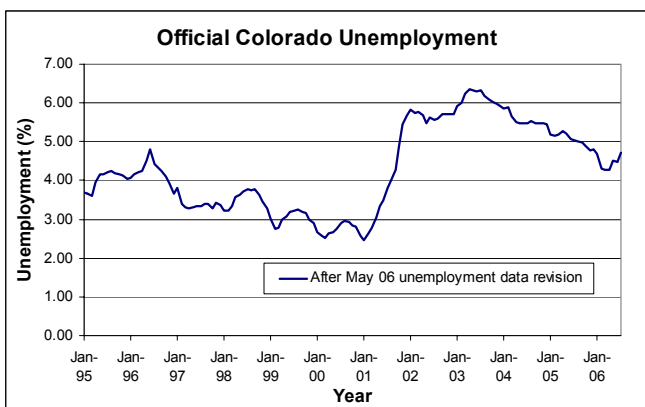
Manufacturing weekly hours are down from the average of 40.5 over the years 2001 through 2004 to 39.4 in July 2006. Manufacturing weekly earnings are up \$61.85 from Jan 01, but adjusted for inflation they're down \$25.34.



“Official” Colorado unemployment is at 4.7%, less than the Apr - Jul 03 6.3%, but well above the 2.5% in Jan 01.

As for overall employment, it's only in January 2006 that Colorado non-farm jobs have reached the level back in Dec 2000.

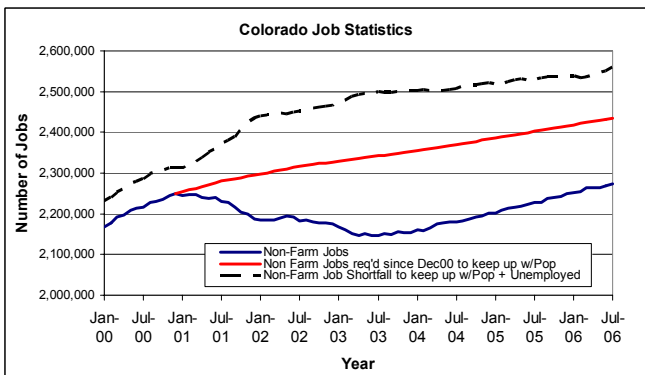
By July 2006 Colorado had only 24,900 more jobs than the Dec 2000 peak. But to keep up with population growth since the Dec 2000 peak, Colorado would have had to add over 185,000 jobs (185,330).



The number of unemployed in Colorado is officially 4.7%, almost 124,000 people (July: 123,840).

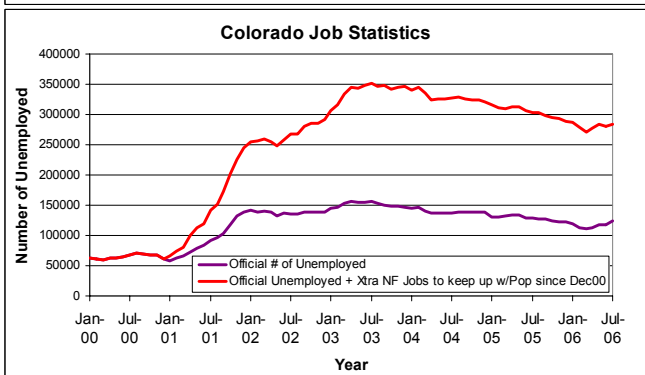
Adding that to the shortfall to keep up with population growth that's $(185,000 - 24,900) + 124,000 = 284,100$ jobs.

Nationwide effective unemployment (U-6) is about 75% more than official unemployment (U-3). U-6 adds to U-3 discouraged workers, other marginally attached, and people working part-time because they can't find a full-time job



Assuming the same ratio is valid for CO, the official 124,000 unemployed would grow by another 93,000 jobs $(.75 * 124,000)$.

Adding this to the shortfall above gives a grand total of $284,100 + 93,000 = 377,100$ jobs needed in Colorado.



And that doesn't include the underemployed.

There is a vast supply of labor compared to demand, both in Colorado and nationally. This is a tragedy and a waste of talent. For more what's happening and on the implications, see [There's no 'free market' for Labor](#).