



THE EQUUS REPORT

—BY BARNABY LEVIN

IS THE U.S. LOSING ITS COMPETITIVE EDGE?

February 1, 2004



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Is the U.S. Losing its Competitive Edge?

Besides obvious issues – like Iraq, terrorism and, for the moment, Mad Cow – the big concern on many people’s minds still seems to be the relatively high rate of unemployment. Economically, high unemployment casts doubt on our country’s prospects for continued growth because, pundits claim, everyone else is already tapped out. Politically, it offers Democrats a campaign stump to challenge the substantial, overall success of the incumbent Party’s tax cut and stimulus package. Realistically, at 5.7%, it is all but irrelevant and, even, misleading.¹

As is so often the case, the media tends to focus on the present day and, in the process, miss the more important “Big Picture.” The truth, according to Anthony Carnevale,² is that “we are about to face a demographically driven shortfall in labor that will make the late 1990s seem like an irritation.”³ Today, workers between the ages of 25 and 54 – which employers consider “prime age” – compose about 60% of the workforce. This group, in turn is dominated by the largest generation in American history, commonly known as the “Baby Boomers.” Within seven years, 30 million currently-employed people will be older than 55 and, as they retire, the workforce will not only stop growing – it will do so at the very time that the average worker’s education, as a percentage of those employed, is stagnating. Already the share of workforce who attended college has grown from 40 percent twenty years ago to nearly 60 percent today. Yet, that 42% growth rate – according to David Ellwood, professor of political economy at Harvard – will dramatically decline over the next 20 years and will grow less than 7% on average.⁴ In fact, Carnevale adds – in the critical fields of engineering and computer science – enrollments have already begun to fall.

The importance of this cannot be overstated: according to the Bureau of Labor Statistics, seven of the ten fastest-growing occupations this decade will occur in the technology and medical fields and, as result of current trends in demographics and education, will result in an

¹ To begin with, the reading itself is very likely inaccurate and overstated. The Labor Department conducts two measures of job creation: 1) a survey of approximately 400,000 companies and 2) a poll of some 60,000 households. But the National Federations of Independent Business, representing more than 600,000 small businesses, says “hiring plans are the strongest since the boom times of 1999, with positive readings in every major industry category.” Source: “So Where Are the Jobs?” James C. Cooper, Business Week, January 26th, 2003

² Former chairman of the National Commission for Employment Policy under President Clinton

³ “The Coming Job Boom,” Paul Kaihla, Business 2.0, September 2003

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unprecedented mismatch between workforce and demand.⁵ What employers will have to do, of course, is to start by bidding up wages. They will raid their competitors and ‘seduce’ older workers to stay on the job longer with increased pay, health benefits and by offering increasingly flexible hours. They will outsource whatever they can – especially overseas to countries from China to India. But, in spite of these actions, by 2005, we’ll start to see spot shortages. By 2010, that shortage will reach 5.3 million. And, by 2020, it will number in excess of 14 million. In the meantime – since things in key technology centers like Silicon Valley have started to pick up – I predict we will soon see a return to the job-hopping trend we witnessed a few short years ago.

And, because of another demographic shift taking place, the problem two generations from now may be even worse. The U.S. Census Bureau’s newest numbers show that married-couple households have slipped from nearly 80% in the 1950s to just 50.7% today,⁶ suggesting “that the U.S.’s 86 million single adults could soon define the new majority. Already, unmarried people make up 42% of the workforce, 40% of homebuyers, 35% of voters, and one of the most potent – if pluralistic – consumer groups on record. We are delaying marriage longer than ever, cohabiting in greater numbers, forming more same-sex partnerships, living longer, and remarrying less after we split up.”⁷ And the implications are immense. Lower marriage rates, combined with declining fertility rates, raise questions about the ability of future generations to support the growing retirement and health needs of older people. But it also challenges the ability of the labor force to continue supplying us with the talent we will need to keep productivity strong. And it suggests that minority groups, which tend to have higher fertility rates, will gain more political power at the very time that an increasingly atomized society of subgroups is vying for their own divergent self-interests. This is not a question of better or worse. It just is. And as these new realities take hold, CEOs, politicians, and judges will all be “challenged to design benefits, structure taxes and develop retirement models that more fairly match the changing population.”⁸

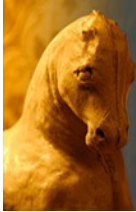
At a recent dinner event with Douglas Holtz-Eakin, director of the Congressional Budget Office under President George W. Bush, I expressed my concern with regard to the economic impact of the retiring Boomers as, by the end of this decade, they transition from a “spending” to a “savings” cycle. He suggested that continuing increases in productivity should help offset the negative impact of lower top-line growth under the assumption that, the more technology you

⁵ “The Coming Job Boom,” Paul Kaihla, *Business 2.0*, September 2003

⁶ “UnMarried America,” Jessi Hempel, *Business Week*, October 20, 2003

⁷ “UnMarried America,” Jessi Hempel, *Business Week*, October 20, 2003

⁸ “UnMarried America,” Jessi Hempel, *Business Week*, October 20, 2003



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put in, the fewer workers you will need to produce the same or even greater output.⁹ But, according to Cathleen Barton, U.S. education manager at Intel, whenever new technology eliminates less sophisticated jobs, it tends to create higher-level positions elsewhere: “In 1982, Intel had about 20,000 U.S. employees and an entry-level plant operator needed only a high-school education. In its current 49,000-person U.S. workforce, that entry-level applicant now needs a two-year degree in applied science and, in twenty-one years of steady improvements in equipment and processes, Intel’s workforce has only grown.”¹⁰ In other words, outsourcing simply improves the quality of the people who still work for you. And by giving them all the new, productivity-enhancing technology possible, what it’s really doing is to force them and the companies they work for to become more logical in the way they do business. A new computer, as Peter Drucker says, “can handle only things to which the answer is yes or no. It cannot handle maybe. And, as a result, it’s not the computerization that’s important; it’s the discipline you bring to your processes.”¹¹

The truth is that, in many instances, the process of arriving at sound business decisions simply isn’t systematic enough to be supported by computers. With a computer, “you have to take the assumptions out of the mind of the decision maker and put them explicitly into the process – along with a method to check them – and only then can a computer help you manage it.”¹² One day, some of the work now being done in the area of artificial intelligence may change this, but that day is still a long way off. And until then, some of the best ideas will still come about through such esoteric notions as “inspiration,” “synergy” and those rare moments of relaxation we oh-so-briefly enjoy each morning in the shower as our minds wander and randomly connect seemingly unrelated concepts, none of which can be counted upon to take place on a day-to-day basis. It takes time to develop truly breakthrough ideas and, even then, we are still faced with the challenge of what to do with them.

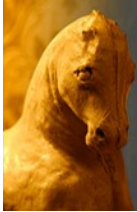
With regard to the coming crunch in finding qualified people – by raising wages and benefits, the labor force will shift as workers are ultimately induced to change careers, emigrate and retrain and, eventually, a good portion of the demand in those sectors will be met. But it will be done at a cost. And as the shortage grows more acute, projects will ultimately be abandoned. In addition to diminishing demand from retiring Boomers, economic output and opportunities in even some of the hottest growth sectors may ultimately slow, adding to the downturn that I believe will take place between 2010 and 2020 as our Nation transitions to a savings mode.

⁹ Stanford Institute of Economic Policy Research, Associates Meeting, November 11, 2003

¹⁰ “The Coming Job Boom,” Paul Kahl, Business 2.0, September 2003, page 101

¹¹ “Peter Drucker Sets Us Straight,” B. Schlender, Fortune, January 12, 2004

¹² “Peter Drucker Sets Us Straight,” B. Schlender, Fortune, January 12, 2004



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I don't mean to be bleak. America, after all, is a nation of risk takers and is still an incredible land of opportunity. It is built on the concepts of capitalism, innovations, hard work and reward. It's just that, as IBM CEO Sam Palmisano explains in the November 17, 2003 issue of *Business Week*, "innovation" is more than mere invention. It is the "intersection of invention and insight; the fusion of new developments and new approaches; and is focused less on things and more on ideas, collaboration and expertise."¹³ And, even more importantly – since innovation is taking place in an increasingly knowledge-based, global economy – it is now occurring within a global context. In other words, it is no longer a predominately American phenomenon. As I said in my February 2002 article, "Creative Destruction": "Until recently, convergence and globalization have been drivers of innovation, economies of scale and ongoing investment. Now, there is a massive shift to outsource and focus on narrower core competencies. Also, we no longer live in a world where the U.S. has a monopoly on the fastest-growing areas of innovation, be it healthcare, technology or otherwise. Things truly have gone global and, with the widespread use of the internet, new ideas will spread at the speed of light."¹⁴

The bottom line is that the dominance of the U.S. is already ending and, emerging in its place, is a world composed of blocs, from the EU and NAFTA to the ASEAN. As Peter Drucker says: "There's no one center in the world economy."¹⁵

IBM recently commissioned a study of the 42 industries represented by the Council on Competitiveness and found that these industries will create 13 million jobs worldwide over the next two years alone.¹⁶ Over the next decade, the count will rise to 95 million. The question is where those jobs will be. China, India, and South Korea are each replicating the structural advantages that have made the U.S. the center of innovation by investing in education; teaching their citizens the language of commerce; and building modern network infrastructures. My concern, now, is how the U.S. and other developed nations will respond. Certainly the worse thing I can imagine is the rumblings I hear of trade sanctions, union strikes and of a global drift toward protectionism. Raising barriers is an ultimately futile effort to fend off the inevitable and is the last thing that we or any other nation needs to do.

Geoffrey Colvin, senior editor at *FORTUNE* magazine, suggests that "those developing countries, which obviously have always had people just as smart as ours, are now turning out people just as educated. We're looking at three billion people getting better by the day at the things that make us

¹³ "How the U.S. Can Keep Its Innovation Edge," Samuel J. Palmisano, *BusinessWeek*, November 17, 2003

¹⁴ "Creative Destruction," Barnaby Levin, Citigroup/Smith Barney, February 1, 2002

¹⁵ "Peter Drucker Sets Us Straight," B. Schlender, *Fortune*, January 12, 2004

¹⁶ "How the U.S. Can Keep Its Innovation Edge," Samuel J. Palmisano, *BusinessWeek*, November 17, 2003



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the world's leading economy (and) our markets need to adjust. So do our schools.”¹⁷ This sentiment was seconded in a recent interview by the San Francisco Chronicle with John Hennessy, president of Stanford University, who noted how our country is already beginning to lose important jobs, especially here in California. “The state,” he said, “has become an expensive place to run a business; an expensive place to live; and, to a large extent, we have relied on imported labor. It's now getting more attractive to go back to India, Taiwan, Korea or mainland China after you do your graduate work in the United States. When I first came to Stanford, nobody went back. That's a real change and it's going to affect our ability to have the talent we need to make this country successful.” At the same time, he says, “this will remain a place where entrepreneurship and new ideas are created and where the leading-edge work is done. The question is whether the activity take those ideas and employ them more broadly.”¹⁸ But the challenge is clearly still there.

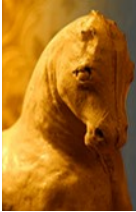
It feels as if we, as a nation, have peaked and that the world is beginning to move beyond us with increasing velocity as some of the most important developments and debates are taking place outside of our shores and our control and that the best we can do now is to stage a series of defensive actions which will only delay the inevitable. But, in my opinion, it is inevitable. From Egypt to Rome to Great Britain, history has shown that no nation remains in power forever.

So the problem is *not* unemployment. It is a growing and soon-to-be significant mismatch between what is needed and what is available. As my clients already know, I believe that our Nation will be sorely pressed to avoid a serious, prolonged recession that, due to demographics, will take place starting at the end of this decade as the Boomers transition from a spending to a savings mode and, ultimately, retire.¹⁹ As they stop buying, it will cause a contraction in GDP – which, itself, is a product of supply and demand – and which, in my opinion, increased productivity will be unable to offset. And this recession, I'm afraid, could last as long as seven or eight years – as it did

¹⁷ “The U.S. is falling asleep on the job,” Geoffrey Colvin, FORTUNE, September 1, 2003

¹⁸ “On the Record: John Hennessy,” Robert Rosenthal and Ken Howe, San Francisco Chronicle, October 19, 2003. In response to this trend, Hennessy recently presided over the formal opening of Stanford's James H. Clark Center, a research facility where scientists from over 20 different disciplines, ranging from biochemistry to physics to mechanical engineering to computer science and cardiovascular medicine can collaborate. The Center is “focused on realizing the vision of what we call translational medicine – taking breakthroughs at the lab bench to real practice. My hope is that the Bay Area becomes known not only as the information technology center of the world, but also the biotech and bioengineering center of the world. This is the century of biology, in the same way that the science that dominated the last century was physics. With everything from the human genome to a better understanding of how the human brain works; from a better understanding of how cells work at the most intimate level, to how signals are transported across that cell and how a cell functions. We're trying to bring people together at Bio-X, to put them in one building.”

¹⁹ “Demographics,” Barnaby Levin, Citigroup/Smith Barney, April 16th, 2003



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one and two generations ago – until the next generation comes along and, itself, begins to drive economic growth and development. But, as a nation, we can take action that could help minimize the impact. Through a renewed emphasis on education – and, in the corporate world, on continuing education and retraining – we can push ourselves and our children. As John Hennessey is doing at Stanford, we can do our best to stay on the cutting edge: to drive a sense of community, collaboration and innovation and – in an environment which, hopefully, will continue to reward those who do – with the aim of creating results that improve the length and quality of life for all.

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