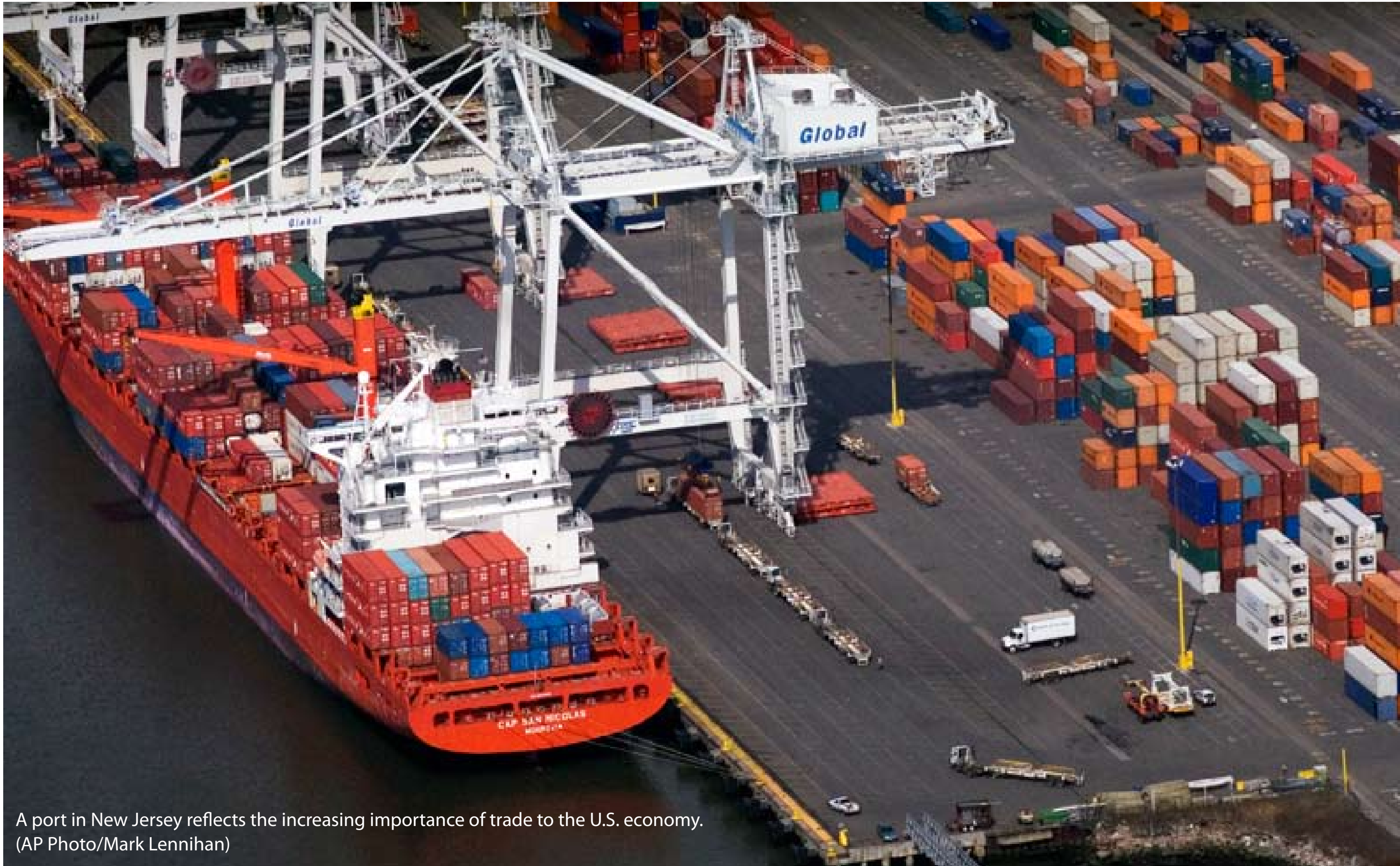
U.S. DEPARTMENT OF STATE
BUREAU OF INTERNATIONAL INFORMATION PROGRAMS

USA ECONOMY IN BRIEF



A port in New Jersey reflects the increasing importance of trade to the U.S. economy.
(AP Photo/Mark Lennihan)

Challenges

"The panic itself was felt in every part of the globe," the *Wall Street Journal* reported. "It was as if a volcano had burst forth in New York, causing a tidal wave that swept with disastrous power over every nation on the globe." One of the after-effects was "an accumulation of idle money in the banking centres." The date of this item? January 17, 1908.


President Barack Obama inspects a hydrogen-cooled generator being manufactured for a power station in Kuwait at a General Electric plant in Schenectady, New York.

The United States endured the 1908 crisis, the Great Depression, and assorted other recessions, panics and bubbles; the country emerged from each with its economic vigor restored and its democratic political institutions intact.

Americans view their economy as one that embraces competition, invites striving and invention, heaps rewards on winners and gives second chances to those who fail. The United States has achieved a highly flexible economic system that arguably offers more choices and opportunities than any other, and one that has displayed repeatedly its capacity to recover from mistakes and adapt to recessions, wars and financial panics, gaining strength from its trials.

Evolution of the Economy

The U.S. economy has changed beyond recognition over two centuries, but some features endure: a vigorously competitive marketplace, spurts of invention and innovation, political swings between more government regulation and less, between higher protective tariffs or other barriers and freer trade.

Spanning much of the territory between two great oceans, the United States is blessed with tremendous natural resources: a treasure of forests, seacoasts, arable land, rivers, lakes and rich mineral deposits.

At the time of U.S. independence, the economy depended heavily on exports of those resources and imports of many other basic and finished products. Then, in the era of rapid industrialization and a growing internal market after the Civil War, it became less dependent on trade. Since the end of World War II, exports and imports have played an increasingly important role again.

When George Washington took office as the first president of the United States in 1789, eight out of 10 Americans lived on farms, mostly just feeding themselves, and the largest U.S. city,

Alexander Hamilton, pictured standing, fought for a strong currency.

New York, had only 22,000 residents.

During Washington's eight years in office, two rival political factions emerged. Their ideas have influenced U.S. economic debates ever since.

One faction was led by Thomas Jefferson, a Virginia planter and principal drafter of the Declaration of Independence. That group wanted the United States to remain an agrarian society with minimal government intrusion.

The other faction was led by Alexander Hamilton, one of General Washington's top aides in the Revolutionary War against Great Britain. His group sought a strong federal government to promote U.S. manufacturing through government support of infrastructure improvements, protective tariffs on imports, a strong currency and central banking.

The Constitution of the United States, ratified in 1788, outlines the federal government's role in the economy. At Hamilton's insistence, it gives the federal government and not the individual states the power to issue money. Hamilton's objective was to create a strong national currency for a creditworthy economy. The federal government also received the sole power to grant patents and copyrights to protect the rights of inventors and writers.

The Constitution prohibits tariffs on goods moving between states. It gives the federal government sole power to regulate this interstate commerce and to impose tariffs on foreign imports. The first Congress in 1789 imposed the first U.S. tariffs to raise revenue and to protect U.S. manufacturers of glass, pottery and other goods.

Tariffs became a longstanding, divisive regional issue. Manufacturers and financiers in northern cities favored tariffs to raise the prices of goods from overseas. The mostly rural southerners opposed tariffs, which raised prices of goods they imported from Europe and led Europeans to retaliate by reducing imports of commodities from the U.S. South.

People in newly added western states were divided over tariffs. They disliked the higher prices on imports, but they liked the government revenue that paid for canals, roads and railroads.

By far the most divisive regional issue was slavery. Northern states, with economies grounded in industrial manufacturing, had over time abolished slavery, but the South's wealthy planters depended on African-American slaves to harvest tobacco, sugar, hemp, and, above all, cotton. Low-cost cotton provided raw material for textile manufacturers in the U.S. North and Great Britain.

Slavery worsened regional tensions. In 1861, 11 southern states seceded from the United States and created the Confederate States of America. The U.S. Civil War (1861–1865) ended slavery in the United States, and it led to many more changes.

In the absence of opposition from southern legislators, the wartime Congress expanded the power of the federal government, passing the first national tax system, issuing a national paper


Workers celebrate the 1869 completion of the transcontinental railroad track at Promontory Summit, Utah.

currency, paying for public land-grant colleges and authorizing the construction of the first railroad to span the north american continent.

After the war, the agriculture economy of the defeated South moved from a plantation system to one of tenant farming. Former African-American slaves and rural whites lived in poverty for most of a century afterward.

The industrial and commercial economy of the victorious North, meanwhile, continued its great expansion. The first railroad linking the Atlantic and Pacific coasts, completed in 1869, enabled a true national economy to develop, one capable of trading on equal terms with Europe and Asia. "The American economy after the Civil War was driven by the expansion of the railroads," historian Louis Menand wrote.

Throughout the 19th century, American inventors were transforming how Americans worked. Before the Civil War, inventions — such as Eli Whitney's cotton gin, John Deere's steel plow and Cyrus McCormick's mechanized grain reaper — were already improving farm productivity. In the decades after the war, steam tractors, gang plows, hybrid maize, refrigerated railroad freight cars, and barbed wire fencing to enclose rangelands all appeared. From 1800 to 1890, the typical time required for a farmer to produce 100 bushels of wheat plunged from about 300 hours to roughly 50.

By the 1880s U.S. manufacturing and commercial output surpassed farm output in value. With European financial backing, new industries and railroad lines proliferated, attracting immigrant labor to the North's sprawling cities.
The 19th century delivered other startling U.S. inventions and innovations, including Samuel Morse's telegraph, Alexander

Graham Bell's telephone and Thomas Edison's light bulb and phonograph, and systems for distributing electric power to homes and businesses. By the early 20th century, electric power surged throughout the U.S. economy, powering factories, lighting offices and homes, illuminating department stores and movie theaters, lifting elevators in skyscrapers and powering city streetcars and subways.

The new industrial economy did not make all Americans prosperous. Debt-ridden farmers in the South and West were battered by tight credit and falling commodity prices. Severe economic recessions wracked workers and businesses in the 1870s and again in the 1890s.

The changes wrought by industrialization and urbanization changed the country. Organized labor unions sprang up. In the 1890s a short-lived Populist political party, focusing anger at wealthy financiers and industrialists, demanded lower interest rates on loans and inflationary monetary policy to let debtors repay their debts with less valuable dollars.

In the early 20th century, a political movement called Progressivism found adherents among both major political parties, Democrats and Republicans alike. The Progressive movement reflected a growing sense among Americans that, as historian Carl Degler wrote, "the community and its inhabitants no longer controlled their own fate."

Progressives used government power to represent common people against the interests of powerful industrialists and financiers. President Theodore Roosevelt, a Republican, vigorously enforced antitrust law to break up concentrations of economic power in railroads, oil, beef and tobacco. President Woodrow Wilson, a Democrat, strengthened the antitrust laws and started collecting income taxes from corporations and

Alexander Graham Bell makes the first long-distance telephone call in 1892.

The hungry line up at a soup line during the 1930s' Great Depression.

wealthy individuals. In 1913, Wilson created the Federal Reserve. The 1920s saw strong U.S. economic expansion and prosperity for many Americans but also increasing speculation in the stock market. The decade ended with a stock market crash and the onset of the Great Depression. Prices collapsed, impoverishing farms, businesses and families. About 40 percent of U.S. banks failed and many depositors lost their savings.

The United States imposed punitive tariffs on imports, and its trading partners retaliated in kind, spreading the economic contraction around the world. The U.S. unemployment rate approached 25 percent. These hardest economic times created years of anxiety.

The 1932 election of President Franklin D. Roosevelt and a Congress dominated by his fellow Democrats enabled passage of a "New Deal" economic program. "The only thing we have to fear is fear itself," Roosevelt assured Americans in his inauguration speech. On taking office, Roosevelt temporarily shut down all banks and a few days later allowed reopening of the solvent ones strong enough to survive, effectively ending the runs on banks.

An improviser and pragmatist more than an ideologue, Roosevelt launched many programs aimed at halting the banking crisis, creating government jobs for the unemployed and raising farm prices by reducing output. Most of these initiatives lasted only a few years; debate over their effectiveness continues today.

Other New Deal initiatives have continued to the present. These include a minimum wage law, the Social Security retirement pension system, regulations on banks and the stock market, and government insurance for consumer bank deposits. Roosevelt injected the federal government into economic activities previously deemed the domain of the private sector. A controversial example was creation in 1933 of the Tennessee Valley Authority, a federally charted corporation formed to control flooding and generate electric power in an impoverished region of the South.

Strong, lasting economic recovery finally came about as American industry mobilized to support the United States' entry into World War II in December 1941. Factories supplied war materiel to U.S. and Allied armed forces in both the European and Pacific theaters. The U.S. auto industry ceased producing private vehicles and produced tanks instead, some 30,000 during 1943 alone.

At war's end, with much of Europe and Asia in ruins, the United States stood alone as the world's greatest economic power. But American policymakers understood that one key to long-term prosperity was a world in which the economies of other nations prospered and grew. U.S. influence led to the creation in 1944 of the International Monetary Fund and World Bank to promote a balanced global financial system. The world's wealthiest countries subsequently negotiated a General Agreement on Tariffs and Trade for reducing import tariffs. The World Trade

President Franklin Roosevelt signs into law the legislation creating the Social Security retirement system.

Organization succeeded the GATT in 1995.

After World War II, international trade and finance became ever more crucial to the U.S. economy. By the 1950s the value of farm and factory output was surpassed by the output of services such as wholesale and retail trade, finance, real estate, health, law, and education. In 2009 the United States ranked first in imports and third in exports, first in direct investment in foreign

Levittown, New York, typified the mass-produced suburban development after World War II.

countries and first in direct investment by foreign countries. From World War II until 2007, Americans experienced periods of unprecedented economic expansion and prosperity, propelled in part by the 76 million Americans born in the 1946–1964 “baby boom.” The recessions that did occur in the postwar years

until 2000 were relatively short and did relatively less harm to Americans’ lives than the depressions of previous eras.

In 1965 President Lyndon Johnson pressed Congress to expand sharply the social safety net by passing Medicare and Medicaid government health insurance programs for the old and poor. Congress also adopted a raft of other programs, many of them short-lived, intended to eliminate poverty by improving education and housing.

An inflationary spiral began during the Johnson administration and got worse through the 1970s. During that time President Richard Nixon had briefly imposed government wage and price controls in a failed attempt to arrest inflation. Oil shocks to the U.S. economy following the 1973 Arab-Israeli War and 1979 Islamic revolution in Iran contributed to stagnant economic performance. The inflationary spiral did not end until the U.S. Federal Reserve raised interest rates sharply in 1981–1982, causing a recession.

Tax cuts and business deregulation pursued by President Ronald Reagan in the 1980s marked resumption of robust economic expansion and a long rise in stock prices. Those policies also marked, however, the start of a long climb in federal government debt. This period also saw a widening income gap between the wealthiest Americans and the rest of the populace. California-based entrepreneurs introduced transformative computer technologies. These sparked new domestic and international consumer markets, and invigorated the U.S. economy. The raw material for semiconductors gave the California computing region the name Silicon Valley.

The 1990s (not unlike the 1920s) saw strong economic expansion, increased prosperity and stock market speculation. When the resulting "dot com" bubble burst in 2000, the stock market crashed and the economy went through a short recession.

In the first decade of the 21st century, the United States engaged in costly wars in Afghanistan and Iraq. Meanwhile, the cost of providing Americans with health care increased sharply at great cost to federal, state, and local governments. Federal government debt, already $3.4 trillion in 2000, was approaching $14 trillion in 2011, an increasing proportion of it owed to foreigners.

Following the dot-com recession, another speculative bubble arose, this one fueled by sustained low interest rates, which distorted the U.S. real estate and home mortgage market. The overbuilt housing market crashed in 2007, followed in 2008 by a financial crisis that spread to much of the world. For the first time since the Great Depression, U.S. unemployment soared to 10 percent in 2009, slipping only to 8.8 percent in March 2011.

The governments of the United States and other developed countries took extraordinary measures to combat the crisis. Interest rates were lowered close to zero, and more money was borrowed to support economic stimulus projects and to prop up ailing banks and major industries. The theory was to spend as necessary to forestall another Great Depression and to

The digital revolution invigorated the U.S. economy.

repay creditors once economic growth had been restored. The recession officially dated from December 2007 to June 2009, but high unemployment persisted in the slow economic recovery.

Nevertheless, the U.S. economy remained the largest in the world, and the share of economic output per person remained the highest among the G-20 major economies. Both statistics testify to the resilience of the U.S. economy and its ability to remain productive even during comparatively hard times.

Apple computer CEO Steve Jobs demonstrates the iPhone. Apple is one of Silicon Valley's best-known companies.

What the Economy Produces

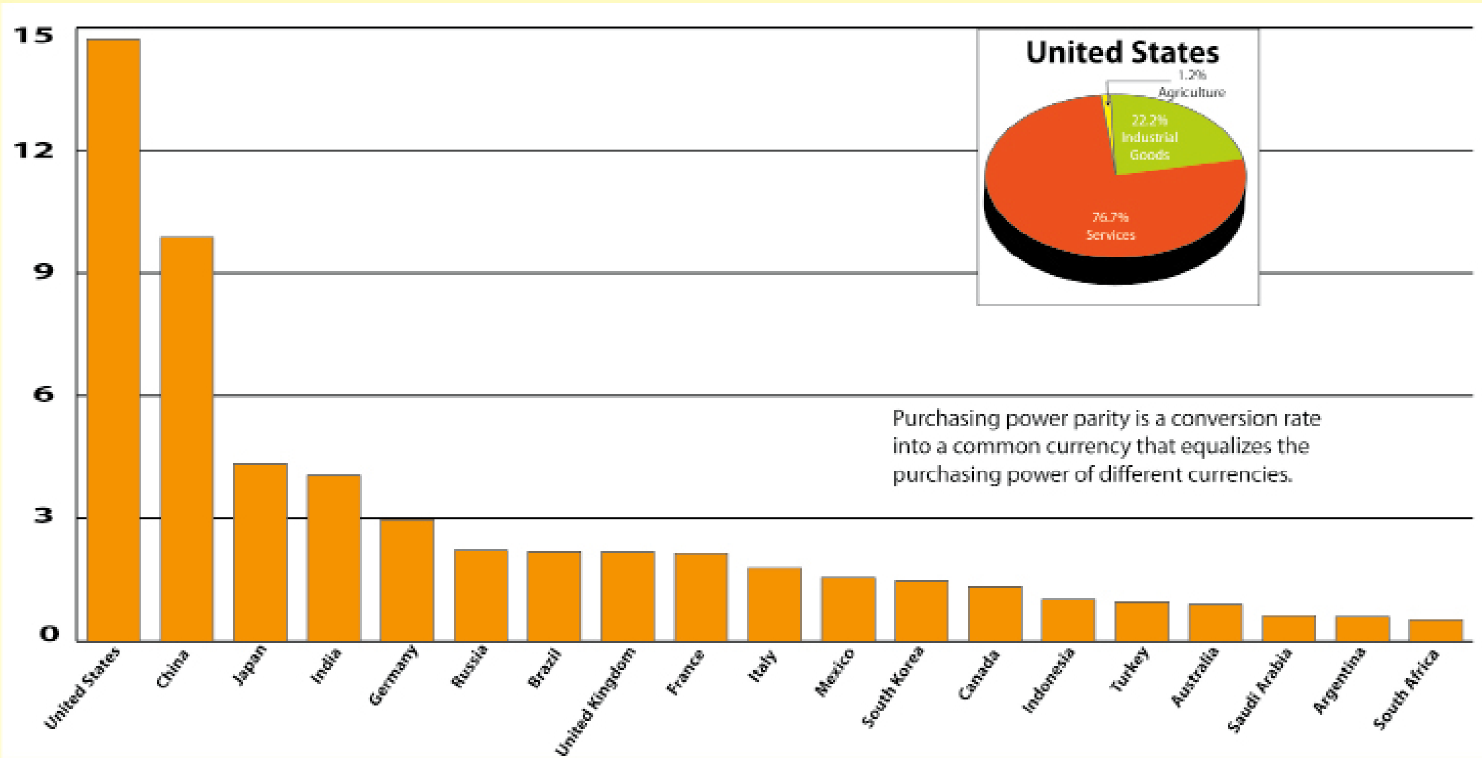
Today, the U.S. economy is in the midst of its second radical economic transformation. 19th-century shift from agriculture to manufacturing and a 20th-century shift from manufacturing to services and information, a change that has continued and accelerated in the first decade of the 21st century. Yet, the United States still produces more farm and factory goods than most other countries, even while the proportion of workers engaged in those sectors shrinks.

In the recession year 2009, the U.S. economy, measured as real (inflation-adjusted) gross domestic product (GDP), amounted to $14.3 trillion. Although this reflected a decrease of 2.4 percent from 2008, the U.S. GDP was still more than a third higher than the next biggest economy, China's (measured by the purchasing power of the two countries' currencies, not by official exchange rates). That represented:

- $10.1 trillion in personal spending by consumers,
- plus $1.6 trillion in private investment in homes and businesses,
- plus $2.9 trillion by federal, state and local governments,
- minus a $392.4 billion international deficit (reflecting mostly an excess of imports over exports).

GDP among G-20 economies, 2010

Trillions of U.S. dollars, purchasing power parity



Source: CIA World Factbook

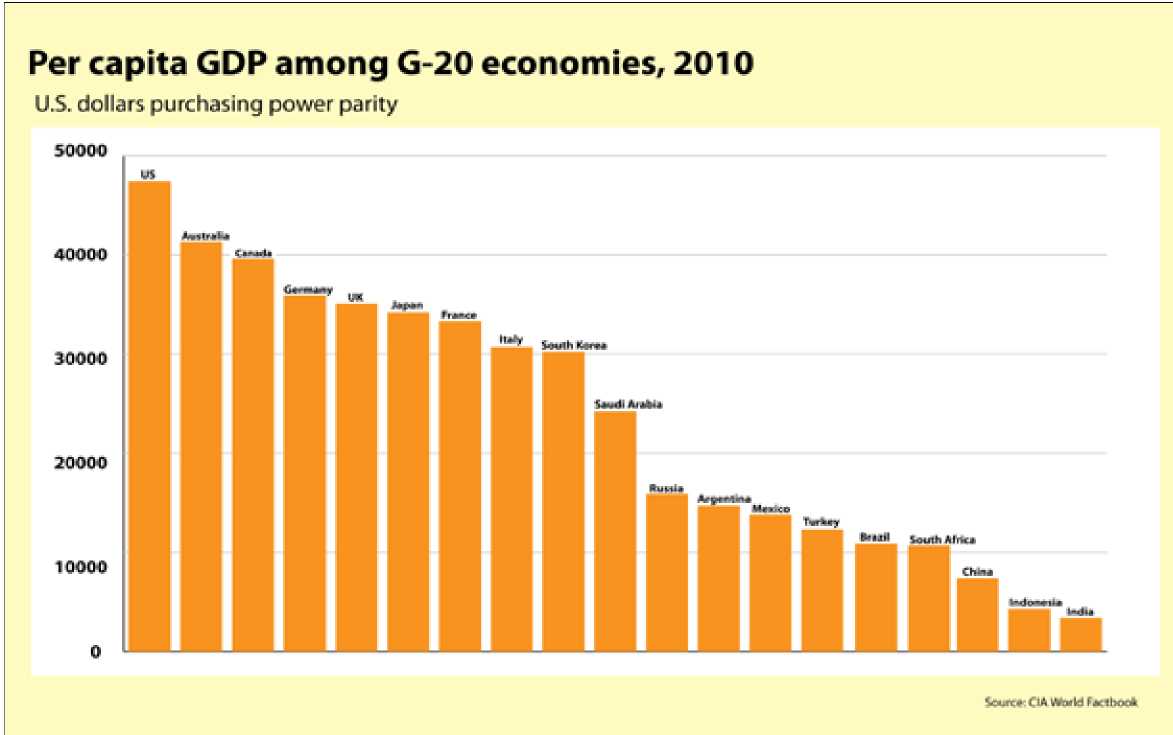
Viewing GDP from the perspective of producing goods and services, private industry accounted for 86.4 percent of the value added in 2009, and different levels of government accounted for
the rest.

Private-sector production of goods accounted for 19.6 percent of GDP as follows:

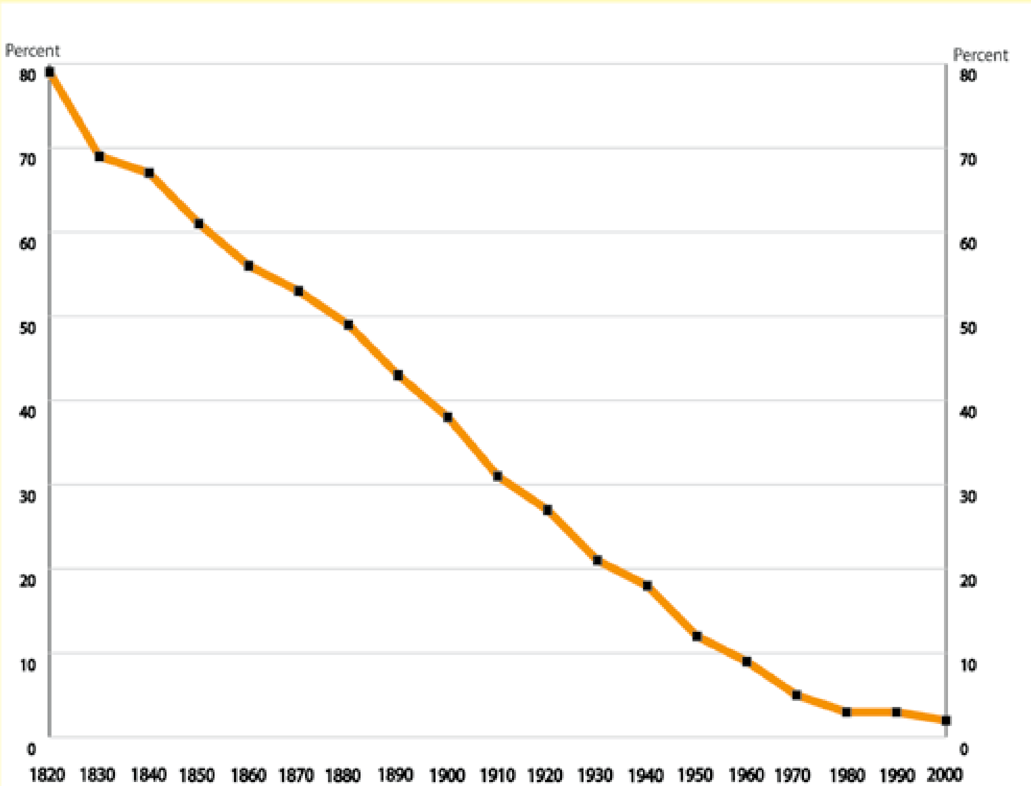
- Manufacturing, 11.0 percent.
- Construction, 4.1 percent.
- Utilities, 1.9 percent.
- Mining, 1.6 percent.
- Agriculture, forestry, fishing and hunting, 1.0 percent.

Private-sector production of services accounted for 66.8 percent of GDP:

- Real estate, 13.0 percent.
- Professional and business services, 12.1 percent.
- Finance and insurance, 8.4 percent.
- Health care and social assistance, 7.3 percent.
- Retail trade, 5.9 percent.
- Wholesale trade, 5.6 percent.
- Information (including



Farmers' share of U.S. labor force



Source: U.S. Department of Agriculture, National Bureau of Economic Research

broadcasting and telecommunications, publishing, motion pictures, sound recordings, and data processing), 4.4 percent.

- Accommodation and food services, 2.9 percent.
- Transportation and warehousing, 2.8 percent.
- Private education, 1.1 percent.
- Arts, live entertainment, and recreation, 1.0 percent.
- Other private services, 2.5 percent.

Governments produce mostly services, including infrastructure, not many goods. The federal government accounted for 4.4 percent of GDP, and state and local governments, 9.2 percent, including public education.

Agriculture's share of the U.S. economy has dropped steadily for centuries. Farmers and farm workers, who in 1810 made up about 72 percent of the work force, accounted for less than 2 percent in 2010. A 2007 survey counted 2,204,792 U.S. farms. Of these, 125,000 big farms accounted for 75 percent of farm production (measured as revenue).

The United States remains the world's second biggest producer of crops and livestock, behind China and ahead of India, Brazil and Russia. The top U.S. agricultural commodities in 2009 were cattle, $43.8 billion; maize, $42 billion; soybeans, $30.1 billion; dairy products, $24.3 billion; and broiler chickens, $21.8 billion.


Aircraft producer Boeing Company is one of the largest U.S. manufacturers.

Manufacturing's share of the U.S. economy peaked in 1953 at about 28 percent and has dropped since then to 11 percent in 2009; yet U.S. manufacturing's global share of value added — the difference between the final sales price of all the world's factory goods and the cost of producing those goods — has slipped little from its 1980 level of 22 percent.

In 2008 the four largest U.S. industries — chemicals, computers and electronic products, fabricated metal products and food — accounted for 44 percent of U.S. factory output.

Increased productivity has allowed fewer factories and factory workers to maintain the United States' level of manufactured output. Manufacturing workers now produce about three times more per person than they did in the early 1970s and about twice as much as in the mid-1980s. Today, factory workers account for 8 percent of the U.S. work force compared with 26 percent in 1953.

U.S. manufacturing has long faced strong competition from industrialized European economies and Japan and now faces even more challenges from rapidly emerging economies.

The United States was still the top producer of factory goods (measured by value added) in 2009, according to economic forecasting firm IHS Global Insight, which predicted that China would surpass the United States in a few years.

It added, however, that while China excels at manufacturing relatively low-tech consumer products — such as textiles, apparel and appliances — the United States specializes in high-tech products such as aircraft, machine tools, medical equipment and electronic media devices.

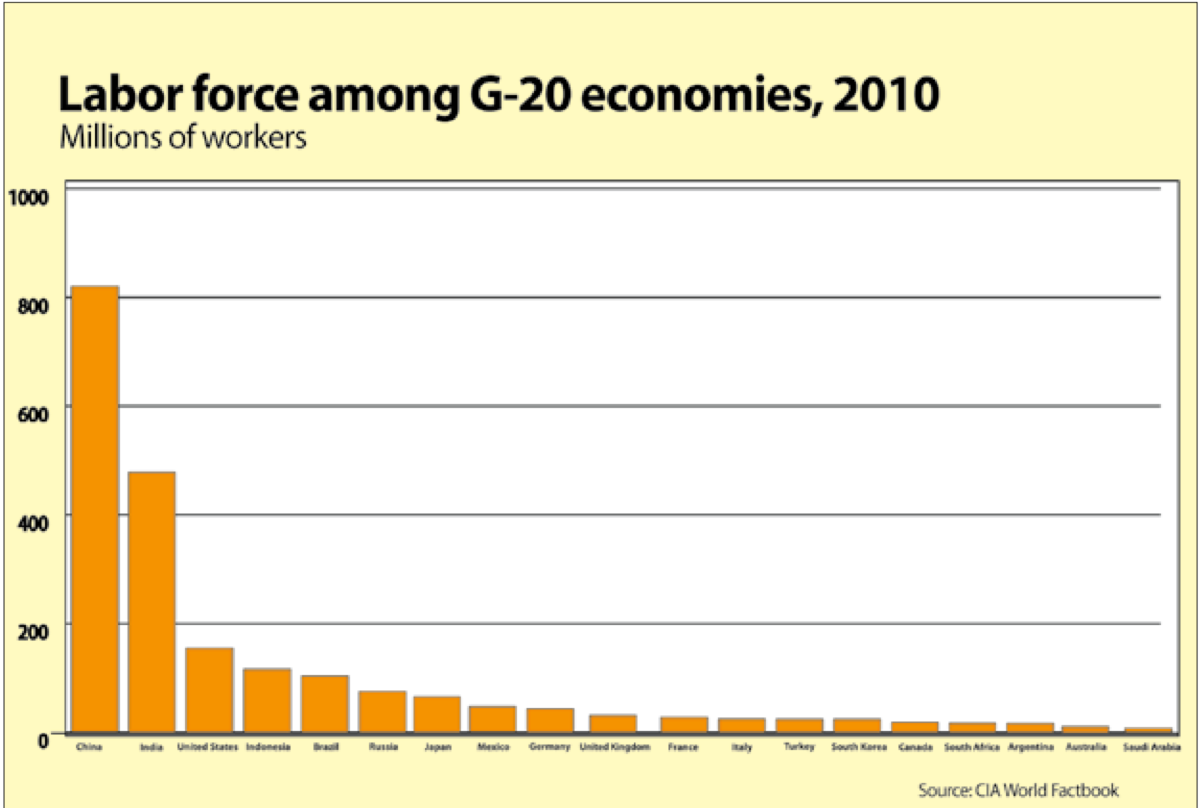
American manufacturers have responded to rising competition and higher labor costs through such strategies as moving some operations abroad, purchasing foreign parts and components and concentrating on higher-value products where innovation offers a competitive advantage.

Since the 1950s, the services sector has dominated the U.S. economy. Even after the 2008-2009 financial crisis, finance, insurance and real estate accounted for more than 21 percent of GDP. In 2009, of the total U.S. full-time and part-time work force of 137 million people, private goods-producing industries accounted for 15 percent of employment; private services-producing industries, 67 percent, and federal, state, and local governments, 18 percent.

On average, American workers made $43,460 in wages in 2009. Farmers and ranchers made about average wages, $42,710; computer hardware engineers, $101,410; elementary school teachers, $53,150; surgeons, $219,770; security guards, $26,430; barbers and hairdressers, about $27,000; lawyers, $129,020; cashiers, $19,030; truck drivers, $39,260, and models, $36,420.

Retailers like this Best Buy store in Los Angeles are service producers that have dominated the economy for decades.

Today, income is distributed less equally in the United States than in other large industrialized countries. The households with the 5 percent highest income earners received about 21.5 percent of all income in 2009, while the 20 percent lowest received about 3.4 percent.



Since 1975, most gains in household income have gone to the top 20 percent of households, the CIA World Factbook says, noting "the gradual development of a 'two-tier' labor market in which those at the bottom lack the education and the professional/technical skills of those at the top and… fail to get comparable pay raises, health insurance coverage, and other benefits."

Political leaders are struggling to identify the best ways to develop a better-educated work force that can thrive in the current labor market.

Competition

Joseph Schumpeter, an Austrian-born economist, coined the term "creative destruction" in 1942 to describe the turbulent forces of innovation and competition in market economies. The "incessant gales" of markets cull out failing or underperforming companies, clearing the way for new companies, new products and new processes.

Because the economic winners have substantially outnumbered the losers, the churn of competition remains a defining characteristic of the U.S. economy. One of the United States' most important competitive advantages is the willingness to encourage and embrace — and at times endure — change. Jobs, companies — and even entire industries — come and go. Cities and entire regions expand and, if they cannot adjust to change, contract. For decades some industrialized cities in the "Rust Belt" of the Northeast and Midwest and some agricultural states in the Great Plains lost residents to the "Sunbelt" in the South and West, and to other parts of the country. Now California, Nevada, Florida and other "Sunbelt" states suffering economically because of excess housing construction are losing some residents.

Outsiders often equate the U.S. economy with its largest corporations. They may be surprised, then, by the vital part that small businesses play. Economic change takes place most readily in small businesses, those with fewer than 500 employees. Shop owners and other small businesses account for more than half of the U.S. private-sector nonfarm economic output and work force.

Many small retailers compete with national chains that boast billions of dollars in annual revenue and thousands of

Small businesses such as this draperies producer in California bolster economic competition.

employees. Many other small businesses provide goods and services to such large companies.

Small businesses account for the majority of new U.S. jobs, especially as large manufacturers continue to shed jobs in the face of stiff global competition. In 2005 the number of jobs in small businesses increased by 979,000 over 2004 while larger companies added only 262,000 jobs.

American entrepreneurs remain eager to risk their own savings to start small businesses, despite the potential for failure. In 2008, 43,546 U.S. companies filed for bankruptcy.

One obvious reason why so many Americans choose this path is the relative ease of starting a small business. The World Bank ranks the United States as No. 4 among 183 economies in ease of starting a business.

Small businesses such as this store in Massachusetts account for more than half of economic output.

Launching a business in the United States is relatively easy — and so is trying again after a failed attempt. The philosopher Erich Fromm said that the "freedom to fail" was essential to overall freedom, and the adage is often cited as a basic tenet of American economic life. Business failure does not carry the social stigma in the United States that it does in some other countries. In fact, failure is often viewed as a valuable learning experience for the entrepreneur, who may succeed the next time.

U.S. bankruptcy laws govern business failures. The U.S. Congress has tried to strike a balance that recovers as much of a failed company's assets as possible for creditors while providing financial protections that can allow entrepreneurs to make a fresh start.

Delivery company FedEx started out as a small company. Today it employs more than 275,000 people.

A small business that cannot pay its bills will usually go through what is called a liquidation, selling all its assets to pay what it can to its creditors. Some of the debts are paid ahead of others, and a bankruptcy court appoints a trustee to make sure the process follows the rules. Banks and other secured lenders are high on the repayment list, as are employees' wages. If the business was a small corporation, the shareholders — who assumed risk in exchange for potential reward — are at the bottom of the list and often receive nothing as the business closes its doors. Large companies that cannot pay their debts may choose what is called a Chapter 11 bankruptcy process, which allows a company to stay in business while it tries to recover. If the company still has valuable assets or some cash coming in — and if its crisis seems temporary — creditors may initially choose to take less than full repayment of their claims in order to allow the company to survive and continue repaying. In this case, too, shareholders might lose their investment, but the business can survive.

Bankruptcy laws also allow individuals and families to escape unmanageable debts and start over, although in many states they may lose their homes. This escape route can be crucial for some.

Schumpeter's creative destruction is evident at the top of the economy in the rise and fall of the largest, most powerful U.S. corporations. *Fortune* magazine's Fortune 500 list of the top U.S. companies ranked by revenue tells the tale: In 2009 Wal-Mart, with $408 billion in revenue, displaced the previous year's top-ranked Exxon Mobil, with $285 billion, as commodity prices fell. That same year the plunge in auto sales moved General Motors from sixth place to 15th place.

Of the 12 companies that Dow Jones listed in 1896 when it created its famous stock index to represent the U.S. industrial sector, only one, General Electric, remains on the index of 30

Grocery stores such as Andronico's Market in San Francisco often face fierce competition.

From 2002 to 2007, the number of U.S. businesses owned by African Americans increased 60.5 percent, spurring 22 percent job growth.

companies now. Others disappeared from the index as they were acquired by other companies, split into smaller companies, became relatively smaller players in the economy, or simply dissolved. Some of the companies that replaced them started out as small businesses.

Competitiveness is integral to American culture and the U.S. economy. "Nowhere else has change occurred in so short a span," historian Walter A. McDougall said. "America was not just born of revolution, it is one."

Geography, Infrastructure

Americans pack up and move to different regions of the United States with freedom and relative ease. In 2009, nearly 2 million Americans moved from one region of the country to another. The largest number, about 738,000 people, moved from other regions to the South, but about 591,000 moved out of the South to the Midwest, West, and Northeast.

Distinct regions with regional identities and personalities persist: New England, the mid-Atlantic from New York to Washington, D.C., the industrial states around the Great Lakes, the South with its historical legacies and new economic dynamism, the breadbasket of farmlands from the Midwest to the Great Plains, the thinly settled wilderness and desert regions along the Rocky Mountains, the high concentration of Hispanics in Texas and the Southwest, the southern tip of Florida with its ties to the Caribbean, the Pacific Northwest. The states of California, Alaska and Hawaii are each in many ways regions of their own.

In the U.S. federal system of government, the states set many laws and policies affecting economic performance.

In a case decided by the U.S. Supreme Court in 1932, Justice Louis Brandeis wrote in praise of differing practices from place to place in the United States.

"It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory, and try novel social and economic experiments without risk to the rest of the country," Brandeis said. States remain laboratories of policy innovation.

Even as Americans relocate between regions and as immigration, resources and culture define regional differences, other economic and cultural forces work to break down regional barriers and integrate the nation's regional economies. These include a common currency, a legal system that recognizes the rights of private property, and federal laws that create uniform policies for commerce among the states.

The California Aqueduct is a crucial part of that state's infrastructure.

Transportation infrastructure ties the country together. The federal government alone had the authority and capital to launch the 19th century's greatest infrastructure project — the first transcontinental railroad. Two companies were granted the task of building the line in the 1860s, crossing deserts and mountains with the labor of 10,000 workers, including European settlers, freed slaves and Chinese immigrants.

The railroad united the nation from coast to coast for the first time. Grain, coal to make steel and illuminating gas, copper, iron ore, petroleum, timber, clothing to supply new city department stores and mail-order retail businesses, food — shipped in newly invented refrigerator cars — all could cross the country in search of markets.

The 20th century was the era of the automobile and trucks. By 1925 a 5,456-kilometer route called the Lincoln Highway ran across the country from New York to San Francisco. Beginning in the 1950s the federal government began construction of the Interstate Highway System of modern, limited-access roads.

The Interstate Highway System bolstered trucks as rivals to railroads.

Today Interstate highways cover 75,440 kilometers. They accelerated the relocation of city dwellers to the suburbs, encouraged the spread of industry from older northern cities to towns in the South and West, and established the trucking industry as a rival for railroads in shipping freight.

The telegraph and then the telephone also worked to unite the nation. But it was broadcasting — first radio and then television — that created nationwide audiences, a more common culture, and a truly national economic market. Americans living thousands of miles apart could experience domestic and global events simultaneously.

Broadcasting in the United States has evolved along a privately owned, publicly regulated model. While radio and television stations are licensed by the federal government with a requirement to serve the public interest, most are run to generate profits for their private-sector owners from selling advertising time.

Endless innovation in telecommunications devices employing the Internet are flooding users with opportunities to gather information, do business and maintain social contacts across the country and around the world.

Government's Role

Americans have long debated the proper role of government in the economy. In 2010 that debate focused on issues including government rescues of big financial institutions and automobile manufacturers in the recent severe recession, mandated expansion of health insurance coverage to more people, tougher financial regulation and offshore oil drilling.

The debate goes back to the nation's founding. A range of taxes imposed by the British helped trigger the Revolutionary War in 1775. Alexander Hamilton, the United States' first secretary of the Treasury, succeeded in establishing a national central bank but lost his campaign for a federal policy to promote strategically important industries. The central bank charter was allowed to expire in the 1830s; the United States had no central bank from then until the creation of the Federal Reserve in 1913.

Government intervenes in the economy in at least four ways:

- It provides such goods and services as roads, education, public safety and national defense.
- It transfers income between groups of people, most notably to retirees from younger workers through the Social Security and Medicare programs.
- It collects taxes and borrows money to pay for spending.
- It regulates business activity.

Federal, state and local governments have from the beginning regulated the economy, intervening to help the interests of specific regions, industries and individuals. Just how far the government should go in doing this has long been the source of much debate.

Federal Reserve Chairman Ben Bernanke, left, and Treasury Secretary Tim Geithner are charged with carrying out federal monetary and economic policy.

The legal justification for federal economic regulation rests on a few sections of Article I of the U.S. Constitution. These give Congress authority to collect taxes and duties, borrow on credit, pay the federal government's debts, create a U.S. currency and regulate its value, establish laws governing bankruptcy and naturalization of immigrants and grant patents and copyrights.

The most general — and controversial — language lies in Article I, Section 8, which authorizes Congress "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

Courts interpreted the Constitution's "commerce clause" narrowly in the 19th century. Later, with the consent of the courts, the federal government interpreted the clause to justify far-reaching programs that the nation's Founding Fathers could probably never have imagined. In the 1960s, for example, the courts affirmed civil rights laws against racial discrimination on the basis of Congress' power to regulate interstate commerce. Beginning in the 1990s, a number of court rulings sought once again to narrow the scope of the commerce clause to issues directly connected with economic activities.

In the life cycle of an American business, the first step is the least regulated of all. An entrepreneur seeking to form a new

Financial Regulation

Some U.S. financial institutions are subject to government regulation, and some are not. Banks are the most highly regulated U.S. financial institutions. Since the 1860s the federal government has required national banks to maintain adequate capital reserves, a measure designed to deter excessively risky loans. Since the Great Depression of the 1930s the government has insured bank deposits up to a defined level (currently $250,000 per depositor per bank).

Financial institutions that manage investments of stocks, bonds, and other instruments are not subject to as much regulation as U.S. banks. The government requires these firms to disclose fully to investors the risks of investing but does not prevent investors from taking excessive risks, does not insure investments and mostly relies on industry self-regulation.

Essentially unregulated are a number of other non-bank financial activities, including the over-the-counter derivatives market, foreign exchange markets, secondary sales of U.S. Treasury bonds, nonbank mortgage lenders and hedge funds.

Ease of doing business for G-20 economies

(Ranking among 183 economies
June 2008 - May 2009)

4	United States
5	United Kingdom
7	Canada
10	Australia
11	Saudi Arabia
16	South Korea
18	Japan
22	Germany
26	France
34	South Africa
35	Mexico
65	Turkey
79	China
80	Italy
115	Argentina
121	Indonesia
123	Russia
127	Brazil
134	India

Source: World Bank

business need only register with state tax authorities. Those entering specific professions like medicine and law may need a license, typically awarded only after passing a comprehensive examination, but starting a company requires no permission.

No legal business in the United States escapes some regulation. Laws passed by Congress and regulations adopted by administrative agencies so authorized by Congress seek to prevent businesses from exercising monopoly power or operating fraudulently. Financial regulations aim to protect people's savings and investments from business mismanagement or unscrupulous practices [see sidebar on financial regulation, page 51]. Health and safety regulations are designed to protect the public from unsafe foods, drugs, toys, autos, airlines and other products and services. Another set of statutes and regulations protects workers' health and safety.

Other legal provisions balance the rights of workers and employers. In most states workers are considered "at will" employees, meaning they can be discharged whenever the employer chooses — except in narrowly defined circumstances. Under federal law, workers may not be fired because of their race, gender, age or sexual preference. A federal "whistle blower" law protects employees who disclose an employer's illegal activities.

Congress in 1898 gave workers the right to organize labor unions and authorized government mediation of conflicts between labor and management. During the Great Depression, Congress passed the National Labor Relations Act of 1935 (commonly known as the Wagner Act) that more specifically set out the rights of most private-sector workers to form labor unions, to bargain with management over wages and working conditions and to strike to obtain their demands. The Fair Labor Standards Act passed in 1938 established a national minimum wage, prohibited oppressive child labor and provided for overtime pay in designated occupations.

Enforcement of U.S. antitrust laws (or competition laws) for more than a century reflects the evolving debate over government regulation. By the end of the 19th century, concerns about economic power had focused on monopolies that controlled commerce in industries as diverse as oil, steel and tobacco, and whose operations were often cloaked in secrecy because of hidden ownership interests.

The monopolies typically took the form of "trusts," with shareholders giving control of companies to a board of trustees in return for a share of the profits in the form of dividends. More than 2,000 company mergers were accomplished from 1897 through 1901. In the latter year, Theodore Roosevelt became

Corruption perceptions ranking for G-20 economies, 2010

(Ranking among 178 economies from lower to higher perception of corruption)

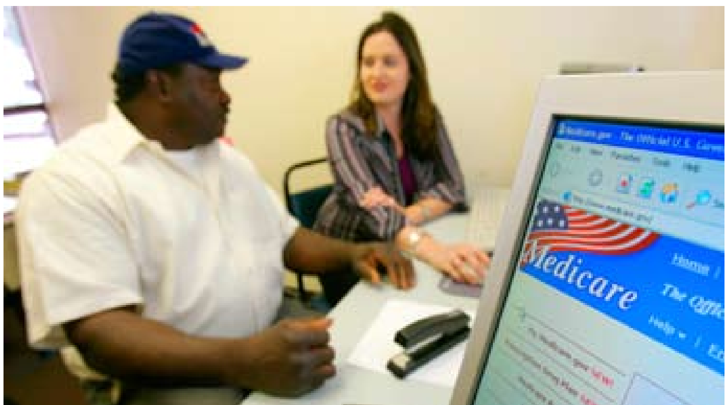
6	Canada
8	Australia
15	Germany
17	Japan
20	United Kingdom
22	United States
25	France
39	South Korea
50	Saudi Arabia
54	South Africa
56	Turkey
67	Italy
69	Brazil
78	China
87	India
98	Mexico
105	Argentina
110	Indonesia
154	Russia

Source: Transparency International

president and began a "trust-busting" campaign aimed at what he called the "malefactors of great wealth."

Under Roosevelt and his successor, William Howard Taft, the federal government won antitrust lawsuits that broke up most of the major monopolies, including John D. Rockefeller's Standard Oil trust; J.P. Morgan's Northern Securities Company, which dominated railroads in the Northwest; and James B. Duke's American Tobacco trust.

The government's main antitrust authority resides in two laws. The Sherman Antitrust Act of 1890 aims to stop conspiracies



The federal government transfers income from working people to the elderly through Social Security, Medicare and other programs.

among companies to fix prices and restrain trade; it also empowers the federal government to break up monopolies into smaller companies to promote competition. The Clayton Act of 1914 defines anti-competitive and unfair practices more specifically and gives government the right to prevent mergers of companies that could undermine competition. Additional federal statutes address specific industries.

In deciding how far government should go to protect competition, the focus at the start was on the conduct of dominant companies, not their size and power alone. In 1911, the Supreme Court set down its "rule of reason," which stated that only unreasonable restraints of trade — those that had no clear economic purpose — were illegal under the Sherman Act. A company that gained monopoly power by producing better products or following better strategies should not face antitrust penalties.

During the Great Depression, however, Congress passed the Robinson-Patman Act aimed at maintaining a balance between nationwide manufacturing and retailing businesses on one side and small businesses on the other. The idea that the law should preserve a competitive balance by restraining dominant companies regardless of their conduct was reinforced by court decisions into the 1970s. At the peak of this trend, the federal government was pursuing antitrust cases against IBM Corporation, the largest computer manufacturer at the time, and AT&T Corporation, the national telephone monopoly.

In the 1980s, under President Ronald Reagan, the federal government shifted its competition policies in line with the philosophy of University of Chicago academics, such as Nobel Prize-winning economist Milton Friedman. According to "Chicago School" theory, government antitrust enforcement usually fails to promote competition. Chicago School proponents assert that self-correcting market forces will almost always restore competition.

Each presidential administration interprets antitrust law with varying degrees of aggressiveness. Under President Bill Clinton in the 1990s, for example, the Justice Department prosecuted the Archer Daniels Midland (ADM) company for allegedly conspiring with Asian partners to monopolize the sale of several feed products and additives. Eventually three ADM executives went to prison, and the company paid $100 million in fines.

The Clinton administration also launched in 1998 a case against Microsoft Corporation, which then controlled most of the market for personal computer operating systems software. When Microsoft built its Internet Explorer browser software into its dominant Windows operating system, antitrust regulators accused Microsoft of leveraging its market power over operating systems to dominate the browser market.

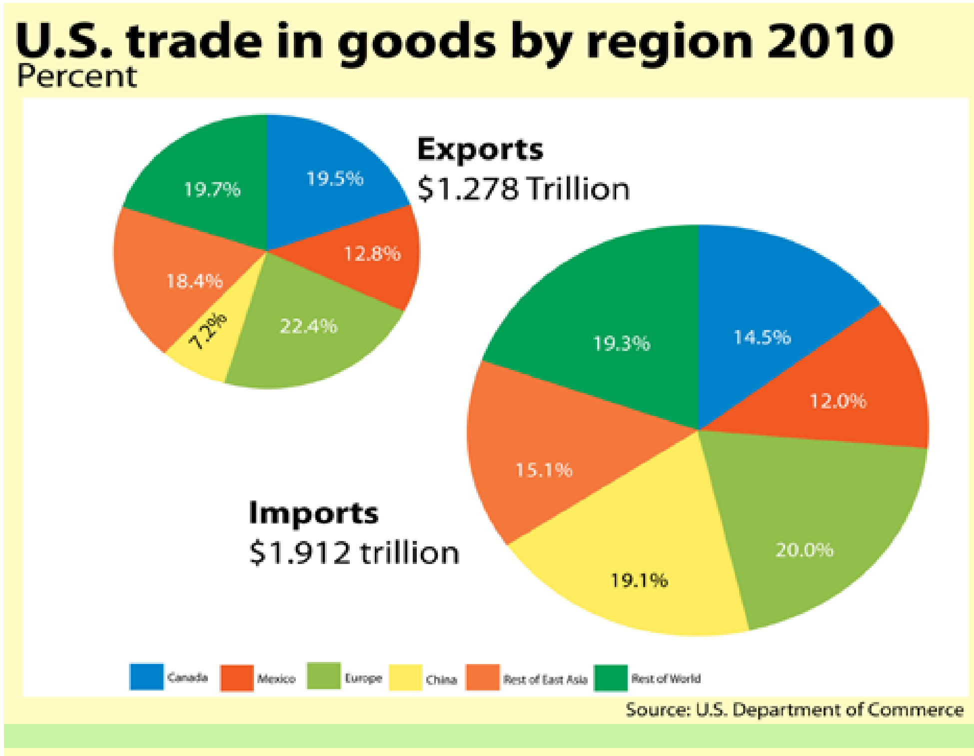
A federal judge ruled against Microsoft, but an appeals court overruled that decision. In the appellate judge's view, Microsoft's offer of its browser software for free, while hurting smaller competitors, nevertheless benefited consumers and allowed the kind of innovation that ultimately promotes economic competition. President George W. Bush halted the Justice Department's case against Microsoft.

The severe recession that began in late 2007 has shattered many people's belief that markets are self-correcting and have no need for regulation. President Barack Obama pledged to enforce antitrust law with vigor. His Justice Department prosecuted cases against a number of foreign air freight carriers and against a number of Asian manufacturers of liquid crystal display panels, resulting in collection of more than $1 billion in fines in 2009, the second highest total for any year.

Rapid globalization has also forced reconsideration of competition law. Fewer U.S. markets remain primarily domestic; more U.S. producers compete against foreign companies that operate under different regulatory regimes. For more than a decade, the Justice Department has been forging cooperative agreements with antitrust authorities in foreign countries. It entered into such an agreement with its Russian counterpart in 2009 and has started engaging relatively new competition authorities in China and India.

Linked to the World

Trade ties the U.S. economy inextricably to other world economies. In 2010, U.S. exports of goods and services amounted to $1.8 trillion, about 12.5 percent of gross domestic product; U.S. imports were much higher, $2.3 trillion. Americans have for years imported



far more goods and services than they exported, incurring increasing debts to foreigners in the process. The U.S. deficit of $470 billion in 2010, although down in the recession from $706 billion in 2008, still came to more than five times that of Spain, the country with the next largest deficit.

Huge tides of financial transactions flow daily across U.S. borders. At the end of 2009 U.S. companies and individuals had more direct (non-stock share) investment in non-U.S. companies than those of any other nation. U.S. companies similarly were the greatest recipient of foreign direct investment. U.S. exports of goods in 2010 came to $1.3 trillion. Top exports were autos and auto parts ($112 billion), civilian aircraft and aircraft engines ($53 billion), pharmaceuticals ($47 billion) and semiconductors ($47 billion). Categories of chemical exports added up to $67 billion. The United States' largest trading partners in 2010 were Canada, China, Mexico, Japan, and Germany.

In 2010 the United States remained the top agricultural exporting country, shipping goods worth a record $116 billion. "For the first time, China emerged as the top market for U.S. agricultural products, with $17.5 billion in sales," Secretary of Agriculture Tom Vilsack said. "Canada was second with $16.9 billion." About a third of U.S. harvested acreage is exported.

Total U.S. imports of goods in 2010 came to $1.9 trillion. By far the biggest import was crude oil, $252 billion, down from $342 billion in 2008 because of the recession. Other top exports were autos and auto parts ($225 billion), pharmaceuticals ($85 billion), and computer accessories ($61 billion).

Services accounted in 2010 for 30 percent of total U.S. exports, $543 billion; more than 30 percent of services exports involved travel and transportation. Services imports, including transport of goods on non-U.S. ships and flights on non-U.S. airlines, that year came to $394 billion.

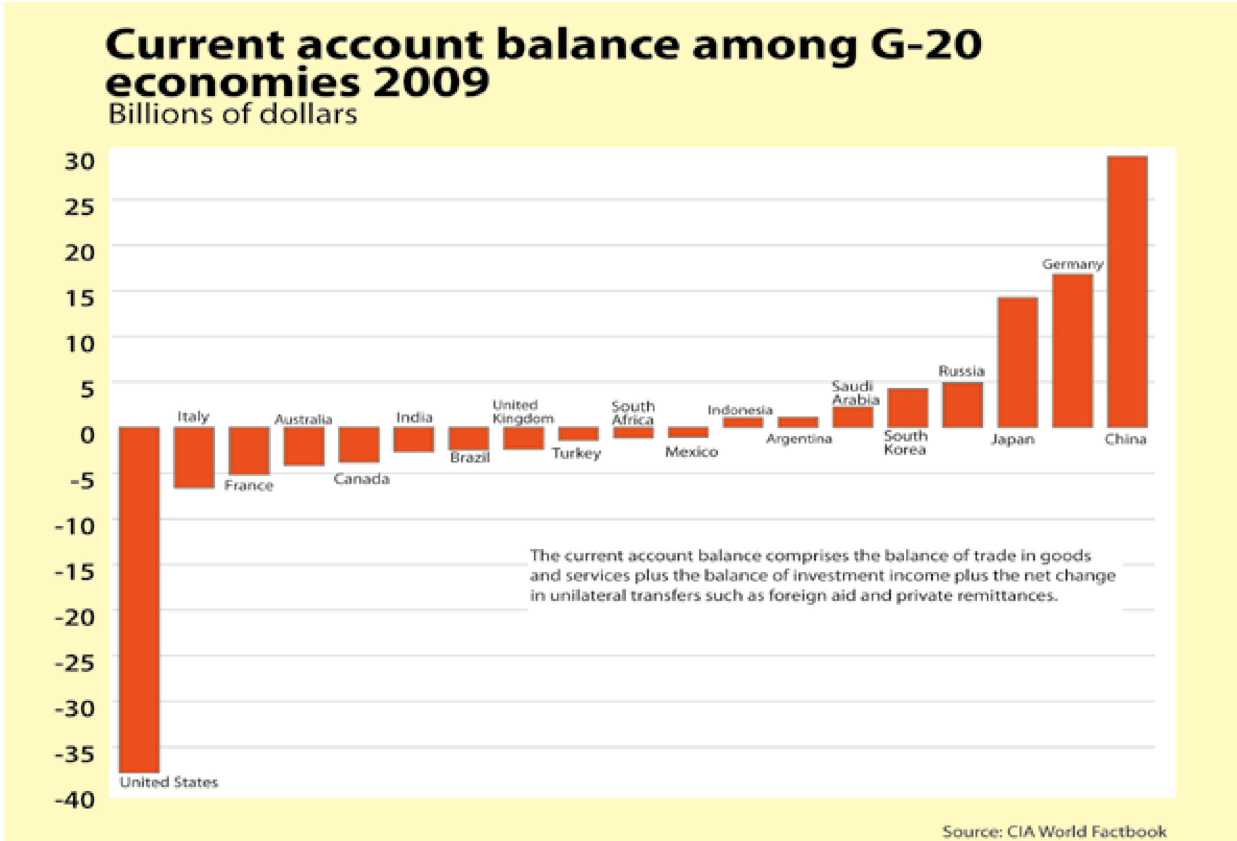
The United States has remained the top agricultural exporter.

The U.S. economy is one of the most open to trade and foreign investment, but that was not always so. The record high tariffs imposed by the Smoot-Hawley Act of 1930 brought retaliatory tariffs by U.S. trading partners and, in the view of many scholars, worsened the worldwide Great Depression.
Since World War II, the United States has become a leader for free trade. In General Agreement on Tariffs and Trade (GATT) negotiations and, since 1995, in World Trade Organization

(WTO) negotiations, the U.S. has pressed for tariff cuts and reductions in nontariff barriers.

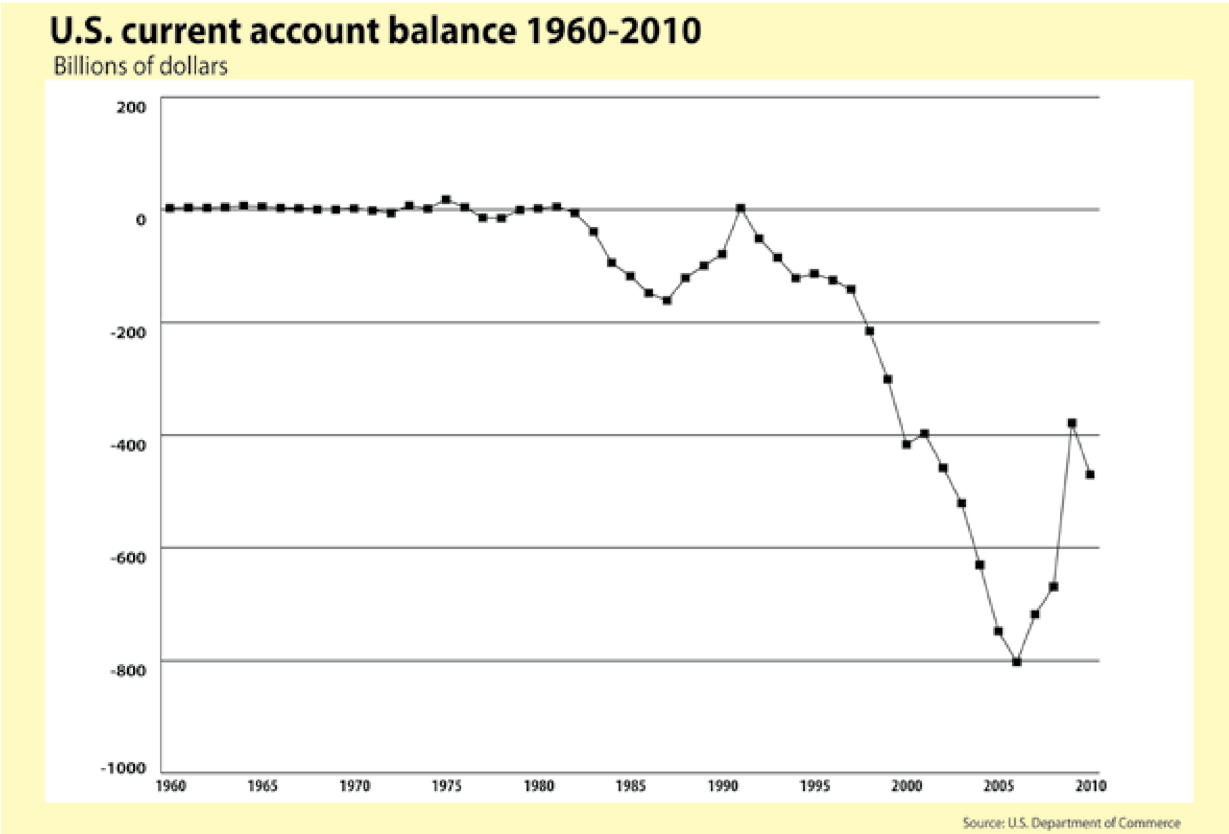
Trade negotiations have become increasingly difficult, however. A WTO round launched in Doha, Qatar, in 2001 has stalled

Reflecting the change in policy, U.S. Secretary of State Cordell Hull said in 1948 that open trade "dovetailed with peace; high tariffs, trade barriers, and unfair economic competition, with war. … If we could get a freer flow of trade … so that one country would not be deadly jealous of another and the living standards of all countries might rise, thereby eliminating the economic dissatisfaction that breeds war, we might have a reasonable chance of lasting peace."



for nine years over major divisions between developed and emerging economies on a range of agricultural subsidy issues.

At a June 2010 meeting in Toronto, G-20 leaders dropped previous language setting a target date for completion of the negotiations.



The United States negotiated a number of free-trade agreements (FTAs) with partners from 1990 through 2005. The biggest ones — with Canada, Mexico, and Central America (NAFTA and CAFTA) — remain politically controversial in the United States. Subsequent FTAs negotiated by President George W. Bush's administration with Panama, Colombia, and South Korea continue to await congressional approval.

Financial Crisis

Debate will likely persist for decades over what forces combined in 2007 to trigger the financial crisis that led to the worst U.S. recession since the Great Depression. In earlier periods of economic turmoil, the economy bounced back after the Federal Reserve moved vigorously to lower interest rates. But record low interest rates in 2008-2010 failed to spark the bank lending required to get the economy expanding again. One difference between the most recent recession and earlier recessions is the level of consumer, corporate and government debt.

Many Americans took on significant amounts of debt to purchase homes during a period when real estate prices increased dramatically. When housing prices plunged and borrowers stopped paying loans, the bubble burst, shocking the entire financial system. High-risk mortgage-backed securities were at the heart of the crisis.

In 2010 Congress passed and President Obama signed legislation called the Dodd-Frank Act. The law is designed to:

■ Prevent banks and other financial firms from becoming "too big to fail" thus requiring a government bailout.
■ Give regulators authority to take over and shut down troubled financial firms in an orderly way before they threaten economic stability.
■ Prohibit banks from engaging in speculative investments on their own – that is, not based on demand from a customer.
■ Identify and address risks posed by complex financial products and practices before they threaten economic stability.
■ Give the Federal Reserve authority to regulate non-bank businesses such as insurance companies and investment firms that predominantly engage in financial activities.
■ Regulate such potentially risky practices as over-the-counter derivatives, mortgage-backed securities and hedge funds.
■ Protect consumers from hidden fees and deceptive practices in mortgages, credit cards and other financial products.
■ Protect investors through tougher regulation of credit rating agencies.

During the severe economic recession President Obama has signed legislation that increases the federal budget deficit but has also committed to bringing the deficit down in years ahead.

A New Chapter

"The hard truth is that getting this deficit under control is going to require broad sacrifice."
President Barack Obama, 2010

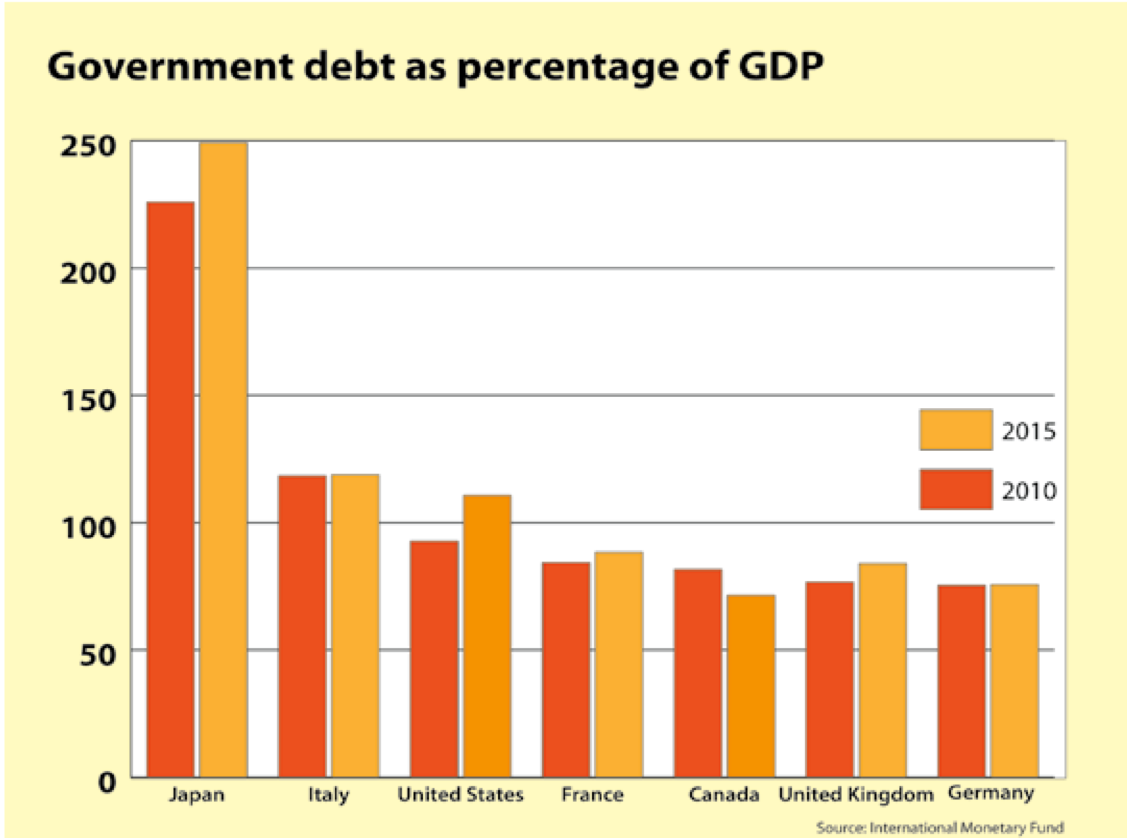
The United States and much of the developed world escaped the worst of the possible outcomes associated with the 2008 financial crisis. But the United States and other industrial nations still faced high unemployment, unsatisfactory economic growth and a vulnerable economic future. Financial emergencies in several European nations in 2010 demonstrated that parts of the world's banking system were still on thin ice.

Several conclusions seemed inescapable. Economic globalization, which has linked banking and trade on every continent, enabled the financial market contagion to spread worldwide. Leaders of the United States and other major economies agreed that a new system of financial market supervision and regulation would have to be created to restore investors' battered confidence in markets and revive investment.

The United States enacted financial reforms in 2010 in order to raise banks' capital requirements, strengthen consumer protections and empower regulators to take action against major banks that faced risks of insolvency. The legislation left key details up to regulators, however, and their actions would determine the effectiveness of the reforms. Despite the recognition that leading economies should harmonize their bank regulations, there were large gaps in reform achievements internationally at the end of 2010.

One consequence of the emergency measures taken to stimulate the economy and shore up threatened financial institutions is a drastic increase in the federal budget deficit.

A bipartisan National Commission on Fiscal Responsibility and Reform appointed by Obama concluded in 2010 that the nation was on "an unsustainable fiscal path," forced increasingly to borrow huge amounts to cover shortfalls in revenues. "Since the last time our budget was

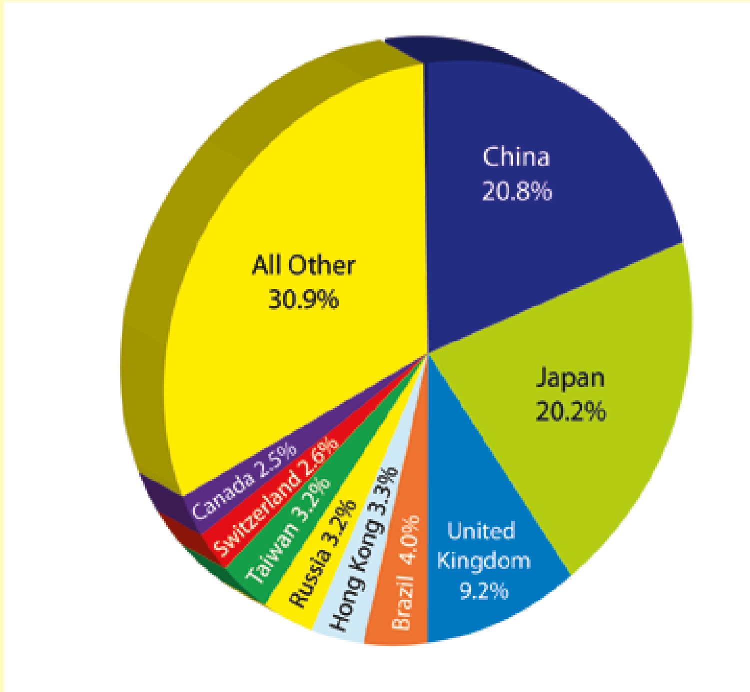


balanced in 2001, the federal debt has increased dramatically, rising from 33 percent of GDP to 62 percent of GDP in 2010," the commission reported.

As the 2000s decade proceeded, foreign investors financed an increasing share of U.S. government debt. In mid-2000, this debt totaled $1 trillion. Eight years later, the total was $2.7 trillion, with foreign government-owned banks or "sovereign" investment funds holding the fastest-growing share. U.S. dollars flowing overseas for manufactured goods and oil enabled foreign entities to purchase U.S. Treasury securities and other U.S. government debt. America, in essence, was borrowing from the future to finance current consumption.

Major foreign holders of U.S. Treasury securities

July 2010



Source: U.S. Treasury Department

"The next crisis will be related to our own federal government's daunting fiscal challenges," according to economist Mark Zandi.

The Congressional Budget Office predicted that the fiscal deficit in the year ending September 30, 2011, would surge to $1.5 trillion, about 9.8 percent of gross domestic product, attributable mostly to an extension of 2001 tax cuts that had been scheduled to expire in 2010.

President Obama has stated that "The hard truth is that getting this deficit under control is going to require broad sacrifice." After the 2010 elections, Republicans resumed control of the House of Representatives, clashing

Unemployment rate 1948-2010

Percent

Median weeks unemployed 1967-2010

Source: U.S Labor Department

with Obama over how much and where to reduce government spending.

A growing disparity in the distribution of the economy's rewards raised even higher the political hurdles to achieving both domestic economic reform and international economic cooperation. Scholars have identified a number of possible factors that, taken together, have increasingly concentrated income and wealth gains among a small minority of the U.S. population.

Among them: the decline in higher-paid manufacturing jobs and a shift toward lower-paid service employment, the growing employment disadvantages of less-educated workers in a highly technical economy, and the burden of rising medical care costs for America's lower- and middle-income families. Because of these and other factors, the average wage of U.S. nonfarm workers has not increased appreciably since 1980, after taking inflation into account.

Immediately following his election to the presidency, Obama began to shape a large-scale federal response to the emergency. The massive economic stimulus plan passed by the U.S. Congress early in his administration distributed federal funding, loans, and tax cuts throughout the faltering economy. It also sought to use federal dollars to fuel a rapid expansion of new, advanced-technology energy and environmental initiatives. These developments, it was hoped, would create new markets at home and overseas for American companies and millions of jobs for workers across a wide range of skill levels.

The Obama administration invested an unprecedented $32 billion in stimulus funds, and billions more in tax credits and loan guarantees, in a wide range of clean-energy research and development initiatives in 2009 and 2010. The ventures spanned many fronts: advanced nuclear reactors, wind and solar generation, advanced storage batteries, "smart" electricity meters and electricity grid-monitoring equipment, biomass, and greenhouse gas sequestration from coal plants. Many projects combined research from U.S. universities and national laboratories and financial backing from private venture investors, accompanying government grants in a characteristic synergy of U.S. innovation.

Some Americans posed philosophical and political challenges to this vision, and longstanding quarrels over the desirability of government intervention in the economy continued.
More optimistic observers noted that America still could bring important resources to bear on the challenge of devising new energy strategies, among them its entrepreneurial culture, the

Wind power is one type of clean energy promoted by the Obama administration.

depth and breadth of its educational system and the freedom it afforded capital to seek the highest returns.

Applying these real strengths to the nation's equally real challenges will be a great test for the current generation of Americans. But it also is true that Americans have faced and surmounted such challenges in the past, as President Obama reminded the nation in his 2011 State of the Union speech.

"We know what it takes to compete for the jobs and industries of our time. We need to out-innovate, out-educate, and out-build the rest of the world," Obama said. "We have to make America the best place on Earth to do business. We need to take responsibility for our deficit and reform our government. That's how our people will prosper. That's how we'll win the future."

In other times of crisis, the country found a way forward despite the fractious aspects of democracy. With much at stake, the new century provides Americans the opportunity to write a new chapter of the nation's economic story.

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