The Economist

Special report: Business in America

The coming recovery

It could take a while, but Main Street will bounce back

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Getty Images

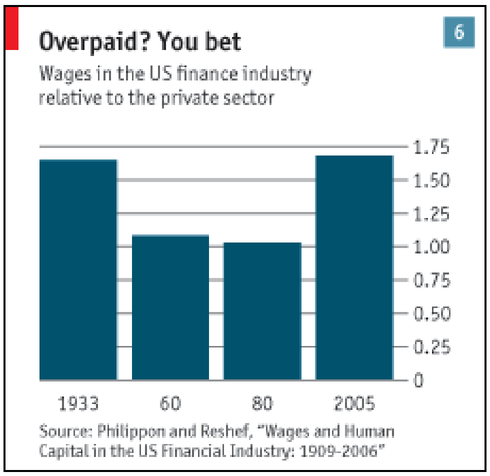
JOHN RICH, a country-music star, sings an angry song about the recession. “While they're living it up on Wall Street in that New York City town/Here in the real world they're shuttin' Detroit down,” complains Mr Rich. He adds that “The boss man takes his bonus pay and jets on out of town/And DC's bailing out them bankers as the farmers auction ground.” The accompanying video shows a car worker losing his job and home.

Mr Rich is not just another bleeding-heart celebrity. He wrote John McCain's campaign song last year and performed at the Republican convention. But he is furious about fat-cats. And whereas one can quibble that the folks on Wall Street are not really having much fun this year, or that carmakers and farmers have also received hefty subsidies, it is worth pondering his rage, for it is shared by Americans of every ideological hue.

Few understand what a credit-default swap is, but everyone knows that Wall Street messed up, and nearly everyone feels it, too. Those who have not lost a job have seen their wages frozen or the value of their savings crumble. The financial collapse has exposed newsworthy frauds, like the colossal Ponzi scheme run by Bernard Madoff. Such swindles were not typical. The crisis owes far more to incompetence than criminality. But neither explanation reflects well on the captains of capitalism.

A Rasmussen poll in April found that only 53% of Americans think capitalism is better than socialism, with 20% preferring socialism and 27% unsure. Those are alarming numbers for believers in free markets. They may be misleading, however. Some Americans are hazy about what "capitalism" and "socialism" mean. A later poll found that 77% of Americans preferred a free-market economy to one managed by the government. And hardly anyone thinks the government would do a better job than the private sector of running banks or car factories.

Americans are angry first and foremost with financiers. They also take a dim view of overpaid and underachieving bosses, particularly if they fly to Washington by private jet to beg for a handout from taxpayers. But they admire entrepreneurs: 79% think them critically important to job creation. And although a slim majority approve of Barack Obama's expansion of government to tackle the immediate crisis, only 13% want that expansion to be made permanent. In short, Americans favour incremental rather than radical change. They want to see Wall Street tamed, but they are not clamouring to reinvent the relationship between government and business.



They will probably get their wish. The financial industry grew far too big. Its share of corporate profits in America peaked at an incredible 41% in 2007. Its employees, who were paid about the same as those in other industries until the early 1980s, pocketed 1.8 times as much in 2007 (see chart 6). Judged by the fruits of their labours, they did not deserve it. Thomas Philippon of New York University and Ariell Reshef of the University of Virginia estimate that 30-50% of the wage gap between financial and non-financial workers between the mid-1990s and 2006 was the fruit of what they judged to be rent-seeking rather than genuine wealth-creation. That will now change. A smaller, humbler, more regulated financial sector will emerge. Many of the brainy youngsters who used to flock to investment banks or hedge funds will put their talents to other, perhaps more productive, uses.

Mr Bush of Athena Health thinks this is terrific. The clever people he could not recruit because Goldman Sachs was paying them $65,000 a month are suddenly available, he says. Robert Kaplan of Harvard Business School, a former vice-chairman of Goldman Sachs, applauds the prospect of pay in financial services reverting to less giddy levels. Only people genuinely interested in finance will seek careers in it, he says. Fewer will do jobs they hate just for the money. More will start their own companies. Mr Bhidé of Columbia University calls for a return to "more primitive finance", with deposit-taking banks strictly regulated and strictly separated from the more innovative, risky financial firms, to avoid a repeat of the recent contagion.

Main Street will recover only when America's finances are on a sounder footing. That will take time. Total private-sector debt (households, financial and non-financial firms combined) reached nearly three times GDP last year. Reducing that load will hurt. Money spent repaying debt cannot be spent on the products that American firms are so desperate to sell.

Corporate profits collapsed by 10% last year, and continue to slide. But they will eventually rebound. Chris Varvares, the president of Macroeconomic Advisers, a consultancy, predicts that they will find a sustainable level of about 9% of GDP by 2011. That is well short of their 13% share in 2006. But it is high enough, for example, to help pension funds to start recovering from their recent pummelling.

There are reasons for guarded optimism. One is Mr Obama. Businessfolk worry that he is too cosy with lawyers and labour unions, that he will raise taxes to enterprise-throttling heights, or that his propping-up of badly run firms is unfair to their better-run competitors. None of these worries is baseless. But the evidence so far suggests that the new president understands America's economic problems and is pragmatic about seeking solutions. There is no reason—yet—to doubt his promise to tackle the budget deficit once the crisis subsides. And America is fortunate to have had a change at the top just as the crisis exploded. A crisis requires a bold response. Mr Obama's fresh mandate and personal popularity make it easier for him to provide one.

The spirit of enterprise

When the crisis ends, America will still be the best place in the world to do business, says Niall Ferguson of Harvard University. Unlike in parts of the developing world, its political stability is not in doubt. American innovation continues apace, just as it did during the Depression of the 1930s (which saw the invention of nylon, canned beer, the photocopier and the drive-in cinema) and the stagflation of the 1970s (Post-it notes, bar codes, the microprocessor). Not only is America's market the largest, but that market is homogeneous: a firm that works in one state can probably work in any other. “I laugh when people talk about diversity here,” says Mr Ferguson. And America has economic policy levers commensurate with its size: the European Union has no central treasury to compare with America's, and America's central bank has acted more aggressively to tackle the crisis because it can.

Finally, there is that gung-ho spirit of enterprise. “I think people will be surprised how quickly [business] will pick up when it does,” says Mr Sorenson of Marriott hotels. One can discount his words, of course. Business people are by nature optimistic, especially in America. But their optimism can be self-fulfilling.