

Down But Not Out

BY JOHN A. WEINBERG

Historically, the United States has rebounded strongly from deep recessions. During the two years following the 1981-1982 recession, for example, GDP growth averaged nearly 7 percent. Many people predicted a similar trajectory for the U.S. economy following the most recent recession, but that has not been the case: Annual average GDP growth since 2010 has been just 2.3 percent. Not only is growth slower than might be expected following a severe recession, it's also a departure from our postwar experience. Between 1946 and 2006, annual GDP growth has averaged 3.2 percent. During no other non-recessionary period has GDP growth been as slow as at present — leading some observers to conclude that U.S. economic growth is “over.”

Why might this be? One argument is that the remarkable improvement in living standards that began around 1750 was an anomaly in American history, not to be repeated. During this period we witnessed extraordinary innovations that greatly increased our economy's productivity, such as the steam engine, electricity, and indoor plumbing, to name just a few. But the innovations of today — touchscreens, streaming video, and new networking platforms — are unlikely to produce the same kinds of gains.

Before assessing these claims, it will help to talk about the factors influencing economic growth in a bit more detail. Basically, growth is a function of employment and labor productivity, that is, how many people are working and how much they can produce. Labor productivity depends on the amount of capital inputs combined with labor, but it also depends on technology — the state of our knowledge about how to produce goods and services from the inputs we have. But it's very difficult to forecast advances in technology and knowledge, which means it's also difficult to forecast changes in productivity.

In the late 1930s, for example, Alvin Hansen, an economist at Harvard University and consultant to the Federal Reserve Board and the Treasury Department, predicted that declining population growth and slowing innovation would cause “secular stagnation” in the United States. But he was quickly proven wrong by the postwar economic boom, and productivity growth averaged 2.6 percent per year between 1947 and 1971.

Productivity changes are hard to quantify even when innovation would seem to be all around us. In the late 1980s and early 1990s, economists identified a “productivity paradox”: Despite tangible advances in computing and the adoption of new information technology by many businesses, productivity growth actually declined. As Nobel

laureate Robert Solow wrote in 1987, “You can see the computer age everywhere but in the productivity statistics.” Just a few years later, however, the computer age *did* show up in the statistics: Productivity growth averaged 2.7 percent between 1996 and 2001. The fact that we do not currently see the innovations of the past few years in productivity statistics might simply indicate that businesses need time to learn about the new technologies and fully incorporate them into their operations — not that the innovations are without value.

What this history suggests to me is that while qualitative observations on technology trends are interesting, it's hard to infer much from them about the future of average, economy-wide productivity growth. That's why I'm not yet ready to agree with those who believe that the current productivity slowdown finally heralds the secular stagnation predicted by Hansen eight decades ago.

That doesn't mean the United States doesn't face some significant headwinds at present. First, population growth is slowing, which means the size of the working-age population is growing more slowly as well. It's also the case that the fraction of the population that is working or looking

for work is near its lowest rate in decades, due to a combination of demographic factors, structural changes in the labor market, and lingering effects of the Great Recession. In addition, although government spending has declined recently, fiscal policy as described in current law is unsustainable, and uncertainty about how we will address our debt and deficit might be inhibiting consumer and business investment.

These factors could be contributing to the current slow rate of GDP growth, and they might restrain growth for some time. But even if growth is likely to be slower over the medium term, history suggests that we should be skeptical of our ability to predict with any confidence what's likely to happen over the long term. Persistence is not the same as permanence.

Moreover, there are a number of reasons to be optimistic about the country's future: America's colleges and universities are second to none and attract students from all over the world. Our public policy problems may be challenging, but they do have solutions. And our markets are flexible and have demonstrated their resiliency time and time again, as when we emerged from the Great Depression or from the stagflation of the 1970s. Economic growth might be slower for the foreseeable future, but in my opinion it is far from over.

EF

Some observers have concluded that American economic growth is over.

John A. Weinberg is senior vice president and director of research at the Federal Reserve Bank of Richmond.