Is America's time up?

Persistent low economic growth, rates of inflation and falling real interest rates within a country's economy is a concept first coined after the Wall Street Crash of 1929, by Alvin Hansen. A term recently revived by Larry Summers, 'secular stagnation' has now become prevalent amongst the advanced economies globally. Proven through the diminishing levels of productivity throughout the United States, predating 2008. Although the crash in 2008 most likely magnified the problem, evidence suggests that the stagnation isn't just a mere repercussion of 2008, or just an attempt to reduce current account deficit, which many economists previously thought to be true.

According to economist Larry Summers, secular stagnation within advanced economies like the US is due to a chronic lack of demand. Within the first decade of the millennia, there were dangerous levels of borrowing, translating into excess savings; quickly escalating to become a housing bubble and effectively triggering the 2008 credit crunch. According to Summers, "recently the aggregate current account deficit of the industrial world has been very close to zero"[1] and has sub-zero inflation rates. Summer's analysis of these markets predicted that these negative/low inflation rates would persist for at least another 30 years. The recent COVID-19 outbreak has exacerbated these trends, with GDP in the US predicted to fall 9%[2] in 2020, further compounding the problem. Real inflation rates over the past 40 years have been on a negative trajectory in the US. This decline has taken place despite a massive lean towards fiscal expansion.

Keynesian theory suggests that fiscal spending should alleviate the problem, with lower interest rates stimulating consumption and investment, as opposed to classical free market economists, such as Hayak, who believes that market powers will resolve inefficiencies and establish new equilibriums. This radical supply side approach, in theory should work, but when we bring in real life factors, the infamous quote, "In the long run, we are all dead"[3] sums it up perfectly. Inferring that the timeframe for recovery is just too long.

Supporters of Summers who favour a Keynesian perspective say a more proactive approach needs to be taken by the US government. A potential policy implementation could be a wealth tax where income would be redistributed from those with a lower marginal propensity to spend to those higher propensity households, causing an injection into the circular flow. This inturn balancing out the failure of real income growth giving the poorest disposable income at a time when the Gini coefficient is relatively high at 0.48[4]. The focus needs to be more on efficient use of capital and the boosting of productivity. The bounce back of the US economy after WW2, spearheaded by Keynes with the social security scheme, showed this approach works. It was implemented with the aim to redistribute wealth to groups with higher propensities to spend in a bid to boost consumption and minimise the hit to the US economy. More recently, one key cause of stagnation was due to wages continuing to fall in real terms, therefore hindering consumption, and hence growth. The US is in a good position as they are able to utilize data from the past, as well as other countries in the same position, to maximise their chances of recovery.

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[1] (Peterson Institute for International Economics, 2019)

[2] (United States GDP Annual Growth Rate | 1948-2020 Data | 2021-2022 Forecast, 2020)

[3] (Keynes, 1923)

[4] (Duffin, 2020)

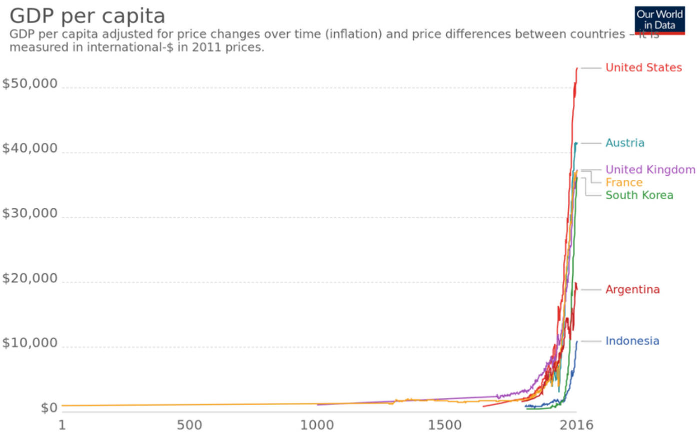
Other modern economies suffering with consistent low and/or decreasing rates of inflation include Japan, Greece and Spain. Japan has been suffering from a long term deflationary problem of low real inflation rates, dating back to the 1990s. Prime Minister Shinzo Abe implemented a radical three pronged attack on deflation: expansionary, monetary and fiscal policies, together with structural reform. Abe originally came to the conclusion that the deflation was derived from monetary problems within their economy but, having looked at the net debt interest payments over the past decade or so, we can deduce this to be false. The Japanese government's desire to stabilise their economy by accepting extremely low levels of interest of below 1% caused the debt to GDP ratio to soar as high as 236.6% in 2018.[5] They couldn't enforce fiscal policy in the form of implementation of higher tax rates due to the depression of nominal GDP. They could continue with these low levels of growth and hopefully recover through market forces, but the outcome was unknown. They decided to risk it and implement expansionary monetary policy to expedite the process, and made the late decision to adopt negative interest rates to combat the ageing population, whose life savings were held in central banks. This forced the Japanese people to withdraw their money. This policy introduction in early 2016 caused a growth of around 2% by 2017[6], but we can now see that it has gone back to original levels of close to zero. This backs up Hayak's view of allowing the market to find its own equilibrium and his belief that government intervention can further create inefficiencies, worsening the initial problem.

The Trump administration's economic policy has clearly been focused primarily on protectionism. Inefficient domestic industries throughout the US, but mainly concentrated in the central south, have been sheltered: it has been estimated that the protection of one steel worker's job can cost upwards of $900,000[7]. Clearly inefficient and a complete misallocation of resources. The US, being the world leader in innovation and technology, should instead focus its resources on markets where they have a comparative advantage. The initial selling points of Trump's campaign have drifted out of the limelight and been forgotten, such as going against his partys' free trade policies and imposing large tariffs, further reducing internal investment.

The US presidential structure allows a president to be in power for a maximum of 8 years, with the volatile nature of the battle between red and blue making it hard for consistent economic policies to be implemented successfully and so, arguably, has led to secular stagnation. During Obama's term between 2009-2017, he implemented long term stimulation policies which led to recovery from the 2008 crisis and contributed to the image portrayed by Trump as saviour of the US, where he might just be taking the spoils. With the recent catfight in the electoral debate, it seems that current US politics is Populism over Pragmatism and future generations will bear the costs of this short termism. In some cases it is better to take the large negative impacts in the short run and obtain enhanced long run investment to stabilize the economy. In other words: let certain, low productivity industries decline and focus on areas of higher return on investment.

[5] (Japan General Government Gross Debt to GDP | 1980-2019 Data | 2020-2022 Forecast, 2020)
[6] (GDP growth (annual %) - Japan | Data, 2020)
[7] (Long, 2020)

Economic expansion throughout time has occurred at an exponential rate. Conforming to both the Malthusian growth model and Moore's law. Malthus proposed at the end of the 18th century that the populations of the world would continue to grow at an exponential rate until stopped by disease, famine or war. Catalytic events like the industrial revolution led to rapid and large changes to the world's economies with huge boosts in real GDP per capita and again in the 20th century driven by the rapid pace of technological advances[8]. Before these rapid expansions, the world's economies were stagnating, proposing the idea of the secular stagnation being a form of retrenchment before the next "industrial revolution" type event. This concept is hard to grasp for us as we are unable to envisage the future. Such as, at the end of the 19th century, where it was thought that they were unable to expand the farming of crops at a rate to cope with the growth of the population. Due to lack of land being a fundamental factor of production, a Nitrogen rich 'cocktail' was invented, being fertilizer, which allowed farmers to maximise their yields without expanding their land. Perfectly displaying that a change in the production process that increases efficiency creates a vast rise in productivity, in turn spurring growth rates dramatically.



Is secular stagnation permanent? It is a definite possibility that secular stagnation might just be a feature of a fully developed economy, being one of the events Malthus alludes to, and hence something the US may have to learn to live with. But, equally, with new and exciting technology being developed (such as Elon Musk's Neuralink and developments within Artificial Intelligence) it is possible that these are indeed the next "industrial revolution" keeping the US as world leaders in economic growth. The COVID pandemic has shown that workers can quickly adapt to new ways of working and use new technologies. This workforce's ability to adopt new methods is essential to maximising productivity. So there is no better time for countries like the US to implement large scale changes in a bid to reignite economic growth and to utilize data from countries like Japan to allow them to create policy bundles to energise their economy. Has America's reign of dominance finally ground to a halt? Can more growth actually be achieved? Only time will tell...

[8] (Roser, 2020)

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