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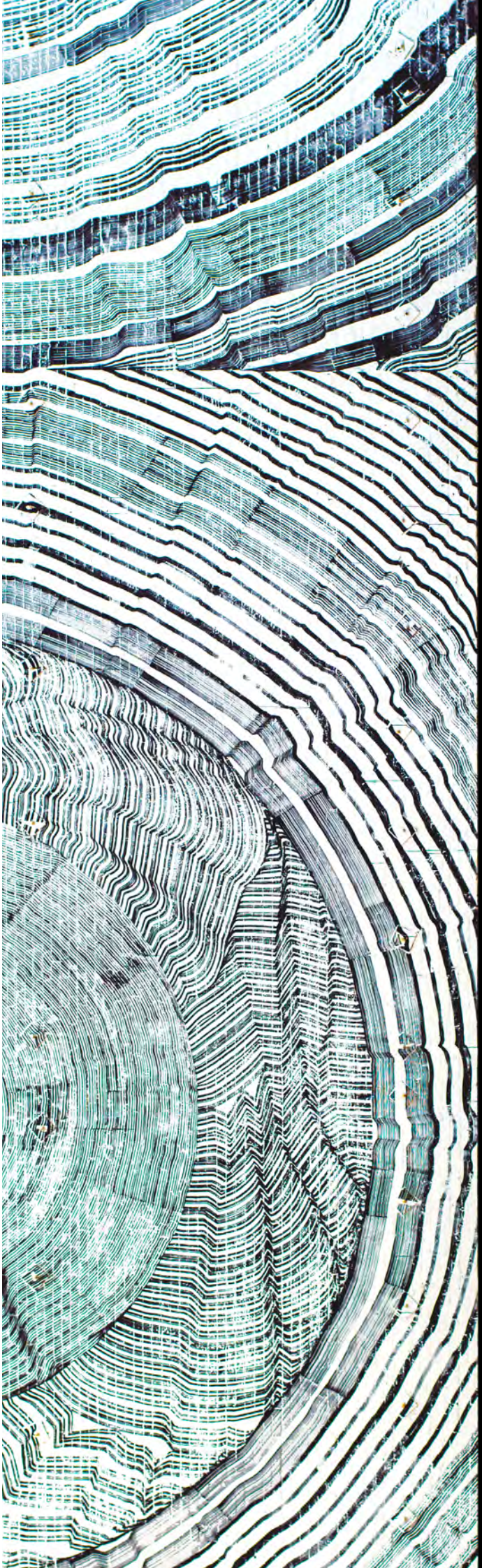
Understanding the ‘New Normal’

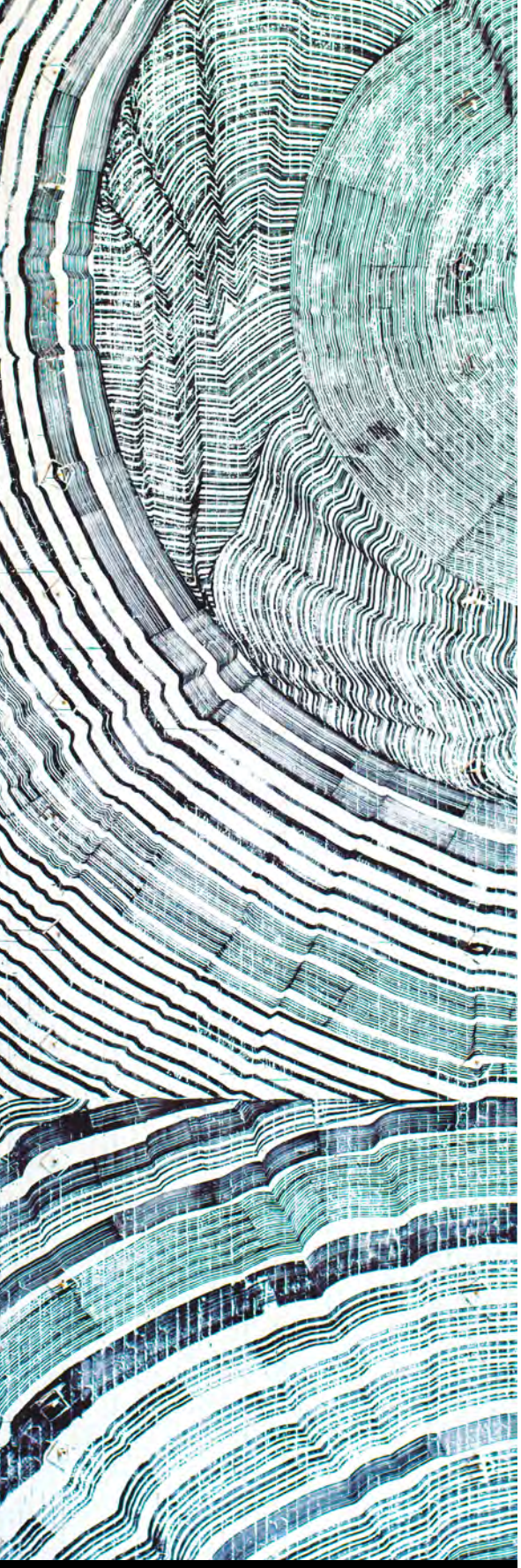
— The Challenge of Secular Stagnation



July 2018

An Economy That Works

Briefing Paper No.1



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Summary

This first in our series of briefing papers on building *An Economy That Works* explores the underlying phenomenon of 'secular stagnation' – a long-term decline in the rate of growth of the Gross Domestic Product (GDP). The paper examines the evidence, explores the causes and discusses the implications of what some now call the 'new normal'. It finds that:

- trend growth rates in GDP across the OECD declined from a peak of 4% per year in the mid-1960s to a little over 1% half a century later;
- trend growth rates in labour productivity declined from 4% per year to 0.6% per year over the same period;
- in the UK, there is a clear rise and fall pattern in labour productivity growth since the early 20th Century, with a peak in 1967 and a sustained fall since that time;
- over the last five years, trend labour productivity growth has remained below 0.3%, lower than at any time since records began in the mid 19th Century.

Perhaps most surprisingly, this analysis suggests that the rise of digital technologies has neither reversed nor even halted this long-term decline in labour productivity growth in the UK. The paper identifies four potential causes of the decline:

- an increasing price volatility in vital economic resources such as crude oil;
- a decline in the underlying quality of such resources – as measured for instance by the energy required to extract them and make then useful to society;
- a structural shift in advanced economies away from mining and manufacturing and towards services; and
- changes in the structure and organisation of the financial sector.

The first three could help to stimulate the transition to a sustainable economy: services are typically less damaging than mining and manufacturing activities and a decline in the use of crude oil could contribute to our carbon reduction targets. The final item on the list is troubling for two reasons. Firstly, there is evidence that these shifts in financial architecture have contributed to higher levels of inequality within advanced economies. Secondly, the changes themselves were motivated by the desire to stimulate economic growth. In other words, the very policies designed to prevent economic instability have ended up contributing to it.

Faced with this conundrum, it is clear that 'more of the same' will not deliver an economy that works for everyone. This paper argues that in order to make progress it is useful to re-frame four fundamental foundations on which the economy is built: enterprise, work, investment and money. Though it is beyond the scope of this paper to elaborate on these foundations in detail, we propose here the broad directions of travel, in which we frame:

- enterprise as a form of service
- work as a vital means of participation in society
- investment as a commitment to the future; and
- money as a social good.

Future briefing papers in this series will develop these themes in more detail.

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“ What if the rates of growth expected by economists and desired by politicians were no longer available?

The Challenge of Secular Stagnation

In November 2013, five years after the onset of the financial crisis, the former World Bank chief economist and ex-US Treasury Secretary, Larry Summers gave a speech to the International Monetary Fund (IMF) which sent something of a shock wave through the audience. He suggested that the slow growth rates and continuing uncertainties of recent years were not just temporary after-shocks from the financial crisis itself. ‘The underlying problem may be there forever,’ he said.[1]

Summers was neither the first nor the only commentator to make such a claim. But he was certainly the most renowned economist to do so. The repercussions were immediate. It suddenly became acceptable to ask previously unthinkable questions. What if the rates of growth expected by economists and desired by politicians were no longer available? What if low growth rates were not (as everyone hoped) a temporary phenomenon but a more entrenched ‘secular stagnation’ – a long-term decline in economic fundamentals?[2]

Economists disagreed over the causes of the slowdown. Summers attributed it to demand side factors, and in particular to ‘under-consumption’ by households in the advanced economies, overshadowed by rising personal debt and heightened political risk. Others believed the phenomenon arose from the supply side. The US economist Robert Gordon suggested that the slowdown in growth was the result of a decline in the pace of innovation since the middle of the 20th century. Many of the big technological advances of the last two centuries are now over, he argued.[3]

Whatever the balance between supply and demand-side factors, the global implications were becoming undeniable. In the mid-1960s, the trend growth rate in global GDP was 5.5% per year; fifty years later it had fallen to 2.5%. The phenomenon seemed particularly acute in the advanced economies. The trend growth rate in per capita GDP across the OECD nations fell from above 4% to a little over 1% per year during the same period.[4] For western countries in particular, secular stagnation is showing signs of becoming the ‘new normal’.[5]

“ Since its peak in 1967, with virtually no remission at all, the trend in labour productivity growth has been falling.

The Productivity Puzzle

Behind the decline in GDP growth lies a now well-documented slowing down in the rate of growth in labour productivity – defined here as the average GDP generated per hour of work carried out in the economy. Not surprisingly, the two trends follow each other closely. But there are some notable differences. Most striking is that the trend growth rate in labour productivity declined even further across OECD nations over the last fifty years than the trend growth rate in GDP per capita. Labour productivity was growing at only 0.6% per year in 2016, a little over half the growth rate in GDP per capita. It is also worth noting that, on current trends, labour productivity growth would reach zero across the OECD by around 2028. In other words, in about a decade, any growth in per capita income could only be achieved by having more people (on average) working for longer. As the ‘futurist’ Martin Ford has suggested, there are ‘good reasons to believe that the economic goldilocks period has come to an end for many developed nations.’[6]

For the UK itself, the picture is remarkable (Figure 1). The UK was the first country to industrialise and may well face secular stagnation sooner than other OECD countries. Broadly speaking, trend labour productivity growth was on a rising trend from the beginning of the 19th century until the mid-1960s. But since its peak in 1967, with virtually no remission at all, the trend in labour productivity growth has been falling. It is notable that this decline preceded the financial crisis itself by several decades. By 2016 the trend growth rate was only 0.12%. For the last five years, it has remained below 0.3% per year, lower than at any time since records began in the mid 19th Century.

It is perhaps surprising to note that this fall was at best slowed down, but never entirely reversed by the introduction of extraordinary new digital technologies such as personal computing, electronic communications and the internet, which should in principle have contributed to dramatic increases in labour productivity. We return to the implications of this below. In the meantime, it is worth commenting on the potential causes of the decline.

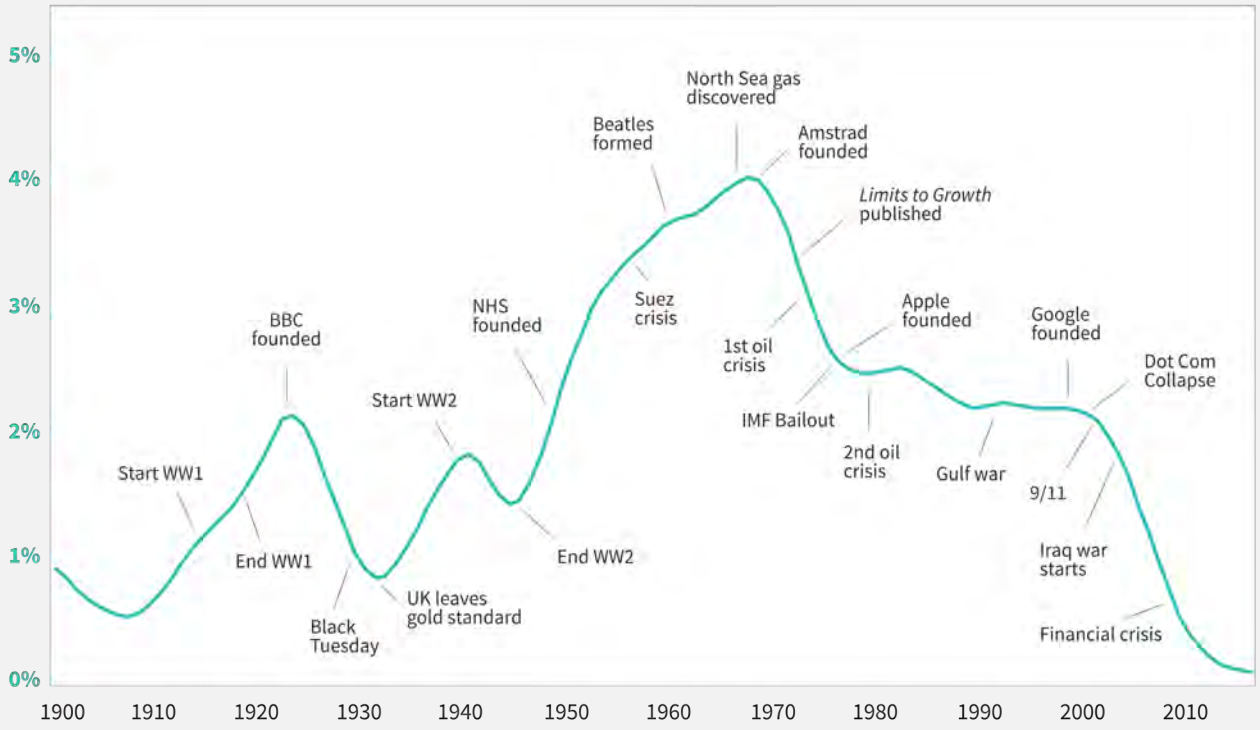


Figure 1
Labour productivity growth in the UK 1900 – 2016 (Source: Jackson (2018) *The Post-growth Challenge*, see note 4.

> In the long run, it is entirely possible that more labour rather than less will be needed to deliver each unit of economic output.

First, it is plausible that resource prices played some role in things. The highest global growth rate in the last half a century occurred in the year 1973, ironically, the year of the first oil crisis. By the time of the second oil crisis in 1979, the trend growth rate had fallen to a little over 3%, during which oil prices had effectively quadrupled in real terms, after several decades of stability. Though oil prices fell through the 1980s and 1990s, they rose again dramatically just before the financial crisis, peaking at $147 a barrel in July 2008.

Second, it is conceivable that the rise and fall pattern had something to do with the quality of the physical resources on which the economy depends. Some economists have argued that the enormous growth in productivity of advanced economies was only possible at all because of the abundance of high-quality fossil energy sources.[7] Any decline in the availability or quality of such resources could be expected to slow down productivity growth and ultimately reduce productive output. Evidence of such a decline already exists. Sooner or later further declines are inevitable. In the long run, it is entirely possible that more labour rather than less will be needed to deliver each unit of economic output.[8]

A third potential candidate lies in the structural shift within advanced economies away from mining and manufacturing and towards services. Service-based activities tend to be less conducive to labour productivity growth, for rather obvious reasons: the time spent by people in the service of others is not always amenable to technological improvement. In fact, the pursuit of labour productivity growth in such sectors may sometimes even be counter-productive. Labour is more important here than material inputs. As we shall see below, such sectors could offer an interesting pathway towards a low-carbon economy. The price may be a slowing down in labour productivity growth.[9]

Finally, it is possible that changes in the financial sector have played some role in slowing down labour productivity growth. In pursuit of economic growth, advanced nations have turned increasingly to low interest rates, financial de-regulation, and (more recently) quantitative easing to stimulate demand and protect fragile private sector balance sheets. But as Summers himself has argued, cheap money has tended to encourage speculation at the expense of productive investment, potentially slowing down the pace of innovation.[10] This strategy has also affected the demand side of the economy, in particular through its adverse impacts on income and wealth inequalities.

The Age of Inequality

When the French economist Thomas Piketty published his treatise on *Capitalism in the 21st Century* in 2014, it was an immediate, if unlikely, best-seller: a voluminous economic text book with an unexpected global impact. Its fame rested on two main features. The first was the clear spotlight that it shone on inequality as an essential aspect of the economy. There is now considerable evidence of reduced inequality between nations.[11] But within the advanced nations themselves the situation is rather different. Piketty showed that the richest 10% of the US population now receives almost 40% of the post-tax income, higher than at any time since the second world war. The post-tax income shares of the richest 1% have risen even faster in recent decades (Figure 2).

Income inequality in the UK is lower than it is in the US but the pattern is similar, with an increasing share going to the top 1% of earners over the last decades of the 20th Century and early years of the 21st. Income inequality in the UK is now higher than in most EU countries and higher than it was in the UK during the 1960s and 1970s.[12]

A recent report by the Institute for Public Policy Research found that wealth inequality is twice as great as income inequality in the UK, with 45% of the wealth owned by the top 10% of the population, while the poorest half of the population own just 9%, a situation that is likely to worsen over the next decade in the absence of appropriate policies.[13]

The second feature on which the fame of Piketty's work rested was a theoretical argument about the reasons for these increases in inequality. Specifically, he suggested a long-run decline in the growth rate was itself sufficient to lead to a rise in inequality. Piketty's argument rested on certain assumptions about the conditions under which secular stagnation takes place. Subsequent analyses have offered a more nuanced picture. What emerges from this is that the distribution of incomes depends crucially on the balance between the protections afforded to the owners of capital and the rights afforded to workers as the growth rate declines.[14] As we have already seen, some of the same policies designed to stimulate growth by protecting the returns to capital end up undermining both economic and social stability.

Figure 2
Post-tax income shares of top 10% and top 1% in the US: 1935–2015 (Source: Data from gabriel-zucman.eu/files/PSZ2018DataAppendix.pdf)

A recent report from the investment bank Credit Suisse identifies several 'channels' through which these impacts occur. First, cheap money leads to financial speculation. Those with access to capital can achieve substantial capital gains as asset prices rise. When assets are already unequally distributed, this leads directly to higher inequality. As income inequality increases, it leads to an excess of savings because richer households tend to save more than poorer ones. This excess of savings leads to more speculation, pushing asset prices up again and accelerating inequality further. Higher speculation crowds investment out of the real economy.[15] Policy responses which attempt to stimulate investment by reducing the interest rate, end up making money cheaper and incentivising more speculation, fuelling a vicious cycle of rising inequality. Faced with this conundrum, it is clear that 'more of the same' will not deliver an economy that works for everyone.

Foundations for an economy that works

A decade after the financial crisis, sluggish growth, faltering productivity and persistent inequality are creating significant uncertainties for the future of the UK economy. Understanding these phenomena is vital. Debt overhang, shifting patterns of demand and the geopolitics of resources all play some contributing role to the decline in productivity. Perhaps the most troubling possibility is that the wide-spread technological advances facilitated by the ready abundance of high-quality energy resources will no longer be available throughout the 21st Century.

The prevailing 'rescue narrative' relies on the hope that new technological breakthroughs will dramatically reverse the decline and bring growth back again. Candidate 'saviours' are various. The most prevalent idea is that new digital technologies will radically alter the world of work and stimulate unparalleled productivity gains. But to date none of these gains are yet visible at the macro-economic level. Worse, there are clearly conditions under which such strategies could lead to the 'immiseration' of labour and escalating inequality.[16] As Summers himself pointed out, creating more and more cheap money cannot in itself solve these problems because it encourages yet more speculative lending.

A clear starting point for a different approach is to recognise that the aim and purpose of the economy is not labour productivity growth in itself. Growth is at best the means to prosperity. Building an economy that works for everyone means providing the capabilities for people to flourish as human beings and to participate fully in the life of society.[17] This will involve nurturing those enterprises which provide such capabilities and contribute most to prosperity. Services such as nutrition, care, education, craft, renovation, and creativity offer the potential for a less materially intensive form of economy which contributes directly to a higher quality of life.[18]

Ironically, this may mean accepting, perhaps even encouraging, lower labour productivity growth in some key sectors – going with the grain of secular stagnation, rather than trying to fight against it. An incidental gain from such an approach would be the creation of a more labour intensive economy – supporting higher levels of employment – as well as a less carbon intensive one. Such a shift in perspective also speaks directly to the balance referred to above in protecting the quality and availability of work.

Work is more than just the means to a livelihood. Good work offers respect, motivation, fulfilment, involvement in community and in the best cases a sense of meaning and purpose in life. The reality, of course, can be very different. Too many people are trapped in low-quality jobs with insecure wages.[19] This enormous waste of human potential undermines the creativity of the workforce and threatens to derail prosperity. The long-term implications are nothing short of disastrous.

Reframing enterprise and work will not be possible without a transformation in the architecture of the financial system. Investment embodies the deepest relationship in economics. Engaging in projects that last over time embodies our commitment to the future and is the basis for any lasting prosperity. But the success of this strategy depends inherently on the destination of our savings. When large proportions of investment are dedicated towards nothing more than rent-seeking behaviour and asset price speculation, the productive relationship between the present and the future is fundamentally distorted, destabilising the economy and undermining prosperity.

Delivering a more sustainable portfolio of investment depends on having a financial system which is fit for purpose. Improving the ability of ordinary people to invest their savings responsibly in ways that benefit both their own community and a wider environment is paramount. But deeper, and more decisive changes are also needed. What is at stake here is the nature of money itself as a social good. Money facilitates commercial exchange; it provides the basis for social investment; it has the power to stabilise (or destabilise) society. Reframing the role of policy on the monetary system is critical in responding to the 'new normal'.

Enterprise as service, work as participation, investment as commitment, money as a social good: these four foundations provide the basis for a more robust response to secular stagnation than wishful thinking about a technological revolution in labour productivity growth. Innovation is certainly key. But one thing remains abundantly clear: building an economy that works for everyone involves embarking on a new and vital conversation about the economy of tomorrow.

This series of briefing papers aims to contribute to that task.

About the Author

Tim Jackson is Professor of Sustainable Development at the University of Surrey and Director of the Centre for the Understanding of Sustainable Prosperity (CUSP). He was for seven years Economics Commissioner on the UK Sustainable Development Commission, where his work culminated in the publication of his book *Prosperity without Growth* which was subsequently translated into 17 languages worldwide. This briefing paper draws partly on that work and partly on a background paper prepared as input to the 2018 Global Strategy Trends review.

Download

This Briefing Paper can be accessed on our website: limits2growth.org.uk/publications.

Notes

1 Summers, L (2014). US Economic Prospects: Secular Stagnation, Hysteresis, and the Zero Lower Bound. *Business Economics* 49(2): 66-73.

2 The term 'secular stagnation' was first coined by Alvin Hansen in his Presidential Address to the American Economic Association in 1938. Its revival in the current context is attributed to Summers.

3 Gordon, R (2016). *The Rise and Fall of American Growth*. Princeton University Press.

4 For more detail see Jackson, T 2018. *The Post-Growth Challenge*. CUSP Working Paper No 12. Online at: cusp.ac.uk/themes/aetw/wp12.

5 Storm, S (2017). The New Normal: Demand, Secular Stagnation and the Vanishing Middle-Class. INET Working Paper No 55, May 2017. Online at: ineteconomics.org/uploads/papers/WP_55-Storm-The-New-Normal.pdf.

6 Ford, M (2015). *The Rise of the Robots*. (Penguin)

7 This was also the message from the 1972 report on the *Limits to Growth* by the Club of Rome.

8 There is evidence to suggest that the energy return on energy invested (a standard measure of the quality of energy resources) shows exactly the same rise and fall pattern illustrated in Figure 1. See Jackson 2018 (op cit, note 4) for details.

9 This feature was pointed out half a century ago by the US economist William Baumol and has been discussed extensively since. See Baumol, W (2012). *The Cost Disease – why computers got cheaper and healthcare didn't*. (Yale)

10 Summers, L (2014). The path to full employment. Keynote: cbpp.org/blog/summers-lack-of-demand-creates-lack-of-supply.

11 IMF (2017). Fostering Inclusive Growth. Online at imf.org/external/np/g20/pdf/2017/062617.pdf.

12 McGuinness, F (2018). Income inequality in the UK. House of Commons Library Briefing. Online at researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7484, p9,

13 IPPR (2017). Wealth in the twenty-first century – inequalities and drivers. Online at ippr.org/publications/wealth-in-the-twenty-first-century.

14 For more on this point see Jackson T and P Victor (2018). *Confronting inequality in a post-growth world*. CUSP Working Paper No 11. Online at cusp.ac.uk/themes/aetw/wp11.

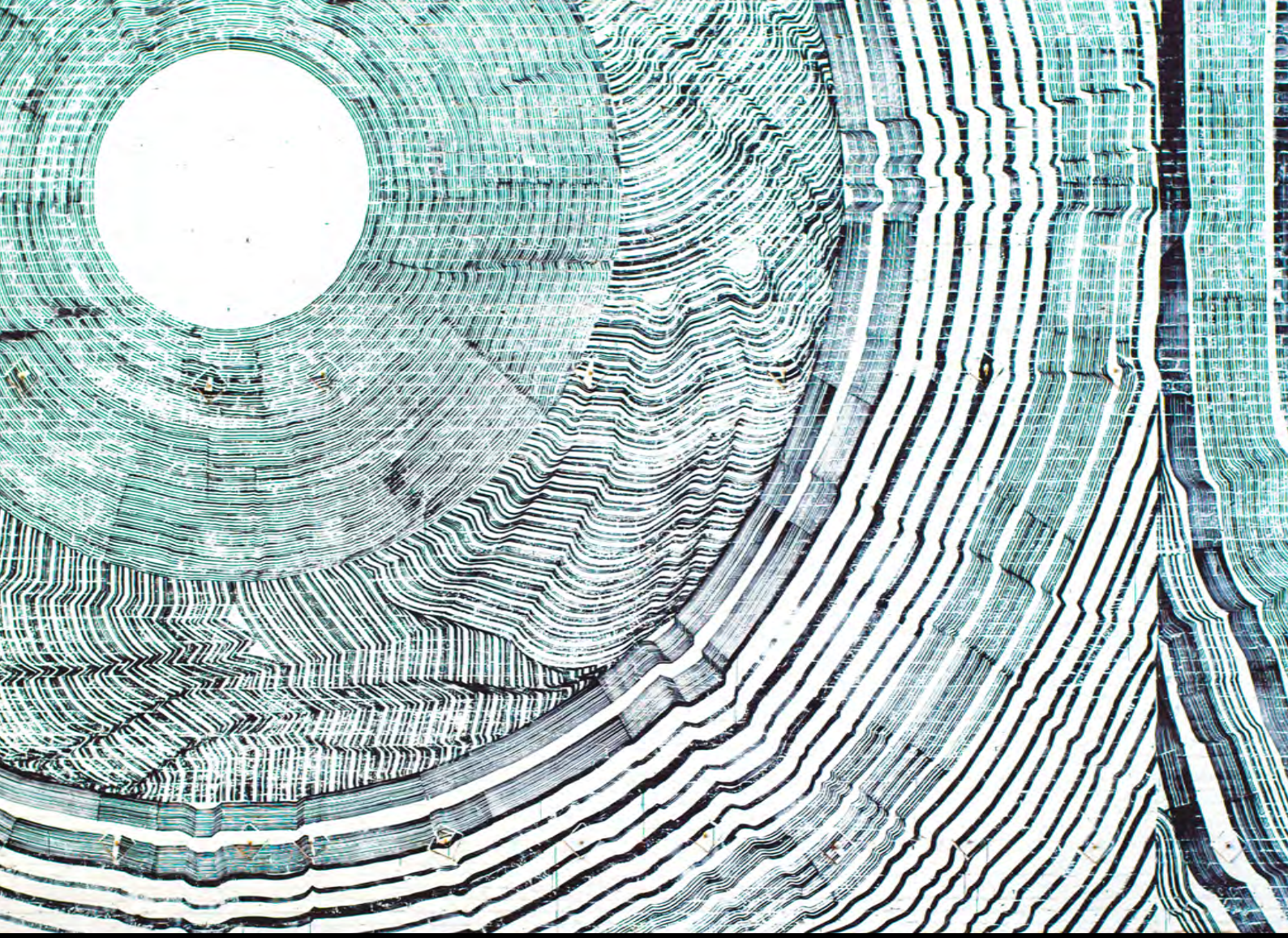
15 Credit Suisse (2014). Global Wealth Report 2014, p34. Online at: publications.credit-suisse.com/tasks/render/file/?fileID=60931FDE-A2D2-F568-B041B58C5EA591A4.

16 Susskind, D (2017). A model of technological unemployment. Online at economics.ox.ac.uk/materials/papers/15126/819-susskind-a-model-of-technological-unemployment-july-2017.pdf.

17 Jackson, T (2017) *Prosperity without Growth: Foundations for the Economy of Tomorrow*. (Routledge).

18 It is worth noting here that even the energy sector can be reframed in terms of the energy services provided to households and businesses. This approach offers a complement to the current industrial strategy: gov.uk/government/topical-events/the-uks-industrial-strategy.

19 Taylor, M (2017). *Good work: the Taylor review of modern working practices*. Online at gov.uk/government/publications/good-work-the-taylor-review-of-modern-working-practices.



An Economy That Works

Ten years after the financial crisis, sluggish growth, faltering labour productivity and persistent inequalities are creating huge uncertainties for the future of advanced economies such as the UK. Under these conditions, it is challenging to meet the investment needs associated with improving people's health and wellbeing or to honour our obligations under the Paris Agreement on climate change. The implications for social and political instability are profound. Is a return to high levels of GDP growth the only way to meet these combined challenges? Is such a return even possible? A series of briefing papers from the All-Party Parliamentary Group on the Limits to Growth aims to explore these questions and to create the space for a vital conversation aimed at building *An Economy That Works* – for everyone.

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