

Sinking into the 'great stagnation'

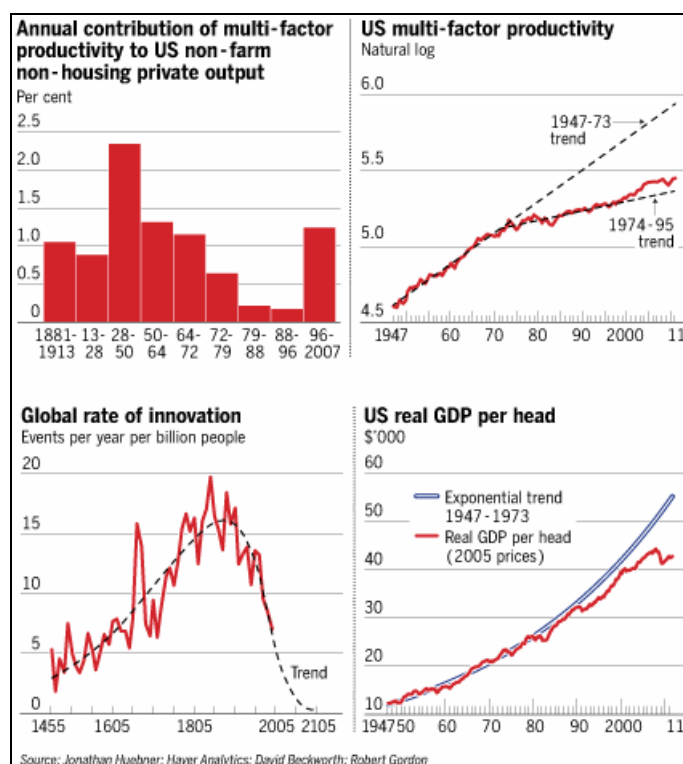
Martin Wolf, *Financial Times*, December 21, 2011

The future is not what it used to be. Nor is the present. This is the theme of *The Great Stagnation* by Tyler Cowen of George Mason University. This is an influential, albeit depressing, little book, first published on the internet.* Its theme is in its subtitle: "How America ate all the low-hanging fruit of modern history, got sick and will (eventually) feel better." The book is a model of popular writing: lucid, brief and provocative. But is the argument also true?



If so, what might it imply? "America is in disarray," states Prof Cowen, "and our economy is failing us." He points to the slow growth of median wages since the 1970s, the illusions of the 2000s and the absence of "new net job creation in this last decade". Moreover, "we face a long-run fiscal crisis, driven by the increasing cost of entitlements, our reliance on debt, and our willingness to let matters slide rather than face up to paying the bills".

So far, so familiar. More novel is how Prof Cowen explains the US predicament: "the American economy has enjoyed ... low-hanging fruit since at least the 17th century, whether it be free land, ... immigrant labor, or powerful new technologies. Yet during the last 40 years, that low-hanging fruit started disappearing, and we started pretending it was still there. We have failed to recognise that we are at a technological plateau and the trees are more bare than we would like to think. That's it. That is what has gone wrong."



The role of both cheap resources and the import of labour in past US growth is clear. But Prof Cowen adds an important point. In 1900, only 6.4 per cent of Americans graduated from high school. In the late 1960s, this ratio peaked at 80 per cent. Similarly, by 2009, 40 per cent of 18-24 year olds were already enrolled in college. Improving labour force quality has become far harder.

Much the most important cause of sustained economic growth is new ideas. Unfortunately, rates of invention and innovation have also slowed. The high point was the late 19th and early 20th centuries, which produced: modern chemicals and so artificial fertilisers; electricity and so the electric motor, light, refrigerator, vacuum cleaner, air conditioner, radio, phonograph and television; the internal combustion engine and so the automobile; the aeroplane; pharmaceuticals;

and, not least, mass production. These transformed lives. "Today, in contrast", argues Prof Cowen, "apart from the seemingly magical internet, life in broad material terms isn't so different from what it was in 1953." I would add the computer and the mobile phone. But it is hard not to agree that the flow of fundamental innovations slowed. It is harder and more expensive to innovate today. (See charts.)

To justify his pessimism, Prof Cowen relies on the stagnation of median family incomes since the mid-1970s. But shifts in income distribution – a distinct, phenomenon – shape this picture. Nevertheless, data on income per head and on "multi-factor productivity" – the part of economic growth not explained by rising inputs of labour and capital – support his point. In the first quarter of 2007, real gross domestic product per head was 13 per cent less than it would have been if the 1947-73 trend had continued. By the third quarter of 2011, it was 22 per cent less. In a thorough study, Robert Gordon of Northwestern University similarly concludes that the growth of multi-factor productivity in the non-farm business sector peaked in the first half of the 20th century and collapsed between 1972 and 1996.** It then surged in the "new economy" wave. But this impulse has faded. It is possible to imagine another surge in economy-wide innovation from biotechnology or nanotechnology. But, today, this is not to be seen.

It is possible to quibble with Prof Cowen's thesis in detail. He exaggerates the negative role of a larger government and understates its positive one: the role of the Defense Advanced Research Projects Agency in creating the internet is a compelling example. But the broad picture he paints seems right.

So what does the stagnation imply for the US and the wider world?

Prof Cowen draws two conclusions. The first is that "politics is very difficult in an America without much low-hanging fruit". The second is that the explanation of the financial crisis is that "we thought we were richer than we were." In effect, he believes that Americans have made demands, both collectively and individually, that they could not afford. It may well be true that the desire to borrow so much and to resist both higher taxes and lower spending reflects the disappointing rises in real incomes. The rent-extraction apparent in the explosive growth of the financial sector is another consequence and a cause of the "great stagnation". Prof Cowen even believes that the US economy is close to full employment. I disagree with that. Nevertheless, long-term trends are somewhat disappointing.

Now consider the wider world. Here we can see good news and bad news. One bit of good news is that the great majority of human beings live in economies that are far indeed from the economic frontier. China's real output per head is about a fifth of US levels and India's less than a tenth. So improvements in education and adoption of already existing knowledge offer huge opportunities. The second bit of good news is that the potential for incorporating a far greater number of people in scientific discovery, invention and innovation is also huge. It may be ever harder to win new knowledge. But the resources devoted to this task can also be far greater than ever before.

The bad news is that the era of cheap resources is not just vanishing for the US. What was once treated as free is costly. This is another – probably far more dangerous – form of zero-sum politics than that within the US. Confronted with painful choices, human beings choose denial. That may not matter so much where resources are marketed. It matters a great deal more when they cannot be, as with the oceans and the air. Here, too, a great deal of innovation will be needed. But for that to happen, the world must offer the right incentives and that, in turn, requires recognition of constraints.

I like this book: it starts from provocative theses and ends with a plea for investment in science. I do not agree with all of it, far from it. But it is good to remember that there are far bigger economic stories than the failure of finance or the appeal of austerity. In the long run, our future depends on good ideas. These may not be ours to determine. But they remain ours to influence.

* Dutton, New York, June 2011.

** Robert J. Gordon, "[Revisiting US Productivity growth over the past century with a view of the future](#)", NBER, March 2010