Get Ready for the Perma-Slump

Sorry to be a downer, but the American economy's best days are behind it. (And China's are too.)

BY DANIEL ALTMAN

Why are the world's great economies having such trouble growing? It's the question on every macroeconomist's lips these days, especially after government officials started downgrading expectations in the United States. A look back at economic history suggests the answer was staring us in the face all along.

For many economists, the central issue today is whether slow growth -- like the particularly terrible quarter earlier this year -- represents a long hangover from the Great Recession or a structural shift. I think it's too early to draw this distinction; only five years have passed since the worst of the recent crisis, which was the deepest in decades. But I also think that structural shifts tend to be the result of long-term trends rather than stuff that happens in a recession which, by some accounts, has actually been cathartic. And when I look at long-term trends, I see a simple explanation for slower growth.

Let's start with the basics. We can split all economic growth into just two factors: expansion of the labor force and increases in workers' output. In other words, the only ways to grow are to get more workers or make each worker more productive. The former is accomplished through fertility, longer life spans, and immigration. The latter depends on workers' access to capital -- human or physical -- and technology.

I'll consider the latter first. The quickest way to give workers access to capital is to move them into cities and suburbs. Not many companies build big factories in the countryside. They want to be near energy grids, transport links, and all the things...
that their workers will need. That's why businesses invest more in urban areas, where it's easier to reach people with public services, too -- hence more access to machines and computers, and also to education and training.

The quickest way to give workers access to technology is to copy it. This is what Japan, Korea, and China have done in sequence over the past half-century. They didn't invent personal computers, mobiles phones, or the internal combustion engine; they just copied them and exported them more cheaply than other countries could. Only a handful of economies are at the world's technological frontier, pushing constantly for new ideas. The rest grow faster by borrowing technology developed by others, duplicating products, and exporting them at lower prices.

These two economic engines -- urbanization and technology adoption -- can generate a lot of growth. (Just ask China.) But eventually, they run out of steam. You can only urbanize so much, and at some point you've stolen all the technology there is to steal. Moreover, wages usually rise as countries grow, so your export advantage will gradually disappear. (Again, just ask China.) Then your country will have to compete on a level playing field with the most advanced economies in the world, and for that you'll need innovation.

Innovation is tough to come by, though. You can't just make it happen. Rather, you need to create the right environment for the entrepreneurial spirit, an exchange of ideas, and speculative investment to flourish. Even in the most innovation-friendly countries, growth driven by the low-hanging fruit of urbanization and technology adoption tends to be faster than growth born of new science and breakthrough products.
By the time a country is relying on innovation to improve productivity, population growth has often dried up as well. Around the world, countries with higher living standards tend to have lower fertility rates, as parents prefer to invest more in a smaller number of children. Some countries -- like the United States -- also crack down on immigration, as citizens try (mistakenly) to keep all their gains for themselves. Regardless of the reason, there does seem to be an association between higher incomes and lower population growth, at least outside of Qatar:

The upshot of all these notions is that countries generally grow rapidly when they first connect to the global economy, but, as they get richer, they slow down gradually until they reach a stable level of innovation-driven growth. And indeed, this is what seems to be happening in several major economies. Except for spurts driven by one-time occurrences, most of the wealthiest countries haven't seen growth on the order of China or even Korea for decades.

To see why, it helps to consider not just how fast countries grow but what their potential to grow might be. In most cases, a shrinking economy is not fulfilling the potential offered by its supplies of labor, capital, and technology. So in the graphs below, years of negative growth are dropped. I've fitted two trends to the data -- one linear, and one logarithmic -- to offer a couple of hints about where these economies are going and where they have been.

First, consider Japan's path from after postwar reconstruction through the present:

And now, look at Korea, which grew in much the same way Japan did after its currency devaluation and the rationalization of its trade policies in 1964:

And before either of these countries experienced their growth spurts, the United States was already settling into its own postwar path:
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