Secular stagnation

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One of the most vigorous growth industries of our time is the expert macro-economic commentary absorbed with touching interest and patience by the world of politics, business, and the ordinary person.

The best-selling product, at least since 2007, has been the panic-mongering forecast. For obvious reasons, it is influential when it is on the frightening side and has self-fulfilling capacity. Like the fashion industry that introduces a new model for a season, panic-mongering puts the blame on one peril at a time. Mid-2007 brought the discovery that government-sponsored American residential mortgages were not all that they should be.

Mortgage backed securities became “ toxic”. Then all asset-backed securities, let alone the options derived from them, became “ toxic, toxic” (often for no better reason that they were relatively new, poorly understood and not yet traded on wide open markets) and the fall of Lehman Brothers in late 2008 “ proved” these dark fears to be wholly justified. Convinced that all this must be just a house of greasy cards, the legitimacy of fractional banking itself was challenged. Wall Street was to be closed down and Main Street reopened. While confidence in any modern financial system was still being shaken and drastic re-regulation of banking and insurance was set in train, the new fashion season brought in a new source of panic: the euro itself was about to crash.

Not at all to its intellectual credit, the German government convinced itself, and convinced its European peers and the IMF, that if Greece was not “ saved” from defaulting on its debt, the “ domino effect” would destroy the euro in no time, causing inestimable damage to the whole economy. It was

never clear why the damage would be so vast, but the macro-panic industry accepted that it would be inestimable and torturing Greece by “ saving” it for the euro was worth any price. With the Greek agony still going on and money to keep Athens within the eurozone was still pouring down the drain, the public was made to discover that nearly half of the Eurozone countries have been getting themselves quite fast into debt to a point where reducing their deficit to a sustainable annual rate was going to be politically very difficult indeed. Persistent suggestions that in a “ truly European” solution Germany should underwrite the incremental debt of the others, were not kindly received in Berlin. From about 2011 onwards, the worst deficit countries of the Eurozone with the exception of France have been fighting bitter political battles to cut pension entitlements, relax job protection, and run down public employee payrolls. These and other austerity measures had some, though only some, of the effects that a devaluation of their currency would have had without having to fight political battles with pensioners, public employees, and trade unions. The initial result was a severe deepening of their economic recession. Subsequently, however, surprisingly encouraging statistics on the budget balance (in primary surplus in Italy), industrial production, unemployment, and the foreign trade balance started to trickle in.

By late 2013, Spain and Portugal were on a nice growth path, their long-term government bond interest was down to below 4 per cent and unemployment falling. This may or may not prove to be a lasting trend, but it was sufficient for commentators to shrug off as over and settled the euro-problem that used to be their chief worry for the last three to four years. It was time to find a new focus for spreading fear for the future. See Japan, by Benjamin

Powell in the Concise Encyclopedia of Economics and the EconTalk podcast Sumner on Money and the Fed for more on this topic. The new fear, secular stagnation, sounds menacing enough. It recalls the two “ lost decades” of Japan where growth was hard to tell from a statistical error, the stock market lost two-thirds of its value, and interest rates ranged from 0 to 2 per cent between short and long terms. Japans stagnation looks like having ended in 2013, though it is surely too soon to be sure. What, however, can one say about any likely end if the world at large is really entering into secular stagnation or has in fact already started to suffer it? True to its new, trendy, and audacious image, the IMF has decided to stimulate discussion about the freshly fashionable stagnation thesis.

It invited no lesser authority on applied macro-economics than Larry Summers to start the ball rolling with a talk that was reproduced in two papers he contributed to the Financial Times (December 16, 2013 and January 6, 2014) and also treated in a paper given at the annual meeting of the American Economic Association in Philadelphia. 1Mr. Summers does not predict secular stagnation, but with his usual mastery of Keynesian orthodoxy, describes the workings of the Meccano of variables that are pushing the economy towards stagnation, without claiming that they will be strong enough to do it. Ever orthodox and sober, Mr. Summers causes little surprise in his comprehensive catalogue of the factors making for secular stagnation. In fact, he finds that stagnation has already begun in the sense that the potential output lost in the recession since 2008”$1. 6 trillion in the United States alone” is not being regained by a fast rebound that would produce growth at twice or more times the normal trend rate.

Exceptional policy measures would henceforth probably be needed in order merely to keep output growing sluggishly, and such policy measures, notably near-zero interest rates, would raise the likelihood of asset price bubbles. Insufficient demand is by definition a corollary of intended saving exceeding investment. There is either over-saving or under-investment.

Reality is described as either the one or the other. The vast population of macro-economists divides into two halves according to how they see a slump as due to over-saving or under-investment. Mr. Summers sees the major shift towards greater income inequality of the last decade as a major factor for stagnation, because it raises the share of saving in income.

He thinks, too, that the virtual replacement of steady inflation by price stability favours creditors who save, over debtors who spend, is another reason for expecting the savings ratio to rise. It is a little difficult to reconcile this diagnosis, reflecting mainly the U. S. economy, with the chronic deficit of the American foreign trade balance. The latter tells the student of statistics that Americans very freely indulge their demand for Asian T-shirts, toys and electronic devices, overload themselves with consumer debt, and do not save enough.

If they did, it is China that would have the trade deficit. There are other strange elements in Mr. Summerss account of why secular stagnation, manifested in insufficient demand, is a genuine danger. In discussing the remedies against stagnation, he calls for a large public investment programme for improving the infrastructure, the environment, and the level of education. With some heat, he speaks of the “ disastrous trend towards

ever less government spending”. However, as we know well enough, the bulk of government spending is on entitlements, primarily of pensions and health care, that is written into law.

The very mechanics of gaining the power to govern a democracy, namely majority voting, renders entitlements untouchable. There is almost no chance of curbing their steady growth, and a strong chance of seeing them suddenly leap up, as in the recent reform of the American public health system. If there is to be a brake on government expenditure, it can only be in the non-entitlement, discretionary part of the budget. Perhaps this is why Mr. Summers calls government spending cuts “ disastrous”. However, what is disastrous is democratic politics under which reducing entitlements is taboo. Mr. Summers mentions the need to curb them, but does so with manifest lack of faith that it will be done.

Price stability or, more obviously, Japanese-style mild deflation, instead of the single-digit inflation that used throughout the post-war period to wipe out sovereign debts as fast as governments were piling it on, is hardly our secular destiny. If anything is a matter of historic destiny, it is recurrent inflation. Deflation is more likely a cyclical event. Other factors upsetting the main equilibria of the world economy are likewise possible causes of prolonged recession, but not of secular stagnation. At worst, they might be aggravated by clumsy government attempts to prevent, alleviate, and cure them. However, these disturbances not only do not add up to secular stagnation, but may on the contrary even render an economic system more resilient, leaner, and willing to deploy greater efforts. They might, pace Mr. Summers, also make for more savings.

In the really long, secular perspective there are two persistent forces that drive the world economy forward. One is that saturation level for aggregate goods and services is unlikely ever to be reached. After a large part, perhaps a third of mankind had achieved a level of material adequacy where food, clothing, and housing were no longer dramatically scarce, it discovered that lifes basic necessities also included a fourth indispensable group of goods: electronic gadgets and entertainment. We may rest assured that by the time a third or a half of humanity finds electronic goods just as easy to afford as pizza, a fifth group of goods and services will emerge and be demanded as an imperative necessity for all.

Higher education" a Ph. D. for all" is a not unlikely candidate. The other long-term driving force that would not long put up with stagnation is that people are only rarely content with what they have. Most of them most of the time have a thing or two in mind that it would be worth some inconvenience to suffer, some new way of getting more for less to devise.

It is all very well to despise this as greed and moral vacuity, it is still the conduct that makes the world turn round. report report