



THE VIEW FROM HERE

BROAD THOUGHTS ON THE ECONOMY

At a Standstill?

The Debate Over “Secular Stagnation”

February 2015

Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

Carl R. Tannenbaum
Chief Economist
312.557.8820
ct92@ntrs.com

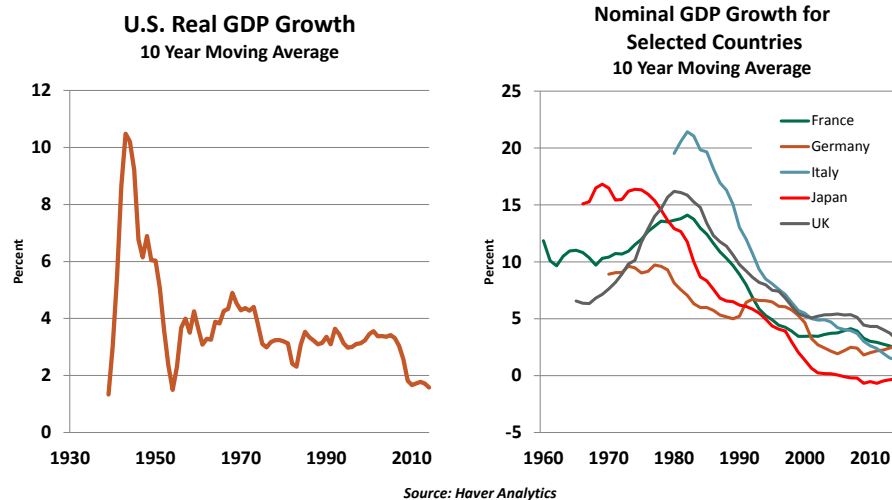
During one particularly stormy day recently, I asked my daughter to unearth herself from the couch and help me clear the snow from the driveway. Unfortunately, the prospective reward of industry was no competition for the television remote, and I was left to fend for myself.

Before braving the accumulating squalls, I warned her that prolonged inactivity could doom her to secular stagnation. She rolled her eyes at the econo-speak and turned her attention back to the *Walking Dead* marathon.

I found irony in her choice of programming as I shoveled. Some in my profession have suggested that developed economies are heading for a zombie-like state, with little growth and frightening consequences for those left alive. Dark-siders suggest that measures aimed at animating things have become increasingly extreme and have done little to slow the advancing danger.

But a careful review of the evidence suggests that we are not doomed to a stagnant future. A number of temporary and cyclical factors have limited recent economic performance, and there are policies we can pursue to improve our fortunes in the longer run. And history is littered with predictions of economic ruin that eventually gave way to renewed prosperity.

It may seem that the notion of secular stagnation has emerged only recently, but its origins date back to the late days of the Great Depression. The ravages of that era led many to wonder whether good times could ever be restored. It took a while, but global expansion eventually resumed. The postwar period was remarkable for developed and emerging markets alike.



Eighty years later, the world economy is once again struggling to regain its former footing. Growth has been reestablished in some places but not in others, requiring significant amounts of performance-enhancing policy to keep things from getting worse.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.



It is this combination of circumstances that led some observers back to the secular stagnation argument. Former U.S. Treasury Secretary [Larry Summers has been the most vocal adherent](#), but economists from around the world have joined him. The debate over the presence and causes of secular stagnation has arguably become the most active in today’s economic discourse.

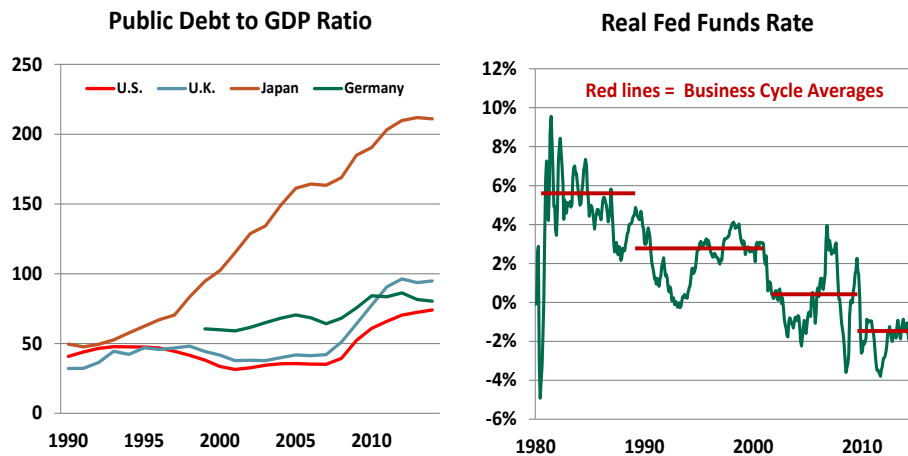
What Is Secular Stagnation?

Those seeking to investigate the issue are immediately confronted with the difficulty in defining secular stagnation. Some would say that the sluggishness seen since the Global Financial Crisis (GFC) is *prima facie* evidence, but that seems to run counter to the “secular” element of the theory. It is well-documented that recoveries amid times of significant financial repair proceed slowly, and this one has been no exception.

To others, the presence of persistently low interest rates is a sign that societies do not see sufficient opportunities for productive investment, which is essential to long-term economic growth. But a long list of factors has increased the global saving over the past generation, not the least of which is the substantial creation of wealth in emerging economies where thrift is a deeply-held value.

The most cogent description comes from Summers. From his perspective, economic growth has been disappointing for quite some time. The boom years of recent decades, he observes, were associated with unsustainable excesses in credit and/or asset prices. Further, monetary and fiscal policies the world over have become progressively more generous, with deficit spending and lower central bank rates playing a prominent role in supporting growth.

Increasing amounts of policy help have been required to sustain economic growth.



Source: Haver Analytics

Of course, it is difficult to establish the validity of this perspective objectively. One cannot go back in time to see how gross domestic product (GDP) might have progressed under stricter policies, or in the absence of housing or stock bubbles. But Summers’ story is more secular than cyclical and makes a certain amount of qualitative sense.

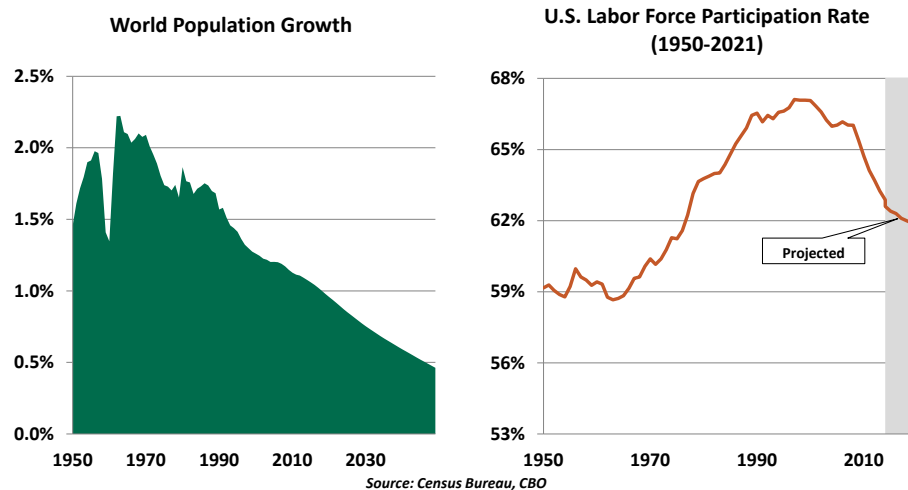
The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.



Approaching the issue from a different direction, Robert Gordon of Northwestern University (among others) has highlighted troublesome trends on the supply-side of the economy. Potential growth is often described as the sum of labor force expansion and increases in productivity. On both of these fronts, many world economies are struggling.

Demographics Matter

The demographic challenge faced by many developed countries is well-documented. Increased living standards and the entry of women into the workforce have both served to depress birth rates. Sizeable post-war generations are gradually moving into retirement, reducing labor force participation. [Projections from the International Monetary Fund](#) suggest that the size of the workforce in many nations may struggle to show any growth over the next 20 years.



Further, older populations are more risk-averse and less innovative. This may be contributing to the clear downward trend in the rate of productivity growth, which had averaged around 2% annually in the United States and double that level in Europe over the decades prior to the GFC. More recently, productivity has been advancing much more modestly. When a flat labor force is increasing its productivity at less than 1% annually, you have very limited potential for economic growth. And soft productivity growth makes labor less valuable and increases the challenge of reaching full employment.

Gordon sees little hope of reversing this trend. His essay, [“Is U.S. Economic Growth Over?”](#) posits that bursts of innovation occur infrequently over history, boosting productivity for a time before petering out. The most recent of these episodes is the incredible advance of computing and related technology; in Gordon’s eyes, the benefits from this paradigm shift are dissipating rapidly.

That latter observation seems a bit extreme. But sustaining innovation requires investment, whose growth has been limited in recent decades. The consequences go beyond crumbling roads, bridges, rail lines and ports. Electrical and communications networks, among others,

Investments in infrastructure and innovation have diminished in recent decades.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.



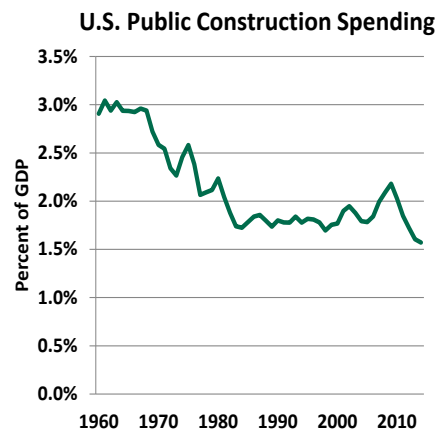
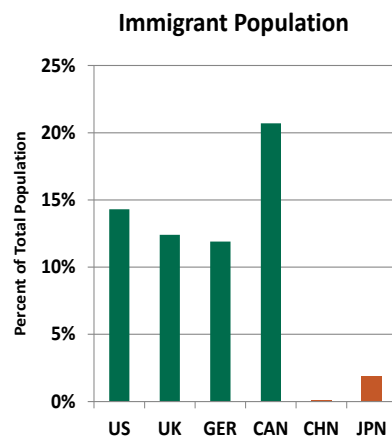
might benefit from some additional attention. In the private sector, growth rates of capital formation and spending for research and development have tapered off significantly, which will limit the returns of innovation in the years ahead.

Policy Solutions

Addressing the potential supply-side roots of secular stagnation could involve some combination of the following strategies.

- **Workforce development.** Increasing retirement ages, providing opportunities for women to remain in the workforce after starting a family, and investments in retraining all have the potential to stanch the erosion of human capital across countries.
- **Immigration reform.** New entrants to the labor market from overseas can do wonders for a nation's demographic balance and its talent pool. Unfortunately, attitudes toward immigrant communities have hardened in many places, for a variety of reasons. Keeping them out, however, can doom a country to demographic demise.

Immigration is a difficult subject, but it is also an economic imperative.



Sources: United Nations, Haver Analytics

- **More public investment.** The global drive for austerity has led to spending restraint that does not discriminate between pure cost and investment. Public spending on infrastructure in the United States stands at its lowest share of GDP in more than 50 years. While some are understandably skeptical about government's ability to efficiently develop human and physical capital, the fact is that government is best-positioned in the short-run to direct such efforts.
- **Tax incentives.** Much has been written about the influence of national tax codes on the level and locus of investment. While governments need revenue in the short-term, discouraging activity with promising future payoffs may limit revenue growth in the long-term.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.



There seems to be general agreement that these steps should be pursued. But some would also like to see remedies for the demand side of the economy. In Summers' view, for example, the problem of secular stagnation stems as much from weak consumption as it does from slowing productivity. This could be addressed in a variety of ways: direct government spending and an easing of sales taxes would head in this direction.

Gordon points to advancing income inequality as another factor limiting global consumption. The propensity to spend declines with earnings levels, so in his view, bolstering incomes among society's lower quintiles could add importantly to demand. There are also those who think that the world's central banks should increase their inflation targets, thereby locking them into a longer path of monetary accommodation.

Strong aggregate demand is always helpful. But the best policy for the moment on this front might be patience. The balance sheet repair necessitated by the GFC is gradually becoming less of a limiting factor and should continue to improve in the years ahead. And the world's monetary policy is already extraordinarily easy, and the efficacy of doing more is not clear.

If secular stagnation is truly upon us, the consequences could be severe. Standards of living and asset values might regress. Limited economic mobility would add fuel to political uncertainty. Debtors could struggle to meet their obligations. Not a pretty picture at all.

But we've heard these jeremiads many times in history, and they've yet to come true. Thomas Malthus fretted in the 18th century that the world was in danger of running out of food. Predictions of imminent economic catastrophe often populate the best-seller lists. Yet populations tend to find a way to be resourceful, and there is no reason to think they won't continue to operate this way. That said, we'll need to set our policy courses carefully to avoid a worst-case outcome.

My daughter redeemed herself when I returned from my battle against the elements. Much to my surprise, she had looked up secular stagnation on the internet, and she had formulated a proposal to deal with the issue. "Buy a snow-thrower," she said. "Investment in technology is the key to boosting potential output." For a moment, I was a very proud papa.

Past rumors of economic demise have been greatly exaggerated.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.