THE TRUE COSTS OF ECONOMIC GROWTH

Overview

The fact is, economic growth can lead to a variety of outcomes, and not all of them are good. For example, business growth can lead to environmentally irresponsible expansion and bloated executive compensation; wage growth can lead to wider income inequality and consumer overspending; and increased productivity can lead to longer work hours and more stress-related illnesses.

Over the longer term, America's economic growth has yielded a puzzling dichotomy. A stark illustration of this is how long it took the economy to recover from the 2008 recession. From a political standpoint, many voters and politicians blamed the lack of growth on Barack Obama's fiscal policies. However, the economy is influenced by many different elements — including monetary policy; fiscal policy; and business, consumer and investor confidence — so the fact that a confluence of factors didn't produce a faster pace left many economists wondering why. Economists attribute the following as some of the reasons for the current state of growth in the United States.

Donald Trump claims that during his administration, America will experience a 3 percent annual growth rate — an ambition on which his current tax and budget proposals depend. However, many economists are skeptical.[1] Historically, a rise in the economic growth rate signaled corporate expansion, higher productivity, more jobs, increased wages and overall prosperity. While some of this happens, some of the time, for some companies and workers, economic growth is not a universal holy grail.

America Has Grown Up

One could argue that America's stint as an emerging market is over. We normally think of the U.S. as a developed market, which it is, but that's a quantitative assessment. In fact, the U.S. declared its independence only 241 years ago, so relatively speaking, we're a newcomer. Emerging markets generally have rapid growth potential relative to older countries. For perspective, consider the measured growth of a child in the first 20 years of life versus the subsequent 20 years. Likewise, the U.S. has emerged from its adolescence strong and fully formed. However, this also means our prospects for continued rapid growth are diminished.

Moreover, we amassed many game-changing innovations during our infancy that drastically advanced our productivity and living standards. These include the internal combustion engine, airplanes, highways and the internet. Time will tell if more advances can lead to such life-altering growth, but for now, most innovation seems to focus on saving time and money.

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Monopolies Control Competition

Much as America has grown up, so have many of our industries. One of the hallmarks of growth is that larger companies tend to grow by buying out their competition. This causes industry consolidation and reduces competition, enabling those larger companies to better control prices and stifle innovation. With fewer new businesses established, there is less job creation — traditionally a key factor in economic growth. Without it, our growth rate is more likely to stagnate no matter how much large firm revenues increase.

CEOs Focus on Short-Term Outlook

Large corporations of late have focused more on achieving short-term financial goals rather than implementing plans for long-term value. Even though the Federal Reserve kept rates at or near zero for eight years, banks and other companies sat on their cash and did not invest in expansion, therefore stunting the growth and job creation that low interest rates are designed to stimulate.[2] This focus on the short term is often referred to as "quarterly capitalism," which emphasizes larger quarterly profits to protect the company's bottom line and pay higher returns to shareholders.

Aging Population

Today's demographics offer yet another example of how America is growing old. Consequently, more people are aging out of the workforce — many did so earlier than expected during the recession — and this, in turn, has yielded reduced consumerism, a reduced tax base and consequently lower productivity and economic growth. One researcher estimated that each 10 percent increase in the share of a state's population over the age of 60 reduces its per capita GDP growth by 5.5 percent.[3]

Vicious Cycle of Reduced Demand

America's corporations aren't the only ones sitting on their cash. Consumer spending remains low despite the uptick in jobs and wages. This probably is due to many factors, including fewer older people in the workforce, the fact that wages have not kept pace with inflation and because the impending retirement crisis has more people focused on saving. Whatever the reasons, lack of consumer demand impedes production and expansion, further stifling economic growth.

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Evolution from Manufacturing to Service

What is being produced isn't exactly job growing. Historically, the employment market was dominated by manufacturing jobs. Today, there is less production of material goods and a greater focus on service industries. Furthermore, the digital revolution has spawned services such as Facebook and YouTube — cheap recreation vehicles that have reduced the need to leave home to see friends and family (activities that previously involved spending money). Streaming services keep people out of movie theaters and have reduced demand for expensive cable television contracts. Amazon has taken a substantial chunk out of the brick-and-mortar retail industry, while Google has rendered encyclopedias extinct.

Economic Measurement

While these "products" offer value, not all come with a price. Thus, another issue is that GDP doesn't fully capture many aspects of 21st century innovation, such as those at play in Silicon Valley. Traditional GDP calculations reflect the price of materials, wages and overhead as a means of measuring economic performance. With so many popular products virtually free to consumers and businesses, economists wonder if traditional economic indicators fail to adequately represent some of our most successful growth industries.

Outdated Economic Tools

Two of the chief instruments in the government's economic tool chest are monetary policy (e.g., changes in interest rates) and fiscal policy (e.g., changes in tax rates). However, in the wake of the last recession, the extension of Bush tax cuts, taxpayer money used to bail out companies deemed "too big to fail" and sustained low interest rates failed to create jobs and stimulate consumerism. These attempts at trickle-down economics, made famous during the Reagan era, were instead used by businesses to bolster their balance sheets, pay dividends to shareholders, repurchase stocks and invest in overseas operations. These activities failed to stimulate economic growth and, as a result, our post-recession recovery took longer than expected.

Growth That Cannot Be Measured...

"There is a lack of appreciation for what's happening in Silicon Valley because we don't have a good way to measure it."[4] — Hal Varian, economist

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Final Thoughts

For these and, for all we know, other yet unidentified reasons, some economists believe that our recent period of slow growth is a paradigm of the new normal. Former Treasury Secretary Larry Summers has termed it "secular stagnation." In other words, because some of the fundamental indicators of economic growth have changed, strategies the government previously used to stimulate growth (such as monetary and fiscal policy) may no longer be effective or as effective moving forward. Not only might we lack the tools to measure growth accurately, but we may no longer have the means to ignite or dampen it, when necessary.

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[1] Larry Light. CBS News. May 19, 2017."What Trump must overcome to hit 3% growth." http://www.cbsnews.com/news/trump-economy-3-percent-growth/. Accessed May 24, 2017.

[2] The Economist. Feb. 16, 2017. "Corporate short-termism is a frustratingly slippery idea." http://www.economist.com/news/business/21717069-firms-are-increasingly-accused-failing-look-ahead-misdiagnosis-corporate. Accessed June 21, 2017.

[3] Alana Semuels. The Atlantic. Oct. 21, 2016. "Why Economic Growth Is So Lackluster." https://www.theatlantic.com/business/archive/2016/10/why-economic-growth-is-so-lackluster/504989/. Accessed May 24, 2017.

[4] Ibid.