Growth STRATEGIES

Trend Analysis That Builds Business Decisions

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IN THIS ISSUE: THE AUTUMN OF OUR DISCONTENT

1 – JUST HOW BAD IS THE ECONOMY?

The state of the economy is awful by most any measure, but compared to where it ***should*** be (based on previous cycles), or compared to where it ***could*** be (based on growth potential), it is tragically bad. University of Chicago professor John Cochrane makes the case on his "grumpy economist" blogspot.

Economists know that levels matter, and that long-run growth matters more than anything else, writes Cochrane. In past recessions the economy has quite reliably returned to the growth trend line. For example, after the severe 1980 recession and the even more severe 1982 recession, the economy recovered to trend by posting a few years of 6% growth. In this most recent recession, by contrast, GDP declined almost 5% but then started growing at a glacial pace, averaging 2.4% since the trough. We seem stuck in this slow growth trap.

We are now 14.5% below the trend line, and each year that goes by like this we lose another half a percent. The average person in the economy is producing 14.5% less, and earning 14.5% less, than if we had followed the path following the 1982 recession.

That's a lot – and a lot more than the litany of quarterly growth rates suggest.

The Congressional Budget Office, which produces economic forecasts, has been steadily lowering its potential output figure and now expects a mere 2.35% long run growth rate. In other words, what we are seeing now is the new normal. This is tragic. The difference between 2.3% and 3.0% adds up fast as the years go by.

Employment has declined by about 7 million people from its peak in 2007, from 63% of the population to about 58%. And it has stayed there ever since. The "job gains" you hear about in the news are just barely keeping up with population growth. As we are about 14% below trend and slowly losing ground, we are 7 million jobs short and sitting there too. This is really tragic.

The link between employment and output is productivity. In the long run, rising productivity is behind everything good in the economy. It's what gives more income per capita. Rising productivity is the only hope for paying for entitlements and getting out of our deficit trap. It's the main hope for long-run GDP growth, after the employment/population ratio reverts to where it should be. Rising productivity comes from new ideas, new companies, new ways of doing business. It isn't all pleasant. Lots of incumbents lose out. Rising productivity is the core of a "growth" agenda as economists understand the word. But productivity growth has slowed as well.

These trends are an economist's horror movie. Real GDP seems not to be recovering at all – no period of swift growth to return to trend. We seem stuck at 2.4% growth forever. The CBO is giving up on us too. Employment will not recover as a fraction of population until the economy recovers. We seem stuck at low employment forever. And now we seem headed to a 1970s productivity slowdown as well.

What to do? We're stuck in sclerotic growth, and to everyone but a few die-hard extremists, that means growth-oriented policies are the only way out.

2 – AMERICA'S LABOR MARKET DEPRESSION CONTINUES

James Pethokoukis is the Money & Politics columnist for the American Enterprise Institute. He makes the following observations:

- This continues to be the longest stretch of 8% or higher unemployment since the Great Depression, 42 straight months.
- If the labor force participation rate was the same as when Obama took office in January 2009, the unemployment rate would be 11.0%.
- Even if you take into account that the Labor Force Participation rate should be declining as America ages, the unemployment rate would be 10.6%.
- If the labor force participation rate hadn't declined since just last month, the unemployment rate would have risen to 8.4%.
- The broader U-6 unemployment rate, which includes "all persons marginally attached to the labor force, plus total employed part time for economic reasons," ticked up to 15.0%.
- Not only is the 8.3% unemployment rate way above the 5.6% unemployment rate that Team Obama predicted for July 2012 if Congress passed the $800 billion stimulus plan, it's way above the 6.0% unemployment rate they predicted *if no stimulus was passed*.

3 – SMALL BUSINESS IS IN A HOLDING PATTERN

Jenel Stelton-Holtmeier writes in Modern Distribution Management:

Optimism continues to fall among independent business owners, according to the latest Small Business Economic Trends report from the National Federation of Independent Business. The Optimism Index gave up another 0.2 points in July, falling to 91.2 – the same level seen during the recession.

Why the decline? According to the NFIB, much of it can be attributed to uncertainty. In the commentary to the report, NFIB Chief Economist William C. Dunkelberg writes: "Uncertainty is a core concept in our business theories and models and there is considerable empirical support for the adverse impact of uncertainty on decision making."

Reinforcing this, most of the indicators within the report were relatively flat. "If it weren't for population growth, Gross Domestic Product growth would be about zero," the commentary in the report reads.

Many business executives report being in a holding pattern until after the election, which means we can expect very sluggish growth for the balance of the year.

4 – IS US ECONOMIC GROWTH OVER, OR ABOUT TO EMBARK ON THE NEXT GREAT GROWTH CYCLE?

From colonial times to the present, the US economy has also been powered by three separate industrial revolutions: 1) the introduction of steam engines and railroads; 2) the inception and widespread use of electricity and the combustion engine; and 3) the invention of computers, the web and mobile communications.

As Northwestern economist Robert Gordon writes in a new paper, these three interlocking events gave rise to a widespread assumption that "economic growth is a continuous process that will persist forever." But what if that assumption is wrong?

Gordon writes that future growth in consumption per capita – the main engine of the consumer-based US economy – could fall below 0.5% a year for what he calls "an extended period of decades." Between 1860 and 2007 that annual growth rate was 1.9%.

What's driving this structural economic slowdown, according to Gordon?

He argues that six "headwinds" are buffeting the US economy, and that these factors were in place even before the Great Recession of 2008. They are:

1) changing and unfavorable demographics; 2) rising education costs and poor secondary school performance; 3) growing economic inequality; 4) increased competition due to globalization; 5) energy and environmental costs and challenges; and 6) high levels of consumer and government debt.

Taken together, these headwinds will slow growth dramatically into the foreseeable future, writes Gordon.

Not everyone agrees. Mark Mills, for example, writes of "the next great growth cycle," a new era that will come from the convergence of three technological transformations that have already happened: Big Data, the Wireless Wired World, and Computational Manufacturing.

The era of Big Data is driven by the remarkable fact that for all practical purposes, computer processing power and data storage are free. When something truly useful becomes virtually free, growth can be explosive. The emergence of the Internet was primarily characterized by the proliferation of distributed personal computing. The architecture for Big Data is epitomized by the proliferation of staggeringly large concentrations of easily accessible, but physically remote, supercomputing that has been labeled the Cloud.

The Cloud comprises an evolving and growing network of tens of thousands of massive warehouse-scale data centers. It will enable industrial, commercial, scientific, and medical revolutions anchored in meta-data analyses. Astronomical feats of data crunching are now affordable, enabling new and previously unimaginable services and businesses. We have so far witnessed only the inklings of what is yet possible.

The second macro trend is the wireless wired world. There has never in history been a time when a billion people could effortlessly communicate, socialize and trade in real time, all the time, anytime, anywhere, with anyone. The economic and social implications of the collapse in the cost of wireless mobile connectivity are as big as those following the dawn of telephony itself, writes Mills.

The third grand technology shift is Computational Manufacturing. It begins with something commonly called 3D printing, or "additive" or direct-digital manufacturing. This is literally the "printing" of parts and devices directly from a computer model or image, using lasers, electron beams, or microwaves, and powdered raw materials.

3D printing is radically improving and accelerating the design process and already produces commercially viable final parts in some niche applications such as highly customized parts for aircraft or medical devices like knee joints.

Computational manufacturing is poised to become a trillion dollar industry, unleashing as big a change in how we make things as did mass production in an earlier era, and as did the agricultural revolution in how we grew things. It is a manufacturing paradigm defined not by cheap labor, but high talent.

These emerging grand transformations – Big Data, Wireless Broadband, and Computational Manufacturing – are all an integrated part of the next great cycle of the information economy, concludes Mills.

5 – A SLOW RECOVERY OR A FAILED AGENDA?

Stanford professor Edward Lazear asks (and answers) the ultimate political question in the Wall Street Journal:

Are there other factors that may have contributed to the slow recovery that we are experiencing? It would be difficult to argue that government polices over the past three years have enhanced confidence in the US business environment. Threats of higher taxes, the constantly increasing regulatory burden, the failure to pursue an aggressive trade policy that will open markets to US exports, and the enormous increase in government spending all are growth impediments. Policies have focused on short-run changes and gimmicks – recall cash for clunkers and first-time home buyer credits – rather than on creating conditions that are favorable to investment that raise productivity and wages.

6 – THE 4% SOLUTION

James Glassman is editor of *The 4% Solution: Unleashing the Economic Growth America Needs*. He writes:

So the United States really has two problems: first, it hasn't recovered sufficiently to get back aboard the trend line after the 2008-09 recession, and, second, even if we do have a recovery spurt, we don't have the policies to get us to sustainable 4% – much less 3% – growth. But we could have policies that will get us growing again. Growth of 4% is a practical goal.

Those policies begin with two principles:

- First, growth must be the focus of all economic policy. Growth lowers unemployment, lowers deficits and debt, raises opportunity. Every policy change should be judged by the question, "Does it increase growth?" If not, forget it.
- Second, the role of government is to help create an environment that fosters growth. Government cannot, on a long-term basis, create growth or jobs. But it can enact the policies that allow the private sector to create them.

The 4% Solution is a serious, non-partisan book with a foreword by President Bush and 21 chapters, five by Nobel Prize-winning economists and the rest by experts in their fields, that propose ways to get to 4% growth. What we should do first? What gets the biggest, fastest bang for the effort?

Here are the answers:

1. Enact comprehensive tax reform: lower rates, broaden the base by eliminating deductions and exemptions, tax consumption rather than income and investment, and make the Tax Code simpler. These ideas have broad support among all kinds of economists.

2. Cut government spending. Several of the book's contributors, citing important research, show that federal spending cuts increase growth in the long run by leaving more dollars in the pockets of businesses and individuals.

3. Expand energy resource development at home. Abundant energy (and the US has more such resources than any other country) lowers the cost of economic growth.

4. Rationalize immigration policy. Stop bringing smart foreigners to the US to be educated and then sending them back to their home countries. If they stayed, they could be among our greatest sources of entrepreneurial strength.