Growth STRATEGIES

Trend Analysis That Builds Business Decisions

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1 – ECONOMIC: PRODUCTION, NOT CONSUMPTION, DRIVES THE ECONOMY

Mark Skousen

Starting April 25, the Bureau of Economic Analysis will release a new way to measure the economy each quarter. It's called gross output, and it's the first significant macroeconomic tool to come into regular use since gross domestic product was developed in the 1940s….

Gross output is an attempt to measure what the BEA calls the "make" economy – the total sales from the production of raw materials through intermediate producers to final wholesale and retail trade. Valued at more than $30 trillion at the end of 2013, it's almost twice the size of gross domestic product, and far more volatile.

In many ways, gross output is a supply-side statistic, a measure of the production side of the economy. GDP, on the other hand, measures the "use" economy, the value of all "final" or finished goods and services used by consumers, business and government. It reached $17 trillion last year.

Why pay attention to gross output? For starters, research I published in 1990 shows it does a better job of measuring total economic activity. GDP is a useful measure of a country's standard of living and economic growth. But its focus on final output omits intermediate production and as a result creates much mischief in our understanding of how the economy works.

In particular, it has led to the misguided Keynesian notion that consumer and government spending drive the economy rather than saving, business investment, technology and entrepreneurship. GDP data at the end of 2013 put consumer spending first in importance (68% of GDP), followed by government expenditures (18%), and business investment third (16%). Net exports (-2%) makes up the difference.

Thus journalists and many economic analysts report that "consumer spending drives the economy." And they focus on retail spending or consumer confidence as the critical factors in driving the economy and stock market. There is an underlying anti-saving mentality in this analysis, as evidenced by statements frequently made during debates on tax cuts or tax rebates that if consumers save their tax refund instead of spending it, it will do no good for the economy. Presidents including George W. Bush and Barack Obama have echoed this sentiment when they encouraged consumers to spend rather than save and invest their tax refunds.

Although consumer spending accounts for about 70% of GDP, if you use gross output as a broader measure of total sales or spending, it represents less than 40% of the economy. The reality is that business outlays – adding capital investment and all business spending in intermediate stages of the supply chain – are substantially larger than consumer spending in the economy. They make up more than 50% of economic activity. The 2012 data are gross output $28,693 billion, and GDP $16,420 billion.

The critical importance of business activity is clear when you look at employment statistics and leading economic indicators. Employees in the consumer side of the economy (retail outlets and leisure businesses) account for about 20% of the labor force, and another 15% work for various levels of government. Yet the vast majority of employees, 65%, work in mining, manufacturing and the service industries.

Gross output also does a better job of gauging the ups and downs of the business cycle. For example, in 2008-09, nominal GDP declined only 2% while nominal gross output fell sharply by 8%, far more indicative of the depths of the recession. Interestingly, since the 2009 trough, gross output has been rising faster than GDP, suggesting a more robust recovery.

Finally, as a broader measure of economic activity, gross output is more consistent with economic-growth theory. Studies by Robert Solow at MIT and Robert Barro at Harvard have shown that economic growth comes largely from the supply side – increased technology, entrepreneurship, capital formation and productive savings and investment. Higher consumption is the effect, not the cause, of prosperity.

2 – LEGAL: ACTIVIST STATE COURTS THWART VOTERS

Steven Melanga

Writing in the *Harvard Law Review* in 1977, Supreme Court Justice William Brennan, Jr., exhorted state judges to embrace activist interpretations of the law. The high court had taken a frustratingly conservative turn, Brennan noted, stepping back from the crucial role it had played as an agent of social change under previous chief justice Earl Warren. Among the most important Warren Court decisions, Brennan argued, were those that expanded individual liberties under Section I of the Fourteenth Amendment, which guarantees citizens equal protection under the law and prohibits state governments from depriving "any person of life, liberty, or property, without due process." Brennan believed that state judges could find in state constitutions and laws "counterparts" of these decisions that would guarantee citizens "even more protections" than those provided by the US Constitution.

Brennan is rightly seen as one of the fathers of the "living Constitution," under which judges continually reinterpret the nation's fundamental law "in light of conditions existing in contemporary society." On the federal bench, he worked primarily to widen the scope of individual rights – protections against government intrusion – like those afforded the criminally accused in *Miranda* v. *Arizona*. But in his *Harvard Law Review* article, Brennan also ventured onto terrain that the Supreme Court had largely avoided: a defense of the idea of constitutionally protected economic, or what legal scholars have come to call "positive," rights – government guarantees of a material nature. In the modern world, Brennan contended, the Fourteenth Amendment's guarantee against deprivation of property "has come to embrace" – he doesn't say how or by whom – "such crucial expectations as a driver's license or the statutory entitlement to minimum economic support, in the form of welfare."

Brennan's 1977 essay helped inspire a "positive rights" revolution in state courts. Over the 36 years since Brennan's appeal, a number of state high courts have aggressively used vague state constitutional language – referring, say, to the general welfare – to force legislators to spend billions of dollars on new entitlements. And more recently, state courts have extended their imaginative jurisprudence to the fiscal battle over government pensions, securing extraordinary retirement protections for state employees at taxpayers' expense. Liberal legal scholars, meanwhile, want state judges to go still further, and mandate everything from universal health care to a guaranteed annual income for every citizen.

The US Supreme Court continued to move away from the Warren Court's activist extremes throughout the rest of Brennan's career, which ended in 1990 under Burger's successor as chief justice, William Rehnquist. The rightward shift disconcerted Brennan, but the liberal judicial lion has had his revenge through his enduring and expansive influence on the judiciary….

State judicial activism has been especially aggressive in compelling taxpayers to spend lots more money on public schools. The US Constitution says nothing about public education, as the Supreme Court recognized in its 1973 *Rodriguez* v. *San Antonio* decision, which ruled that education funding was a state, not a federal, matter. The decision seemed to foreclose efforts to use federal courts to strong-arm states to spend more on education, or to modify their formulas for dispensing education dollars to school districts. So litigants began to look to state constitutions, 48 of which mention education in some way, to push their agenda….

(T)he very generality of the constitutional language on education allowed activist judges to anoint themselves as the final arbiters on education adequacy in 17 states where these suits proved successful – at a cost to the public of tens of billions of dollars….

State judicial activism hasn't just exploded education budgets. Today, state leaders are increasingly struggling with how to pay for lavish retirement benefits for government workers without shattering public finances – and the courts aren't helping, to put it mildly….

In at least two dozen states, courts have provided government workers with far more protections than exist in the private sector, locking in hundreds of billions of dollars in long-term, yet-to-be-funded liabilities. Much of the difficulty with reducing the cost of local pension systems stems from this obstacle….

Taxpayers are the big losers. The court rulings have frozen in place unaffordable benefit levels in retirement systems that have accumulated between $1.5 trillion and $4 trillion in unpaid future liabilities. Last year, San Jose voters approved a pension-reform measure meant to curb costs by requiring workers to contribute more to their pensions, but a California court overturned key elements of the initiative. San Jose's pension costs have soared from $72 million annually to $254 million annually over the last decade, forcing the city to lay off thousands of workers.

Similar battles are taking place in other states. Colorado's government retirees are using previous state court rulings, citing the California rule, to challenge a reduction in annual cost-of-living adjustments voted by that state's legislature. Most legal observers expect the workers to prevail. And Illinois's legislature had balked for years at passing substantial pension reform because the state's constitution describes public-employee pensions as a "contractual relationship" that can't be diminished. Only recently did the state's legislature, facing the worst pension debt among states, try reform that might survive in court, arguing that even contracts don't bar changes for work not yet performed. That legislation is now headed to the Illinois Supreme Court.

Starting in the late 1970s, following a long period of government growth, voters in many states passed constitutional amendments designed to restrain state spending or limit the ability of elected officials to run up debt. Here, too, the state courts have been aggressive defenders of profligate government, shredding the new fiscal protections….

Nowhere have courts been more active in opposing voters' efforts to control spending than in California.

Golden State residents passed Proposition 13 in 1978, amending the state constitution to cap property taxes and requiring localities to obtain the approval of two-thirds of voters if they wanted to enact new, non-property taxes….

The courts swiftly got to work in eroding these taxing and spending limits. California courts let local governments get around Prop. 13's supermajority requirement for new taxes simply by renaming the levies "assessments," "fees," or "charges." Small wonder that California's combined state and local tax burden, after falling from fifth-highest among America's states to 14th in the immediate aftermath of Prop. 13, has now risen back up to fourth-highest….

Constraining state judicial activism won't be easy…. (But) without new constraints on state judicial activism, voters can expect more fiscal pain.

3 — GEOGRAPHIC: THE MYTH OF RISING CITIES, DECLINING SUBURBS

Wendell Cox

Time Magazine's Sam Frizell imagines that the American Dream has changed, in an article entitled "The New American Dream is Living in a City, Not Owning a House in the Suburbs." Frizell further imagines that "Americans are abandoning their white-picket fences, two-car garages, and neighborhood cookouts in favor of a penthouse view downtown and shorter walk to work." The available population data shows no such trend.

Frizell's evidence is the weak showing in single family house building permits last month and a stronger showing in multi-family construction.

This is just the latest in the "flocking to the city" mantra that is routinely mouthed without any actual evidence (see: *Flocking Elsewhere: The Downtown Growth Story*). The latest Census Bureau estimates show that net domestic migration continues to be negative in the core counties (which include the core cities) of the major metropolitan areas (those with more than 1,000,000 residents). The county level is the lowest geographical level for which data is available.

At the same time, there is net domestic inward migration to the suburban counties. Moreover, much of the net domestic migration to metropolitan areas has been to the South and Mountain West, where core cities typically include considerable development that is suburban in nature (such as in Austin, Houston and Phoenix). As the tepid "recovery" has proceeded, net domestic migration to suburban counties has been strengthened (see: *Special Report: 2013 Metropolitan Area Population Estimates*).

There is no question but that core cities are doing better than before. It helps that core city crime is down and that the South Bronx doesn't look like Berlin in 1945 anymore. For decades, many inclined toward a more urban core lifestyle were deterred by environments that were unsafe, to say the least. A principal driving force of this has been millennials in urban core areas. Yet, even this phenomenon is subject to over-hype. Two-thirds of people between the ages of 20 and 30 live in the suburbs, not the core cities, according to American Community Survey data.

To his credit, Frizell notes that the spurt in multi-family construction is "not aspirational," citing the role of the Great Recession in making it more difficult for people to buy houses. As I pointed out in *No Fundamental Shift to Transit: Not Even a Shift*, 2013 is the sixth year in a row that total employment, as reported by the Bureau of Labor Statistics was below the peak year of 2007. This is an ignominious development seen only once before in the last 100 years (during the Great Depression).

In short, urban cores are in recovery. But that does not mean (or require) that suburbs are in decline.