Secular Stagnation: The New Normal for the United Kingdom?

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Abstract

A range of authorities have argued recently that rather than the 2008- global financial crisis (GFC) representing a major, but one-off, downturn mature economies have now entered a period of 'secular stagnation' where underlying productivity growth rates have fallen to very low rates. Growth has only been sustained by various bubbles and is likely to slump to low rates for the foreseeable future. However, much of this literature has been largely focused on the United States. This paper critically examines these approaches in the context of recent British economic performance. There are several grounds for examining recent British performance: before the GFC the economy saw particularly strong property price booms and credit expansion, with demand sustained by what has been termed 'privatized Keynesianism'; since the GFC the British economy has experienced prolonged stagnation in productivity. These developments have taken place in the context of high (and, at times, rising) inequality. This paper examines mainstream approaches to secular stagnation in the context of UK

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Secular Stagnation – the New Normal for the UK?

In November 2013 former U.S. Secretary to the Treasury Laurence Summers made a now famous speech to the International Monetary Fund in which he raised the spectre of secular stagnation, that recovery from the2008 global financial crisis (GFC) was not simply a case of fixing the financial system but instead held out the prospect of slow growth for the foreseeable future. Although the period before the crisis was widely hailed at the time as the 'great moderation' or, in Mervyn King's phrase, the era of 'Non-Inflationary Continuous Expansion', Summers pointed to the limits of that expansion:

> Capacity utilization wasn't under any great pressure. Unemployment wasn't at any remarkably low level. Inflation was entirely quiescent. So, somehow, even a great bubble wasn't enough to produce any excess in aggregate demand.[1]

Recent expansions, Summers argued, have been limited and based (in the US, at least) on bubbles in the housing market, elsewhere in Europe on bubbles based on unsustainable public debt levels (see further Summers, 2014). Others have also argued that developed countries have increasingly been unable to sustain economic activity except through rising public and/or private debt (Streeck, 2014): the experience of Japan from the 1990s has spread across the Western world. As there, extended periods of exceptionally low interest rates have failed to prompt sustained economic recovery. For example, Summers (2015) writes of 'the problem of secular stagnation – the inability of the industrial world to grow at satisfactory rates even with very loose monetary policies'. In some, but by no means all, expositions this has been tied to increases in inequality – with flat or declining real earnings, households maintained consumption through credit, typically under conditions of rising property prices. This can be seen as part of a general pattern where Mian *et al*. (2015) find rises in household debt are associated with lower subsequent growth and also tend to lead to higher consumption and worsening current account positions (see also Jorda *et al*., 2015). The OECD (2014) is less pessimistic in its projections to 2060, but still forecasts a slowing down of growth particularly amongst developed economies.

Although this argument has been widely debated since, much of this has focused on the U.S. experience. There are a number of reasons why the British experience is of interest here. Many of the same trends claimed for the U.S. before the crisis have also been highlighted in Britain; in particular the argument that the pre-crisis expansion was largely based on a house price bubble and associated 'privatised Keynesianism' credit boom (e.g. Crouch; 2009; Hay, 2009; 2011). The limited recovery of the British economy since the financial crisis has been notable for continued stagnation of productivity, arguably indicative of more deep-rooted problems. Output remains below levels many had forecast earlier on in the crisis period, let alone those predicted around 2007.

1. Secular Stagnation – Key Approaches

There are variants of the recent versions of the secular stagnation thesis. As has been widely noted, the term was originated in the 1930s by the American economist Alvin Hansen who diagnosed an exhaustion of growth possibilities in the U.S. economy. Versions of the thesis have periodically resurfaced in economics since (Backhouse and Boianovsky, 2015). In

practice, not only did the U.S. economy boom after World War Two, but the 1930s themselves saw strong productivity growth there with some of the innovations providing the basis for the subsequent growth (Field, 2011). Hansen himself became one of Keynes' earliest academic champions in the U.S. – simple aggregate demand deficiency is one possible diagnosis of Britain's recent economic ills.

The Summers version of the secular stagnation is summed up in the following three propositions:

> First, as the United States and other industrial economies are currently configured, simultaneous achievement of adequate growth, capacity utilization, and financial stability appears increasingly difficult. Second, this is likely to be related to a substantial decline in the equilibrium or natural real rate of interest. Third, addressing these challenges requires different policy approaches than are represented by the current conventional wisdom. (Summers, 2014: 66).

Summers notes that even during the expansion before the GFC inflation remained subdued, unemployment was not especially low by historic standards and capacity constraints did not appear to be binding; this was in the context of a major unsustainable asset boom in the US and elsewhere, and arguably unsustainable fiscal expansion in continental European economies. Summers version of the secular stagnation thesis is thus set within the framework of natural interest rate theory. Shifts in investment and savings behaviour have led to a trend decline in the natural rate; combined with low inflation rates, this has made achievement of the natural rate difficult, if not impossible, with conventional monetary policy tools. The corporate sector has tended to move into cash surplus with reduced demand for external investment funds reflecting lower capital requirements for newer industries, demographic transition to lower (or no) growth of working age population and the trend decline in capital goods prices. The shift in income share from labour to capital tends to raise savings; the accumulation of reserves by a range of central banks has also acted to depress bond yields. Within a loanable funds framework, a shift in savings and investment behaviour of this form would be expected to lead a decline in the natural rate of interest. Achieving this may be hampered by the zero lower bound (ZLB), but in any case the resulting low interest rates are likely to undermine the achievement of financial stability.

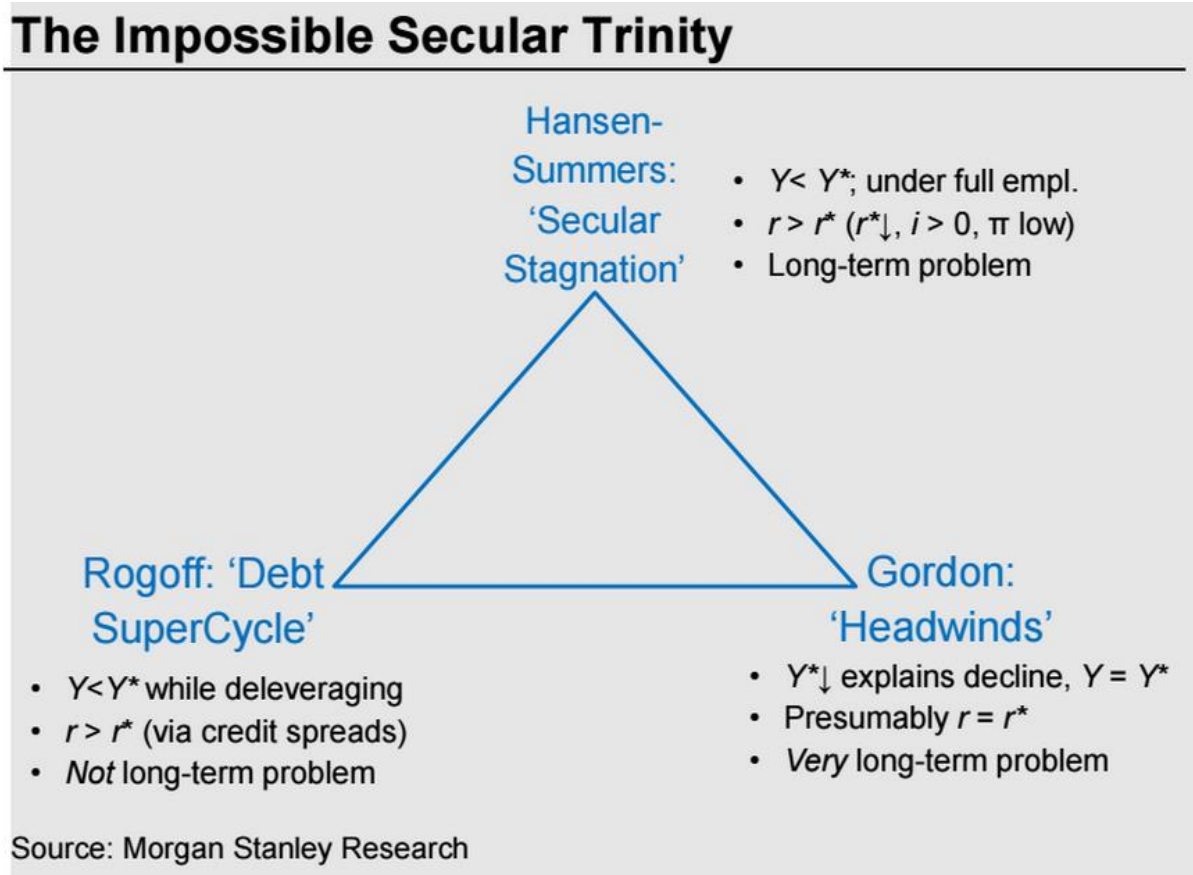
Summers remains agnostic as to whether the underlying rate of technical progress has slowed down. Other versions of the secular stagnation thesis propose precisely that. In particular, Gordon – a longstanding sceptic of the impact of the 'new economy' information and communication technologies (ICTs) (cf. Gordon, 2000) – identifies a range of key headwinds likely to undermine future growth (Gordon, 2012; 2014). Although his focus is on specifically US trends, some at least might apply more generally across developed economies. Broadly, the long run productivity gains from ICTs are less than the more excitable claims for the 'new economy' indicate, and have largely been realised already; post-1973 rates of innovation are likely to persist or slow down further, with the 1990s 'new economy' acceleration in US productivity growth being a relatively short-lived interregnum (cf. Fernald, 2014). Thus, for example, although 'Moore's Law' of ever-rising computing power may in itself may be slowing down, but more significantly here the steady decline in the price of ICT equipment relative to its performance slowed down markedly since 1998. Claims that ICTs constitute a general purpose technology underlying a third industrial

revolution are found to seriously overstate the impact of ICTs (cf. Field, 2011). Additionally, key growth-retarding effects of environmental costs and debt overhang are projected. This account also emphasises the likely course of income levels for average workers and households; it is not simply a projected slowdown in GDP growth rates but the developments that continue to detach wages and household income from GDP per capita growth rates. Centrally the impact of new technologies and globalisation, leading to factor price equalisation effects, is seen to detach wage growth from productivity growth. Such accounts may be a useful corrective to the more optimistic projections of the impact of ICTs, they can be taken as implying a continuation of post-1973 productivity growth rates rather than necessarily presaging further stagnation.

A common response here has been to emphasise the potential for continued technological advance. This may be to miss the point. In the first place, as Gordon (2012) and others noted, continued growth is scarcely a universal feature historically.[2] Second, the "virtual" or "weightless" nature of much the output associated with application of ICTs, where output has virtually zero marginal cost, may make it difficult for companies to realise profits from such output.[3] Post-war evidence indicates that companies have struggled to realise the gains from their innovation (Nordhaus, 2005), and the nature of new economy output may make this particularly difficult.

Some notable extensions of, or alternatives to, this approach have emphasised further the mechanisms by which wage growth has become detached from productivity as the key causal mechanism for stagnation and rising household indebtedness. Galbraith (2014) emphasises these development, continued with the impact on labour-savings innovation on employment and the costs associated with environmental developments. Palley (2012; 2015) has gone furthest in setting out this hypothesis: the inter-related processes of globalisation and the shift to a neo-liberal policy regime have undermined wage growth and led to rising household debt levels. Palley (2015), in particular, delineates the areas of overlap with other secular stagnation theories and key differences between these and his "structural Keynesian" approach. The squeeze on real wages would, ceteris paribus, have led to a shortfall in demand; this was offset by the asset and credit bubble from the 1980s.

The diagram below indicates one recent attempt to delineate the main hypotheses in this field.



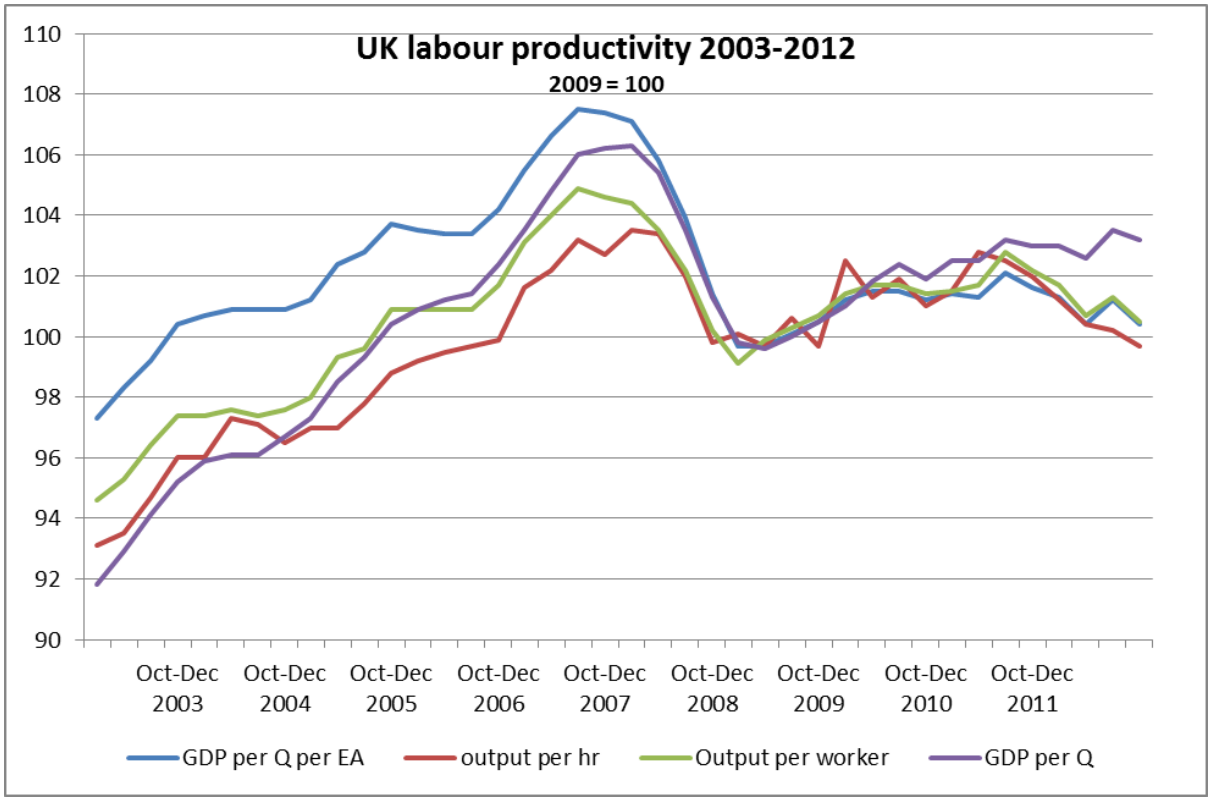
The Rogoff 'debt super-cycle' hypothesis views recent developments in terms of past accumulation of debts (Lo and Rogoff, 2015). Debt overhang is predicted to provide a short-medium term fetter on growth, raising uncertainty and potentially risk premiums. Although Rogoff does consider debt overhang in general, and the impact of private sector developments on public debt (both through bank bailouts and more general macroeconomic processes), the emphasis here is clearly on public debt. This is notwithstanding the well-known criticisms of this approach.

Although this may be useful as an expositional device and for clarifying differences between these approaches, it is somewhat overstating it to see these as mutually-inconsistent alternatives. Summers, as noted, is agnostic over whether there is a slowdown in long run technological progress (or Gordon "headwinds") and Gordon also notes the impact of debt overhang.

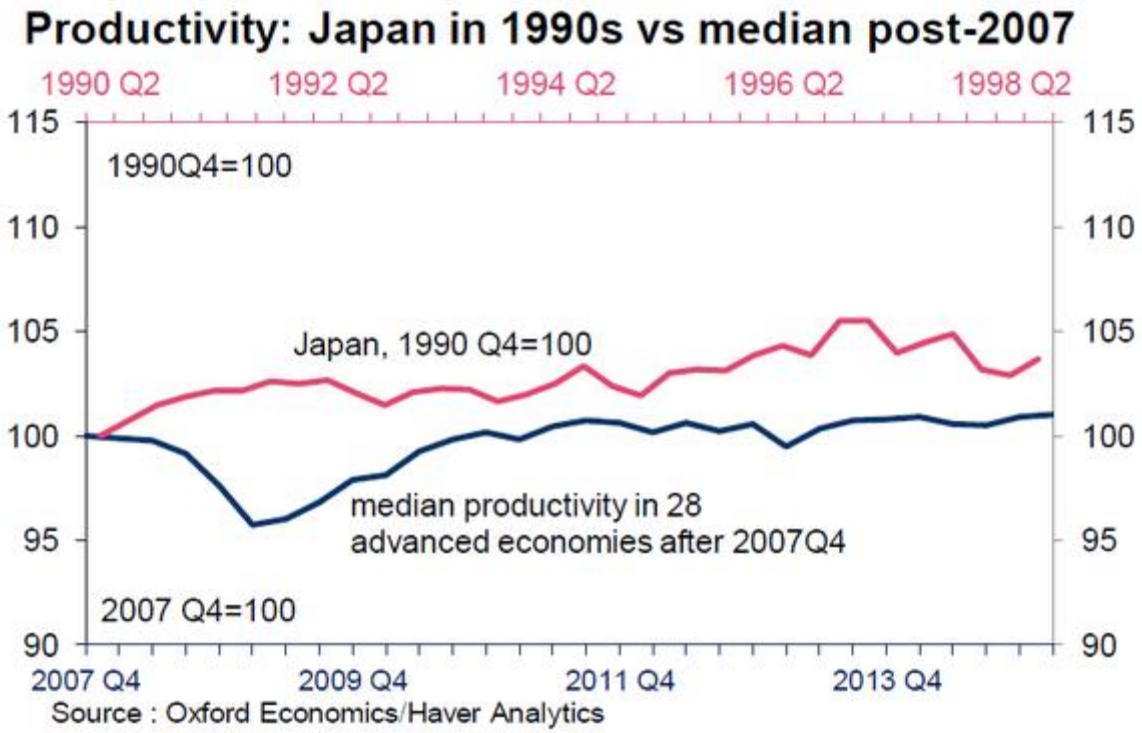
2. The UK Case

There are strong similarities with the broad characterisations of the US, with two key exceptions. The first is demography, the UK has relatively high population growth rates by industrialised country standards; although the birth rate has typically been below replacement rates this growth has been largely driven by net immigration (notwithstanding official UK government policy), much of this working age migrants. Secondly, whereas the

US may be presumed to be at or around the world productivity frontier the UK lags behind this. Indeed, whereas the UK did appear to have narrowed the productivity gap in the 1990s and 2000s before the crisis, by 2013 UK productivity (in terms of output per worker) was 17 percentage points below the G7 average.



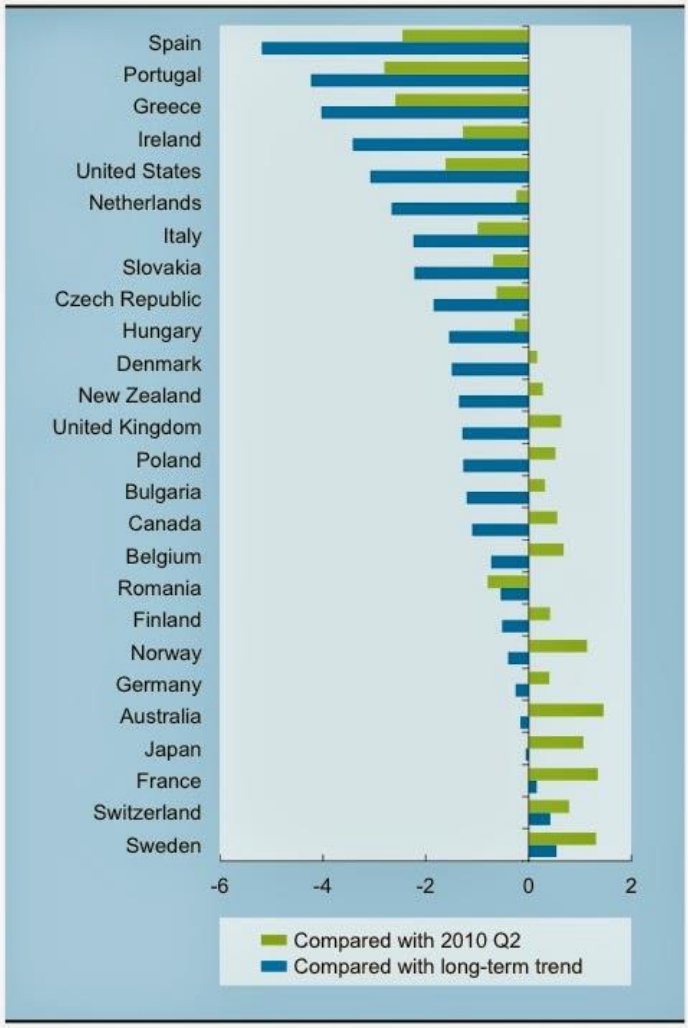
The UK "productivity puzzle" here is compounded, since the pre-crisis productivity growth appeared to be based on application of ICTs as well as improvements in human capital (Barrell *et al*., 2012). This can be seen in terms of austerity and aggregate demand deficiency, so that productivity would be expected to revive with any sustained recovery. The evidence is clear that the UK economy has suffered from aggregate demand deficiency since the onset of the GFC (Martin and Rowthorn, 2012, in particular provide detailed evidence for this). Nevertheless, there are a number of puzzles with a reversal of this magnitude here. Sluggish productivity performance since the onset of the GFC does appear to be a general phenomenon, and thus consistent with an aggregate demand explanation.



However, the difficulty with this as a complete explanation for the UK productivity puzzle is that although the UK economy has clearly experienced austerity since the GFC, relative to industrialised countries this has not been especially pronounced:

CHANGE IN REAL GOVERNMENT EXPENDITURE, SELECTED DEVELOPED COUNTRIES, 2010 Q2–2013 Q4

(Per cent of real 2010 Q2 GDP)

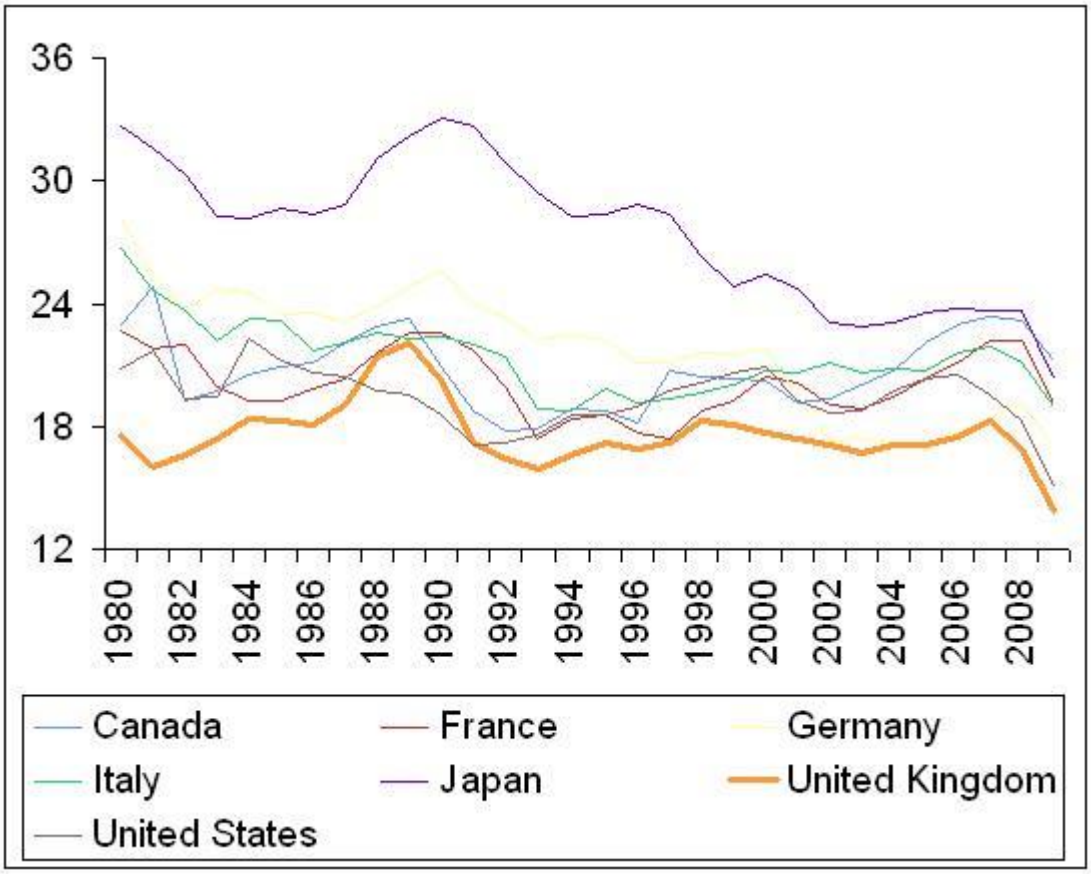


Source: UNCTAD secretariat calculations, based on Economist Intelligence Unit (EIU), *CountryData* database.

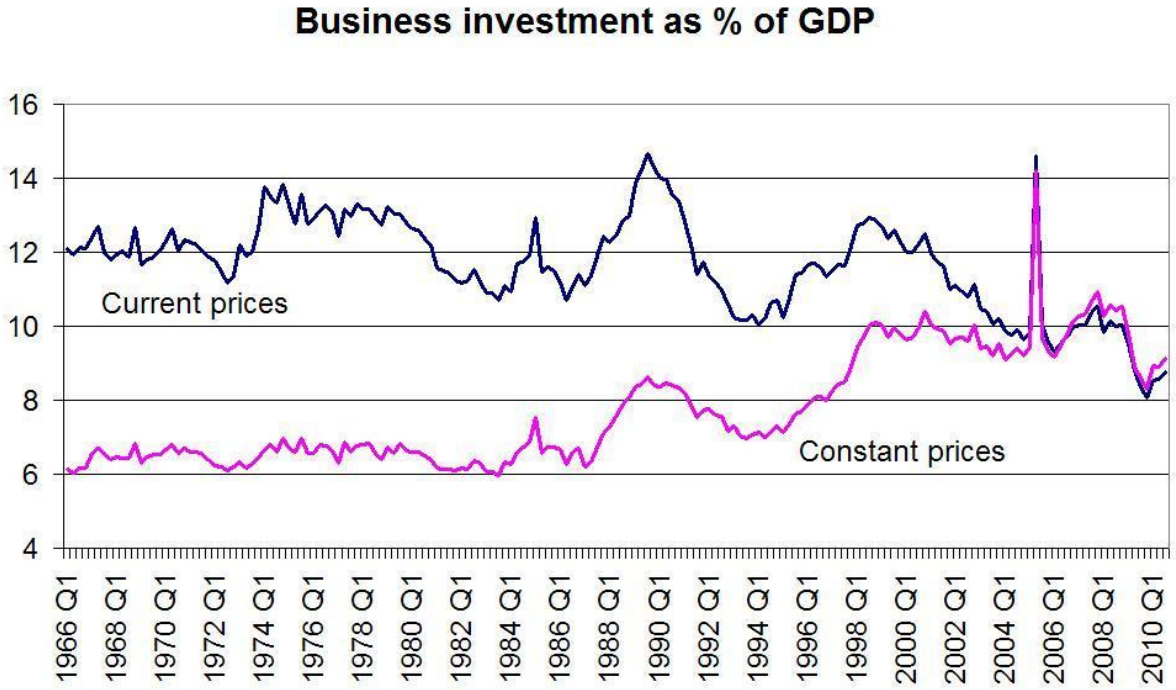
Note: Long-term trend is estimated by applying from 2010 Q2 onwards the average expenditure growth of the period 1997 Q1–2010 Q2.

The longer run developments in the UK mirror much of the secular stagnation story for the US economy. The UK has a longstanding tendency for relatively low investment.

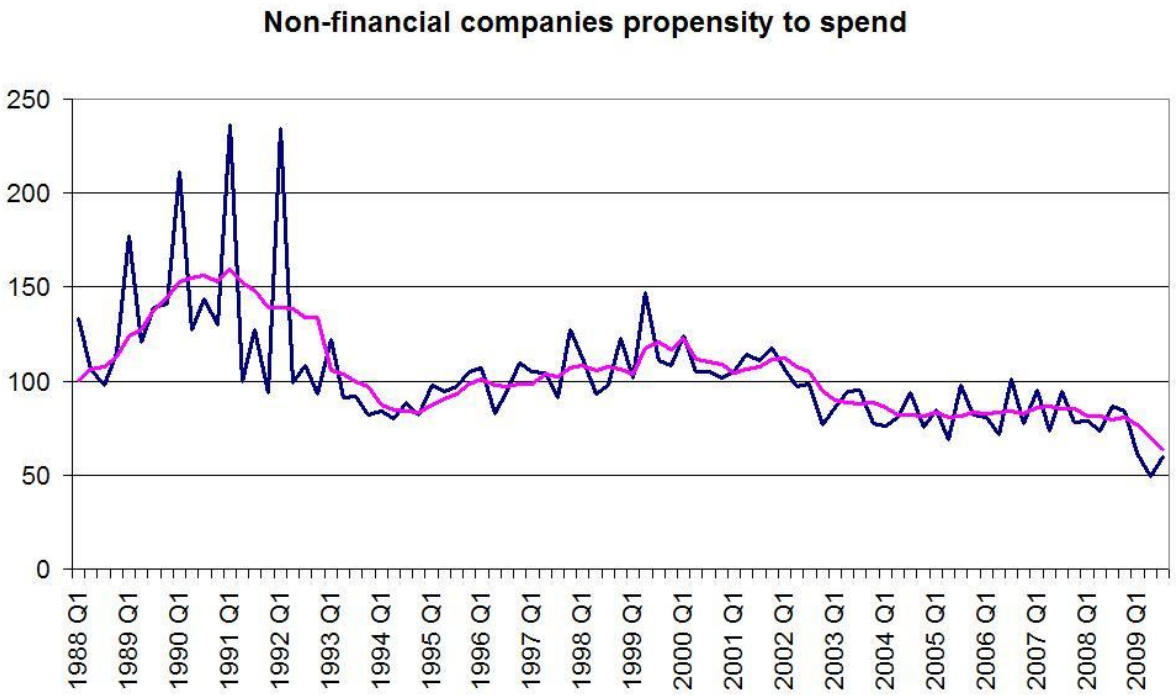
G7 Investment-GDP Ratios



This can be partly misleading since, as noted, the relative price of capital goods has tended to fall and thus expressed in constant price terms the decline is less clear cut.

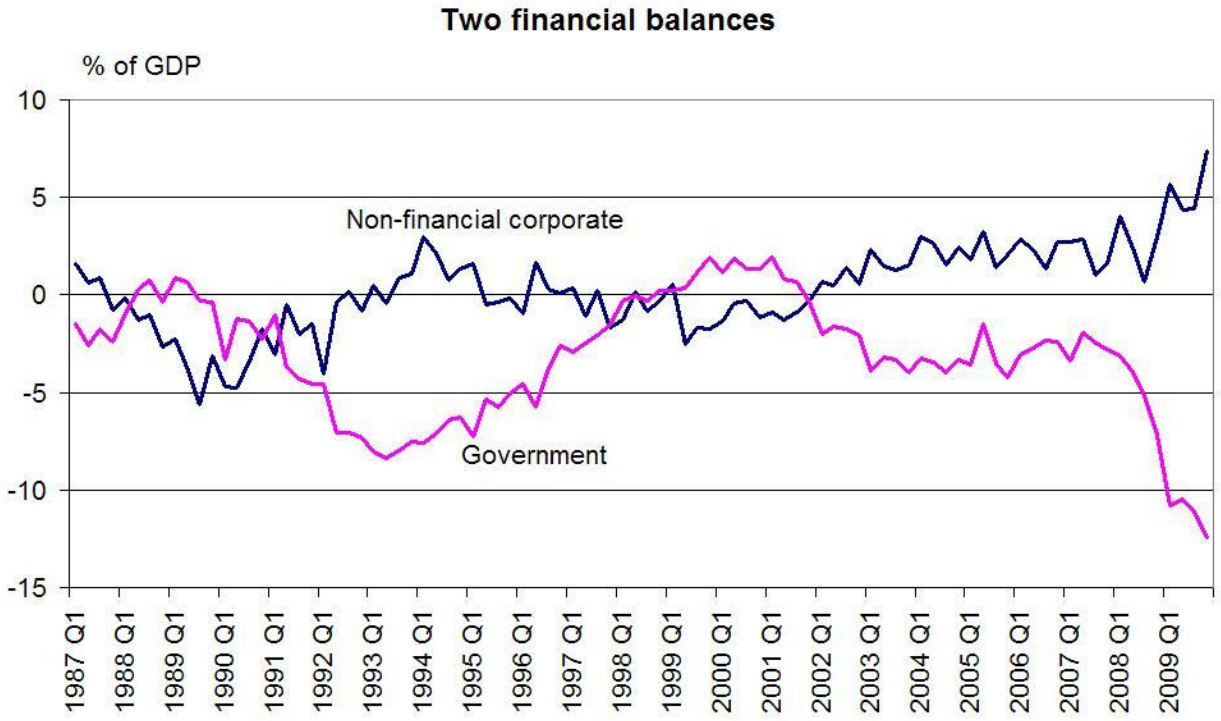


Nevertheless this can be seen in terms of the more general trends. The UK has seen a secular decline in the propensity for firms to invest out of their retained profits:



There are a variety of causes, particularly related to the financialisation of the UK economy, which cannot be explored in full here. The effects of this can be seen in terms of the

development of a corporate surplus through the 2000s (which has only recently been reversed)



The UK has also seen particularly high overall debt levels. Indeed on some measures of total outstanding public and private debt in the UK economy are the highest outside of Japan and show only limited signs of consolidation with the recovery from the GFC (McKinsey, 2012; 2015; Cecchetti *et al*., 2011; Buttiglione et al., 2014). This can be seen in terms of the credit and house price boom from the early 1990s. Here the dynamics are somewhat more complex than the wage-productivity decoupling story, though. Overall the evidence on decoupling for the UK is mixed (Bailey et al., 2011; Pessoa and Van Reenen, 2012); the decline in the wage share has been much less pronounced than for many continental European economies (and thus, by definition, there has been limited decoupling overall). Developments here can be seen more in terms of slow growth of median wages and rises in wage inequality within the UK work and, within this, increased polarisation of the labour force (Goos and Manning, 2007).

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[1] http://larrysummers.com/imf-fourteenth-annual-research-conference-in-honor-of-stanley-fischer/#sthash.t4zDIfhM.dpuf

[2] Although here one hardly needs to be a wholehearted Marxist to note that the take-off in growth is associated with the rise of capitalism, viewed in terms of competing capitals and free wage labour.

[3] For earlier scepticism of how far the new economy was weightless, though, see Perraton (2006).