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The great stagnation

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9-11 minutes

I'VE just read Tyler Cowen's new book, "The Great Stagnation". You should too; it's available online (only), quite short, and just $4. The publishing model is fascinating in its own right and worth a post, but that will have to wait, as the material itself deserves priority. I don't agree entirely with all of that material, but I think it's safe to say that Mr Cowen's book is an important one that will have a profound impact on the way people think about the last thirty years.

There is a lot to the book for such a short read, but I'll try to summarise the key ideas briefly. There are two kinds of economic growth possible in this world. One can take good ideas already in use elsewhere, adopt them, and make use of underused stocks of people and capital. That's what China and India are currently doing, and we shouldn't mistake their rapid growth for something it's not. Or one can come up with new ideas and apply them in ways that allow the economy to grow.

The rich world has been stuck doing the latter for most of the last century, and lately they haven't been doing it as well. Mr Cowen looks at growth rates of output and median income over the last few decades and notes that there's a steady downward trend. And this trend is due, he says, to the exhaustion of the supply of low-hanging economic fruit.

What low-hanging fruit? Educational fruit, for instance. Decades ago, the rich world was moving most of its population from very low levels of education to university educations, and was shifting lots of potential geniuses from the fields to the factories to the research labs. That was relatively easy to do and it fueled a big growth boom. These days, improvements in educational attainment are quite hard. Nearly half of all young people now go to college. Moving marginal students into college will require a lot of effort and won't yield large gains. That doesn't mean it isn't worth doing, he says. It simply means that easy gains from education are gone.

Americans enjoyed low-hanging land fruit for much of their country's history. Immigrants poured into the American continent and hoovered up cheap land for high-yielding farms, high-yielding mines, and high-yielding cities while Europeans had to go through the slow process of shifting land uses. But these days, those low-hanging land dividends are also gone.

But the big setback for society, according to Mr Cowen, is the end of the exploitation of the major innovations of the last two centuries. The 1700s and 1800s yielded revolutionary innovations in industry, chemistry, and electricity. Rich countries spent the 1800s and 1900s figuring out how to exploit those innovations to their fullest, and as recently as the 1950s and 1960s, these experiments were producing products that utterly changed the way people lived. During the lifetime of those born in the 1930s and 1940s, household technology changed fantastically: refrigerators, laundry machines, dishwashers, radios, televisions, electric light, air conditioning, cheap automobiles, and so on. But with a few exceptions (among them computers, on which more later) today's households don't look that much different from their 1970s counterparts. Products have improved, but the development of revolutionary new technologies has slowed substantially. The progress of technology has plateaued.

Mr Cowen supports this assertion by referencing counts of major innovations, by tracking patents, and by asking readers to trust their own experience. Growth is slowing because economies have already gotten most of the innovative benefit out of previous big leaps and are now squeezing out more marginal gains. If we think on many of the big innovations of recent decades, in health care or finance say, we find that they either have primarily private benefits or produce benefits of questionable value.

The internet, on which he has a lot to say, has had enormous benefits, but a striking amount of online activity is free and internet businesses create few new jobs (and displace lots of others). The result is growth in utility without much of a contribution to GDP, which would be fine except that countries and people have bills to pay, on things like health care, pensions, and government debt. Complicating matters is the fact that the fastest growing contributors to measured GDP—the government, education, and health sectors—deliver returns that are very difficult to measure. This suggests, he says, that rich world GDPs are likely overstated; we're poorer than we thought. And that, Mr Cowen concludes, will make it very difficult for us to make good on the many, many obligations accumulated while we assumed that our previous growth trajectory would continue.

It's not a particularly ideological book. Mr Cowen suggests that the rise of big government wasn't about belief systems but about technology. Government, like most institutions public and private, could grow as innovations allowed. It's not really good or bad (though aspects of the rise of big government have clearly been very bad); it's just the way it is. And that's where we find ourselves: a little poorer than we thought, and stuck trying to live within more humble means than we imagined until the next wave of major innovations arrives.

Ok, first a few snap criticisms. Like Matt Yglesias I think Mr Cowen is a little too quick to associate current recovery problems with his broader thesis. I think there's strong evidence that the most of the economic pain experienced from the summer of 2008 to now can be attributed to a big demand shock, and most of it was preventable. I also think Mr Cowen may undersell the potential of recent innovations. I see computing and the internet as revolutionary innovations, every bit as transformative as the steam engine or electrification. I think society is only beginning to reorganise itself around these technologies and huge changes will follow, many of which will produce rapid growth in output and jobs. That assertion isn't incompatible with Mr Cowen's thesis about slow recent growth, and it could be decades rather than a few years before the next acceleration. But I think the economic benefits that result from cognition-augmenting innovations (as opposed to labour-augmenting innovations) will be dramatic. (More disconcertingly, so too will be the expansions of government, as per Mr Cowen's thesis.)

But I really like the book, and I like the trains of thought it suggests. For instance, his views on educational low-hanging fruit suggest that the rich world is likely to reap far bigger benefits from growth in developing countries than from improvements in domestic education and research. While America tries to wring additional innovative capacity out of an already well educated population, the developing world is home to billions of people, including hordes of potential geniuses and innovators, living in poverty and ignorance. Getting their economies rich enough to move people into classrooms and laboratories is far more likely to yield growth-boosting innovations than trying to get a marginal college grad to get a PhD. Mr Obama's State of the Union theme was precisely wrong, in other words; America needs to focus on helping the rest of the world catch up as fast as possible. Meanwhile, looser immigration rules in America would also provide a big boost to American growth potential.

Second, improvements in rich world living standards may, for the moment at least, come from the capture of policy low-hanging fruit. In other words, the rich world should focus on getting rid of blatantly foolish and costly policies. Moving from taxes on goods, like income, to bads, like traffic congestion, would be a good start. Not spending so much on medical treatments with dubious benefits would be another possibility. Cutting out policy foolishness like agriculture subsidies and the mortgage-interest deduction would be another positive step. Amid rapid growth, really silly policy choices could be tolerated, since surpluses continued to rise. As growth rates slow, the failure to cut out bad policies will mean continued stagnation or declines in living standards for some.

And it's a little amusing to focus on the implications of the spread of cheap-to-free internet amusement. As Mr Cowen notes, the availability of good, free internet entertainment has allowed a lot of people hit hard by falling incomes or recession-induced joblessness to maintain relatively high levels of utility (though this available substitute has also made it easier to cut down on physical consumption, with nasty effects on GDP). This suggests that other forms of consumption, like that resulting from the status competition of the relatively well-off, now loom more important in supporting "real" consumer expenditures, of the job-creating, revenue-generating, GDP-enhancing sort. There's an argument there in *favour* of rising inequality, though not a very good one; a society dependent on rich-person status games to boost GDP and create jobs is unlikely to be a stable one, economically or politically speaking.

I look forward to continuing to digest the ideas in the book. It's certainly worth a rigorous debate, as the view it suggests, if right, implies a very different set of policy choices than the ones many current economists and leaders, of all ideological stripes, support.