Fight Over Default Is Fight Over New Normal

By Megan McArdle - Oct 16, 2013
Megan McArdle is a Bloomberg View columnist who writes on economics, business and public policy.

Are you depressed by the spectacle in Washington? You may not be depressed enough. This morning I read a recent paper by Brink Lindsey of the Cato Institute, and commentary by Robert Samuelson of the Washington Post, and frankly, I think I need some Prozac.

You really need to read Lindsey's full paper, but here's the nub:

Notwithstanding huge changes over time in economic, social, and political conditions, growth in real gross domestic product (GDP) per capita has fluctuated fairly closely around an average annual rate of approximately 2 percent. Looking ahead, however, there are strong reasons for doubting that this historic norm can be maintained.

Consider the four constituent elements of economic growth tracked by conventional growth accounting: (1) growth in labor participation, or annual hours worked per capita; (2) growth in labor quality, or the skill level of the workforce; (3) growth in capital deepening, or the amount of physical capital invested per worker; and (4) growth in so-called total factor productivity, or output per unit of quality-adjusted labor and capital. Over the course of the 20th century, these various components fluctuated in their contributions to overall growth. The fluctuations, however, tended to offset each other, so that weakness in one element was compensated for by strength in another. In the 21st century, this pattern of offsetting fluctuations has come to a halt as all growth components have fallen off simultaneously.

Basically, America in the 20th century benefited from (at least) two one-off advances: the movement of women into the labor force and greatly increased education of its young people. These aren't tricks you can repeat. Moving people from third-grade educations, or no education, to a 12th-grade education represented an actual large increase in their productive abilities. So did sending more people to advanced training in various professions. But tacking on another 10 years of education won't produce the same result; for one thing, most people experience diminishing returns from education (learning algebra increases your general productivity more than learning to write a dissertation), and for another, every year of education you add takes away a year in the workforce where you are using those skills. Eventually, the losses from workforce participation outweigh the productivity gains.

You can overcome that, maybe, with higher savings and innovation. But we didn’t do the saving when we had the money. And the innovation has, so far, not materialized.

Samuelson argues that this is, ultimately, the source of the fighting in Washington: The battles are getting bigger because we’re out of money, and out of time.

Slow economic growth now imperils this postwar order. Credit standards have tightened, and more Americans are leery of borrowing. Government spending -- boosted by an aging population eligible for Social Security and Medicare -- has outrun our willingness to be taxed. The mismatch is the basic cause of “structural” budget deficits and, by extension, today’s strife over the debt ceiling and the government “shutdown.”

The temptation is to think that stronger economic growth will ultimately rescue us and make choices easier. This is economic growth’s appeal. It provides the extra income to buy more of what we want. We explain the weak economy as the hangover from the financial crisis and the Great Recession. Their legacy of caution and pessimism will, with time, dissipate. The economy will strengthen. This is plausible.

But it’s equally plausible that slow growth will persist. We rebel at the notion. As economist Stephen D. King writes in his book “When the Money Runs Out: The End of Western Affluence”:

“Our societies are not geared for a world of very low growth. Our attachment to the Enlightenment idea of ongoing progress -- a reflection of persistent postwar economic success -- has left us with little knowledge or understanding of worlds in which rising prosperity is no longer guaranteed.”

Washington used to finesse budget battles with the things deeply hated by good government types -- earmarks and baseline games. You could “cut” something by forcing it to grow more slowly than earlier projections. Or at least saying you were going to force it to grow more slowly than earlier projections. But these cuts didn’t actually hurt current beneficiaries -- or if they did hurt, it was the grinding erosion of inflation, not a sudden notice that your benefits were being cut off.

If those tricks weren’t enough, extra support could be bought by finding little gifts for an individual member’s district. The money wasn’t much, and anyway, tax revenues would be higher next year.

That era is coming to a close. We can’t just gently restrain the growth of a few programs and wait for rising GDP to bail us out. Many of the factors that are making us grow more slowly, like an aging population, are making government outlays grow more quickly than usual. Someone is going to have to pay -- or lose what they've been counting on getting.

Yes, the holdouts in the Republican caucus have been particularly unwise. But we shouldn't count on things getting better any time soon. The Republican Party may be frustrated by its

inability to halt the growth of the welfare state. But congressional Democrats will probably soon find themselves equally frustrated by their inability to get voters to pay for it.