Understanding "Secular Stagnation"*

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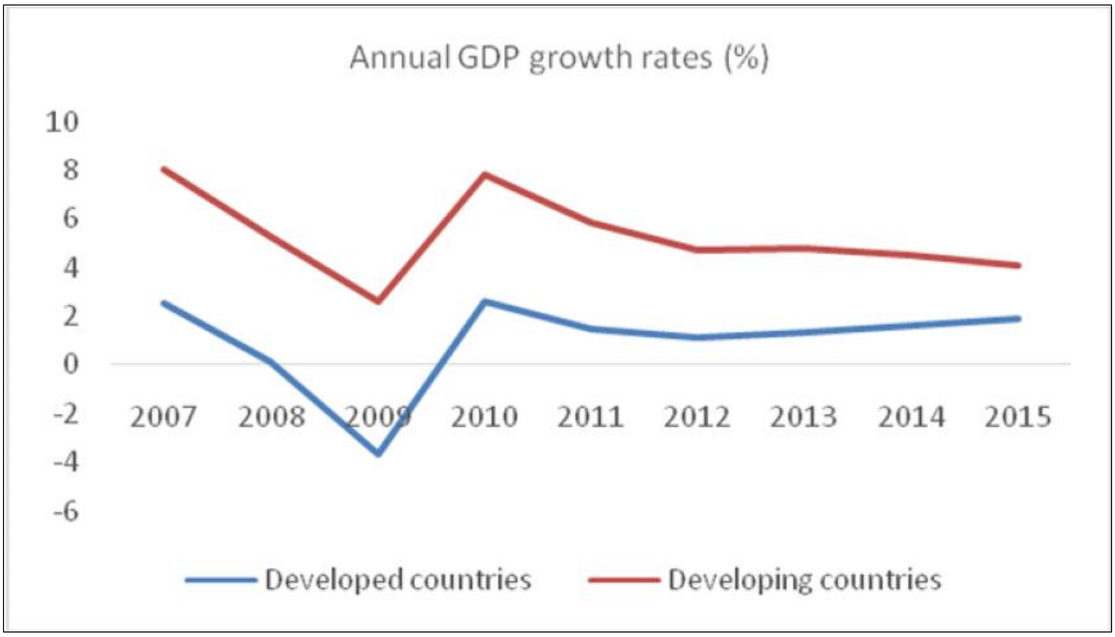
Last week two international institutions released their assessments and analysis of current trends in the world economy. The IMF brought out its biannual World Economic Outlook (WEO) with a blaze of publicity that highlighted how it is increasingly pessimistic about medium terms growth prospects. The Trade and Development Report (TDR) of UNCTAD, by contrast, received much less media coverage. This is a real pity, because the TDR has over the years been both more insightful and more successful than the more hyped WEO in identifying major emerging trends and anticipating potential problems in growth patterns, trade and finance. For example, the TDR pointed to the various dangers posed by deregulated finance in the US and other developed countries in 2006, before the financial crisis caught many other institutions like the IMF by surprise in 2007-08.

The TDR also provides a consistent framework for interpreting what has been called the "new normal" of mediocre or stagnant output growth in the global economy and particularly in the advanced economies. So what exactly is this? Chart 1 shows how, after the heady days of the early 2000s that were characterised by a boom in the global economy, growth in both developed and developing economies has been much less dynamic. More recently they appear to have settled into relatively low rates, and even the developing countries exhibit lower growth, certainly when compared to the immediately prior period.

Chart 2 shows the pattern in the major advanced economies, with even the much-vaunted "recovery" in the US not all that evident within the medium term trajectory. What is also striking in the recent period is that world trade is no longer the engine of growth that it used to be. As indicated by Chart 3, in the past four years global trade volumes have grown much slower than before and even more slowly than global output. In some years and for some regions, trade volumes have actually fallen. So cross-border trade is no longer providing the stimulus for economic expansion that it did in the previous decade.

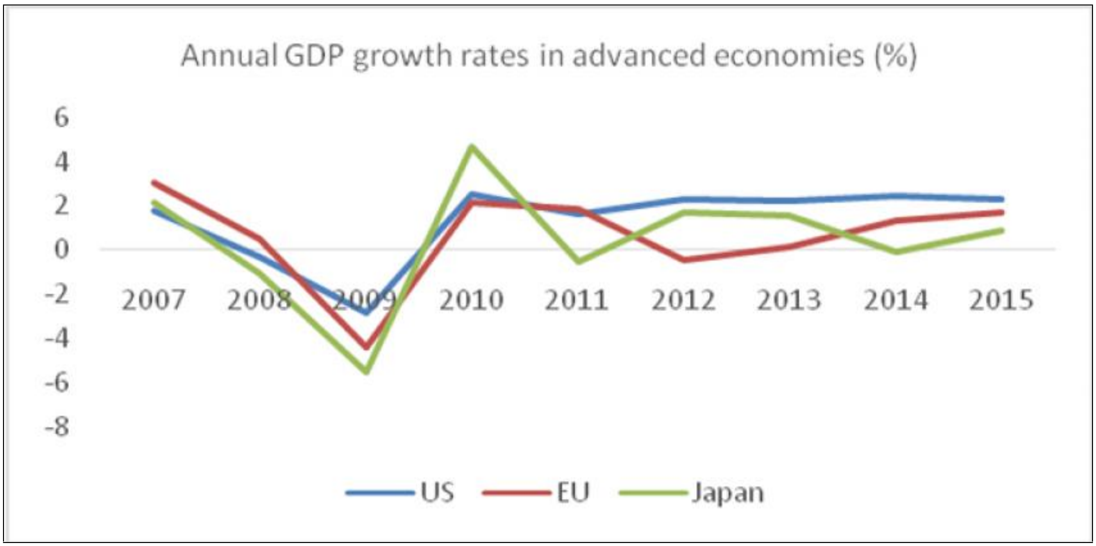
The issue is more complex with respect to developing countries, so in what follows the focus is on the tendencies to secular stagnation in the advanced capitalist economies.

Chart 1



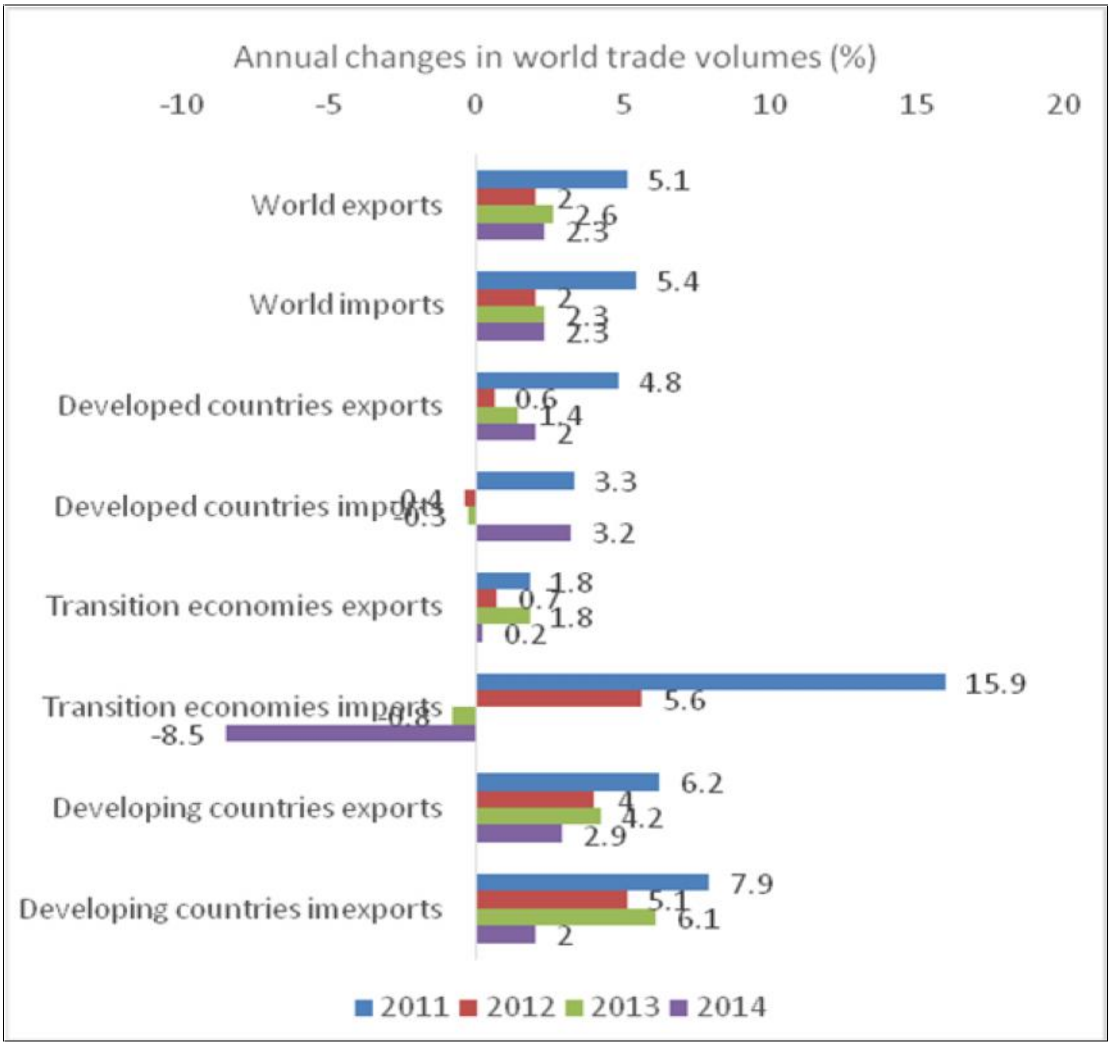
Source: UNCTAD Trade and Development Report 2015.

Chart 2



Source: UNCTAD Trade and Development Report 2015.

Chart 3



Source: UNCTAD Trade and Development Report 2015.

The IMF puts a lot of the blame for this on weaker productivity growth. The WEO accepts that its own forecasts and projections of growth have been faulty, persistently expecting higher output growth than was eventually achieved even according to its own estimates. Over the past four years, output growth has fallen short of IMF predictions by an average of one percentage point each year – a significant shortfall of around one-third relative to the average estimates of around 3 per cent growth per year for the world as a whole.

It further notes that “for a range of economies—including Germany, Japan, Korea, and the United Kingdom — the overprediction of output growth has … been associated with an underprediction of employment growth. In other words, labour productivity has fallen well short of predictions.” (page 10) This lack of improvement in labour productivity is found to be only partly driven by lower investment rates, with “the most important part of the explanation” said to be slowing total factor productivity growth. And this in turn is attributed by the IMF to “slower human capital accumulation, a compositional shift of GDP toward services, and — at least for the United States—gradually declining positive effects on productivity from the information and communications technology revolution". (page 11)

This analysis, implicitly based on the questionable assumption of full employment, is contradicted by the IMF's own empirical finding (described in pages 51-52) that in general financial crises and recessions have been followed by lower output and lower rates of output growth relative to the pre-recession trend. Supply shocks can hardly explain this tendency: some role must be recognised of the impact on output of the protracted declines in domestic demand. So this explanation is rather limited at best, if not possibly somewhat misleading.

The UNCTAD TDR takes up the question of the possibility of "secular stagnation" in a more nuanced and insightful analysis. It recognises the effect of crises on depressing subsequent output, describing a variety of mechanisms for this. A financial crisis affects the balance sheets of public and private agents, and attempts to repair this lead to lower levels of investment and consumption than would otherwise occur. Excess production capacities also imply lower investment, which tends to inhibit productivity growth also by lowering the diffusion of new technologies that are embodied in new plant and equipment; while prolonged unemployment can also affect skills among sections of the work force.

However, the TDR puts greater emphasis on longer term underlying and systemic factors that could be associated with this tendency to stagnation. It argues that these factors were masked in the earlier boom that was based on rapid credit expansion that supported asset bubbles and artificially increased debt-driven consumption and investment in ways that were obviously not sustainable. Now that this phase has come to an end, the underlying stagnationary forces cannot be so easily suppressed.

These forces stem from sustained inadequacy of domestic demand resulting from worsening functional distribution of income (in particular the declining wage share of national income in many countries). The attempts to address this shortfall essentially through monetary and credit expansion does not induce firms to invest in productive activities but rather encourages more investment in financial assets, thereby adding to the further concentration of wealth and continued stagnation of incomes of most people in the society.

This discussion has a bearing on the policy measures required to address this problem. If demand insufficiency is the root cause, then supply-side measures of the kind typically advocated (including by the IMF) such as greater labour "flexibility" would worsen the problem rather than resolve it, by further reducing labour incomes. UNCTAD proposes an alternative approach, which gives a prominent role to income policies like minimum wage legislation and enforcement, reinforcement of collective bargaining institutions and social transfers and public expenditure (especially investment) to address both demand and supply side concerns.

This discussion is crucial to assessing the future potential of expansion in global capitalism. So the Trade and Development Report, often seen to be essentially dealing with issues relevant to developing countries, provides valuable insights on possible strategies for developed economies as well.

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