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THE NEW NORMAL: DEMAND, SECULAR STAGNATION AND THE VANISHING MIDDLE CLASS

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The U.S. economy is diagnosed with two diseases at the same time:

- the secular stagnation of (potential) growth – the U.S. is riding a 'slow moving turtle' (Robert J. Gordon)
- job and income polarisation: a vanishing middle class – the opioid crisis; 'gig' economy; precarious jobs (Peter Temin)

There is a **common root**: the aggregate demand shortfall arising out of "unbalanced growth"

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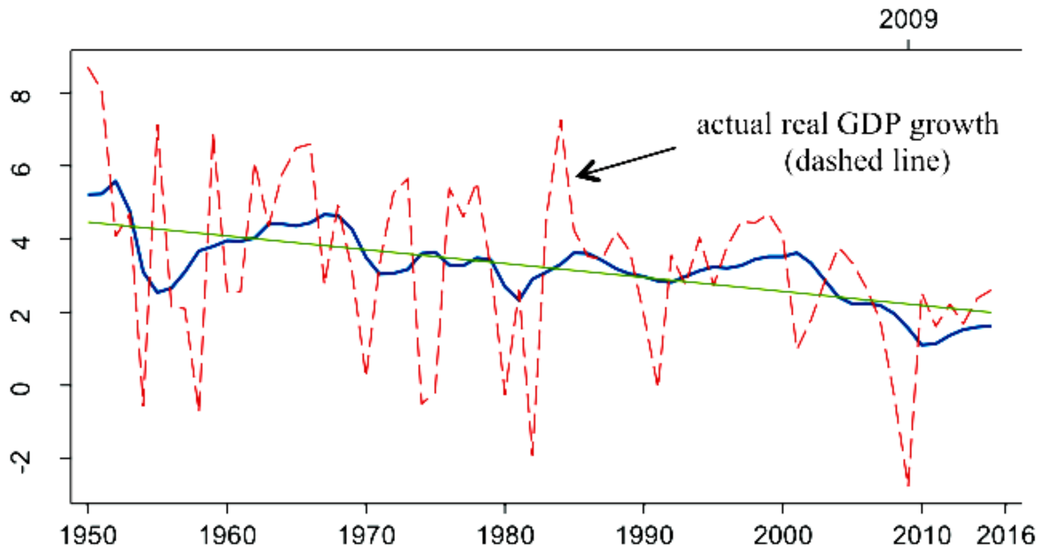
Secular stagnation: long-run decline in potential growth rate of the U.S.economy



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A growth accounting analysis for the U.S. economy (1948-2015) brings out that the slowdown in potential growth is due to a secular decline in Total-Factor-Productivity (TFP) growth, which in turn is mostly caused by:

- either a decline in **labour productivity growth**
- or a decline in **real wage growth**

Which factor is driving the other? Answer: the secular stagnation of real wage growth is the driver.

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The suppression of U.S. real wage growth

—what Alan Greenspan called

the “atypical restraint on compensation increases [that] has been evident for a few years now and appears to be mainly the consequence of greater worker insecurity”—

has been the main driver of faltering labour productivity growth and hence of TFP growth.

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But there is more to the aggregate picture than meets the eye. My growth accounting analysis for the U.S. economy (1948-2015) shows that:

- There is no decline in (trend) productivity growth in U.S. manufacturing and other 'dynamic' industries such 'Information' and FIRE.
- The decline in productivity growth is happening in low-waged services activities (fast-food, cleaning, security, healthcare, entertainment, personal services) and construction – offering what Paul Samuelson called 'mediocre jobs'.

This suggests a **Baumol-like dualisation** of the U.S.

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The **dual economy** ‘at work’:

- faster productivity growth in the dynamic sector (think: AI and robotisation) leads to labour shedding from the core.
- The survivalist stagnant sector is the ‘employer of last resort’, absorbing the ‘redundant’ workers from the core.
- This depresses labour productivity and real wages in the stagnant sector. Wage growth declines more than productivity growth.
- As a result, aggregate demand falls short, and this depresses productivity growth in the dynamic sector.

End result: **Unbalanced Growth** leading to premature secular stagnation of both stagnant and dynamic industries – the model of W. Arthur Lewis (1954) operates in reverse gear.

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Conclusion:

The intentional creation of a structurally low-wage-growth economy, post 1980, has not just kept inflation and interest rates low and led to workers ‘traumatized by job insecurity’ (Greenspan) accepting ‘mediocre jobs’ (Samuelson) in the stagnant sector—

it has also slowed down capital deepening, the further division of labor, and the rate of labor-saving technical progress in the dynamic core (Adam Smith; Nicholas Kaldor).

Mistaken monetary & fiscal policy put the U.S. economy on a ‘slow moving turtle’ by strengthening unbalanced growth.

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What should be done to reverse unbalanced growth?

1st: steering the economy closer to ‘balanced growth’ by a policy of coordinated macro-economic management and guidance. Kaldor’s incomes policy !

2nd: restoring the ‘countervailing power’ of workers vis-à-vis the monopsonistic interests in the dynamic (FinTech) sector – to keep real wage growth in stagnant activities close to that in dynamic sector. For ex.: Rehn-Meidner wage-earners’ fund (i.e. socialising the ownership of the robots).

3rd: Keynes’ “socialisation of investment” to guide the financial sector to prioritise socially useful investments, e.g. ‘greening’ the economy; public transportation; health & education. The point is to create high-waged socially useful ‘employment of last resort’. The instrument is selective industrial policy.

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Two more things:

- Baumol’s cost disease is not a disease but a sign of good economic health !

- Without the “visionary pragmatist” reforms outlined above, U.S. growth will remain ‘unbalanced’— further feeding the groundswell of popular discontent (*as per* Christine Lagarde) with unintended, but potentially upsetting political consequences and risks. Think: **worse than Trump** ………….