

# One Economic Sickness, Five Diagnoses

By N. Gregory Mankiw

Economists, like physicians, sometimes confront a patient with an obvious problem but no obvious diagnosis. That is precisely the situation we face right now.

Let's start with the problem.

There is no simple way to gauge an economy's health. But if you had to choose just one statistic, it would be gross domestic product. Real G.D.P. measures the total income produced within an economy, adjusted for the overall level of prices.

Here is the sad fact: Over the last decade, the growth rate of real G.D.P. per person has averaged just 0.44 percent per year, compared with the historical norm of 2.0 percent. At a rate of 2.0 percent, incomes double every 35 years. At a rate of 0.44 percent, it takes about 160 years to double.

It may be tempting to blame the Great Recession of 2008-9 for the paltry 10-year growth rate. Indeed, this recession was a deep one.

Yet the explanation for the poor long-run performance is not that simple. The recession of 1982 was also a deep one. The unemployment rate peaked at 10.8 percent in 1982, compared with a peak of 10 percent in 2009. But by the first quarter of 1989, as Ronald Reagan was leaving the White House, the 10-year growth rate was up to 2.1 percent.

The difference: The 1982 recession was followed by a robust recovery, whereas the recession of 2008-9 has been followed by a meager one.

So what's wrong with the economy? No one knows for sure. But numerous theories are being bandied about. Here are five of them:

**A statistical mirage** Some Silicon Valley economists suggest that there really isn't a problem. When quality improvements and new products are pervasive and so different from what came before, the national income accountants who construct gross domestic product might underestimate how much life is getting

better. Think of how your smartphone now replaces your camera, GPS, music system and various other previously stand-alone devices. According to this theory, the problem is not in the economy but in the statistics.

There is, however, reason to doubt that this is the whole story. Polls indicate that most Americans think the country is on the wrong track, and that the economy is their top concern. This dissatisfaction comes not from studying the national income statistics but from their day-to-day experiences, which are not living up to their aspirations.

**A hangover from the crisis** The recession of 2008-9 was caused by the worst financial crisis since the Great Depression of the 1930s. Maybe something about financial crises makes recovery from a downturn all the more difficult.

During the recent crisis, many feared another Great Depression would follow. We averted that catastrophe, but the anxiety may linger, causing businesses to be reluctant to borrow to finance risky investments and banks reluctant to finance them. The good news is that hangovers eventually dissipate, but patience is required.

**Secular stagnation** Lawrence H. Summers, former economic adviser to President Obama, has suggested that the problem predates the recent financial crisis. He points to the long-term decline in inflation-adjusted interest rates as evidence of reduced demand for capital to fund investment projects. He cites several reasons for the change, including lower population growth, lower prices for capital goods and the nature of recent innovations, like the replacement of brick-and-mortar stores with retail websites. The result, he says, is secular stagnation — a persistent inability of the economy to generate sufficient demand to maintain full employment.

His solution? More government spending on infrastructure, like roads, bridges and airports. If the government takes advantage of lower interest rates to make the right investments in public capital — admittedly a big if — the policy would promote employment in the short run as projects are being built and make the economy more productive when they are put into use.

**Slower innovation** Robert Gordon, author of “The Rise and Fall of American Growth: The U.S. Standard of Living Since the Civil War,” believes the pace of innovative activity has declined. Previous generations introduced electricity, indoor plumbing and the internal combustion engine. This generation’s innovations, like the smartphone and social media, are just not as life-changing.

This theory is the most pessimistic. If he's right, we may have little choice but to get used to slower growth.

**Policy missteps** When Barack Obama took office in 2009, the economy was in the midst of the Great Recession. President Obama's advisers relied on standard Keynesian theory when they proposed a large increase in government spending to energize the economy. The stimulus package was the administration's first economic policy initiative. As the economy recovered, the administration supported tax increases to shrink the budget deficit.

But even at the time, there were reasons to doubt this approach. A 2002 study of United States fiscal policy by the economists Olivier Blanchard and Roberto Perotti found that "both increases in taxes and increases in government spending have a strong negative effect on private investment spending." They noted that this finding is "difficult to reconcile with Keynesian theory."

Consistent with this, a more recent study of international data by the economists Alberto Alesina and Silvia Ardagna found that "fiscal stimuli based on tax cuts are more likely to increase growth than those based on spending increases."

So there they are. One sickness, five diagnoses. Unfortunately, I have no idea which one is right. The truth may well involve a bit of each.