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Prolonged agony of poor growth

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With news on hand of weak job growth despite some rise in gross domestic product (GDP) in America and Britain, and poor growth and high rate of unemployment in Europe, economists are scratching their heads for explanations.

The US Federal Reserve (the Fed) chairwoman, Janet Yellen in her first appearance this week before Congress reported that despite a 3.2 percent growth in the last quarter of 2013, unemployment rate (6.6 percent) remained stubbornly "well above" the Fed's target of 6.6 percent.

The Bank of England Governor Carney observed while releasing the quarterly inflation report on Wednesday that U.K.'s economic growth is "neither balanced nor sustainable". The unemployment rate is 7.1 percent and the growth recorded in 2013 was 1.9 percent,

The Eurozone has the high unemployment rate at 12 percent with a poor growth rate of 0.2 percent in the last quarter of 2013. Japan, after 15 years of deflation, is now looking up thanks to aggressive stimulus policies since early 2013. However, growth is still weak, at 1.1 percent. The benchmark interest rates in industrialized countries are at historical lows: the US at 0.25 percent, the UK at 0.5 percent and the Eurozone at 0.25 percent.

Stagnation, recession or what?

Students know their definitions: Stagnation is an extended period of little or no growth in the economy, with growth being less than 2 percent. Recession has a technical definition. It is indicated by two-consecutive quarters of negative economic growth. Depression is recession which lasts for years with falling aggregate demand, substantial rise in unemployment

accompanied by decline in bank credit, reduced output and bankruptcies. During depression, consumer confidence is low with low or no new investments, leading to economic shut down.

How about the current situation? There is no continuous negative growth for two quarters, but only persistent weak growth with poor job creation.

Economists have seized the term: *secular stagnation*, coined by Professor Alvin Hansen of Harvard University. In his presidential address to the annual conference of the American Economic Association held in 1939, he referred to the efforts for getting out of the Great Depression which began in 1929 and said that the underlying problem was not cyclical, but rather "secular stagnation."

The term was invoked last September by Nobel Laureate Paul Krugman in his regular *New York Times* column.

He wrote: "There is a case for believing that the problem of maintaining adequate aggregate demand is going to be very persistent – that we may face something like the 'secular stagnation' many economists feared after World War II."

In November 2013, Lawrence Summers, a former Chief Economist at the World Bank, spoke about it at an IMF Conference in Washington.

Secular Stagnation

The theory states when savings rise, but investment opportunities are getting less and less, there is no *ex-ante* equality between savings and investment; *ex-post* equality between the two would arise only when savings decrease to match the low investment. Low investment would then lead to low income and low savings, which will then bring about equality between low savings and low investment. Another factor, which reinforced the fear, was an expected, eventual fall in US population growth, leading to decrease in consumption. Thus, reduction in two major components of aggregate demand, namely investment and consumption would lead to perpetuation of secular stagnation.

Although Krugman and Summers used the term secular stagnation, they know the US history. Hansen's fears of secular stagnation did not materialize. As Hansen spoke in 1939, World War II broke out. The war mobilization efforts with massive investment quickly ended the Great Depression. Same fears, which crept in just before the end of the War, were also quickly removed by return of peace and the baby boom. Rise in consumption and housing activity prevented secular stagnation.

Unreal fears and flawed policies

History also shows there will never be an end to innovations. They need capital investment and labour to work with. So too are investments in physical and social infrastructure.

William Buiter, the chief economist at Citigroup writing in *Financial Times* reminds us that most of humanity lives in the emerging markets that account for 45 per cent of the world's GDP. Their investment needs towards promoting higher living standards are immense and will never end. Pacific island countries and other developing countries are no exception.

Buiter is confident that USA would not repeat mistakes of the “badly designed fiscal austerity”, and the house price boom in UK would also belie the secular stagnation fear.

The latest luminary to join the debate is Joseph Stiglitz, another Nobel Laureate. Writing in the *Guardian* of February 6, he lays the blame on poor policies:

“The difficulties that we are facing now are not the result of the inexorable laws of economics, to which we simply must adjust, as we would to a natural disaster, like an earthquake or tsunami. Our current difficulties are the result of flawed policies.”