

Chapter 1

The World in 2050

There is no evidence that God ever intended the U.S. to have a higher per capita income than the rest of the world for eternity.

—Robert Solow, *Financial Times*, January 15, 2011

Half a lifetime ago, when I was a Yank at Oxford, I wondered why my English contemporaries were not all packing their bags to leave the country. In those days, before Margaret Thatcher, maximum tax rates on incomes above £20,000 were 98 percent. It seemed to me then that having been born in the United States at mid-century was a terrific advantage.

At that time, it probably was. But just because an economy is rich when you are born does not guarantee that it will stay that way. In 1901, when Queen Victoria died, Great Britain had the world's highest per capita GDP, more than \$4,600 in 1990 dollars, 10 percent higher than the United States at that time, and four times that of Japan, the second-biggest economy at the end of the twentieth century. But after the UK was dethroned as the world's dominant economy, real growth rates slowed to a crawl—just 0.8 percent from World War I through 1950. By that year, British per capita GDP had gone up less than 50 percent from Queen Victoria's time, while U.S. GDP per capita had surged by more than 230 percent over the same period.

A Preview of the Future

Much of the great accumulation of British capital that financed world growth in the nineteenth century was dissipated in wars, nationalized, and taxed away, contributing to stagnation that persisted for decades. Note that at 0.8 percent real growth, it would take an economy more than 87 years to double. By contrast, at China's recent growth rates (10.3 percent in 2010 and ranging as high as 11.9 percent in 2008)—its real GDP will double in less than seven years. No wonder economists speak of “the magic of compound interest.” Rapid growth can make a poor country rich in short order, while sluggish growth makes even a rich country poor over time.

When you gaze into your crystal ball to estimate where the United States will stand in the future in the hierarchy of world prosperity, you may be tempted to rely on forecasts of econometric models, which for all their mathematical razzle-dazzle, are actually fairly simple-minded constructs. Basically, they tend to extrapolate long-term growth rates, with allowances for expected changes in population. If you look at the leading forecasts for 2050, almost all of them project that real U.S. GDP per capita will more than double in 40 years.

You'll see estimates of U.S. GDP per capita ranging from \$35,165 (Goldman Sachs), to more than \$38,000 (Carnegie and Price-waterhouseCoopers). This presupposes that U.S. growth will far exceed recent experience. But will it?

Over the longest time scale, from 1889 to 2009, annual average real U.S. GDP growth was 3.4 percent. During the 70-year span from 1939 to 2009 annual average GDP growth actually perked up to 3.6 percent. However, most of the good news was in the past, when the United States had a freer and more soundly based economy. Averaged over shorter time scales, the U.S. growth rate has been steadily decelerating:

- Over 60 years, it is 3.3 percent.
- Over 50 years, it is 3.1 percent.
- The 40-year rate is 2.8 percent.
- The 30-year rate is 2.7 percent.
- Over 20 years, the average growth rate is 2.5 percent.
- The 10-year rate (from 1999 to 2009) is 1.9 percent.

- The current 5-year average annual growth rate is just 0.9 percent.
- The current 3-year growth is zero.

Talk about a slowdown. U.S. growth has decelerated as much as it possibly could without turning negative. The question is, why has there been a sharp deterioration in U.S. economic growth over time? Several explanations come to mind.

Economic historians Carmen Reinhart and Kenneth Rogoff argue that high debt levels, per se, hamper growth.¹ Indeed, there is little precedent for any country becoming great or staying great because of all the money it owes.

This is pertinent because the United States has accumulated the greatest pile of debts in the history of the world. According to Professor Laurence Kotlikoff, the current sum of explicit debts and unfunded promises nets out at \$202 trillion—an amount greater than all the wealth of the world. He says,

I calculate a fiscal gap of \$202 trillion, which is more than 15 times the official debt. This gargantuan discrepancy between our “official” debt and our actual net indebtedness isn’t surprising. It reflects what economists call the labeling problem. Congress has been very careful over the years to label most of its liabilities “unofficial” to keep them off the books and far in the future.

For example, our Social Security FICA contributions are called taxes and our future Social Security benefits are called transfer payments. The government could equally well have labeled our contributions “loans” and called our future benefits “repayment of these loans less an old age tax,” with the old age

¹ See Carmen M. Reinhart and Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (Princeton, NJ: Princeton University Press), 2010; Carmen M. Reinhart and Kenneth S. Rogoff, “Growth in a Time of Debt,” January 7, 2010, www.economics.harvard.edu/files/faculty/51_Growth_in_Time_Debt.pdf; and Carmen M. Reinhart and Kenneth S. Rogoff, “Too Much Debt Means the Economy Can’t Grow: Reinhart and Rogoff,” Bloomberg, July 14, 2011, www.bloomberg.com/news/2011-07-14/too-much-debt-means-economy-can-t-grow-commentary-by-reinhart-and-rogoff.html.

tax making up for any difference between the benefits promised and principal plus interest on the contributions. . . .

The fiscal gap isn't affected by fiscal labeling. It's the only theoretically correct measure of our long-run fiscal condition. . . .²

Thinking people have realized for many years that Social Security, Medicare, and other entitlement spending were based on the smile of a Cheshire Cat. Everyone knew the numbers didn't add up. Everyone knew there would be a crisis some day; we hoped that it would come long after we were gone. The unpleasant surprise is that the fiscal crisis of the welfare state is not just some smudge on a distant horizon; it is a looming problem now. Like most advanced economies, the United States is circling the drain of sovereign insolvency.

Another contributing factor to the slowing of growth has been a collapse in productive investment in the United States. Partly this reflects the far higher costs of doing business in the United States than in other jurisdictions. Yes, U.S. labor costs are generally higher than in other countries. But U.S. regulatory costs and the uncertainty associated with greater exposure to lawsuits also make the United States an unfavorable jurisdiction for business. So does the U.S. tax regime. U.S. corporate tax rates are the highest in the world.

I argue in the next chapter that a major factor contributing to the slowdown in U.S. growth was the advent of peak oil production in the United States in the early 1970s and its association with a perverse reorganization of the U.S. monetary system by Richard Nixon in 1971. Subsequently, not only did debt skyrocket, but the rise in BTUs per capita associated with the surge in U.S. prosperity came to an end in 1979. With U.S. oil production dwindling, the cost of energy-dense oil to fuel the United States rose faster than the rate of GDP growth.

With the stimulus provided by windfalls of high-density energy from oil dwindling U.S. authorities tried unsuccessfully to stimulate growth by artificial credit expansion. A big diversion of resources into

²Laurence Kotlikoff, "U.S. Is Bankrupt and We Don't Even Know It," Bloomberg, August 11, 2010, www.bloomberg.com/news/2010-08-11/u-s-is-bankrupt-and-we-don-t-even-know-commentary-by-laurence-kotlikoff.html.

malinvestment stimulated by credit bubbles was a factor informing the collapse of productive investment. Artificial credit bubbles financed by fiat money, which was counterfeited out of thin air, distort the price signals in capital markets. This distortion induces investors to crowd resources into unproductive sectors because of the artificially high returns they temporarily earn there.

Such was the case with U.S. real estate for more than a decade. During the subprime boom, U.S. housing prices exploded into what Yale economist Robert Shiller called, “the biggest bubble in history.”³ In 1995, inflation-adjusted U.S. home prices were only 10 percent higher than they had been in 1890. But by 2006, prices had jumped by 100 percent over prices in the 1890s. This temporary, unsustainable surge in housing prices led to trillions of dollars in malinvestments to build more houses, which now sit empty or have lapsed into foreclosure as housing prices have plunged by more than they did in the Great Depression.

A Decrease in Productive Capacity

Unfortunately, the trillions invested to build houses with more bathrooms and larger kitchens for subprime borrowers did little or nothing to enhance productive capacity in the American economy. While money poured into housing counts as “investment” in the national income accounts, it should not be confused with fixed investment in plant and equipment that actually creates productive capacity.

As John Ross (visiting professor at Antai College of Economics and Management, Jiao Tong University, Shanghai) has pointed out, the long-term slump in U.S. savings has created such a pronounced slowdown in fixed investment in the United States that the U.S. economy now consumes more capital than it creates. Ross directs your attention to:

. . . the continuation of the long term downward trend of US savings, with inevitable oscillations in business cycles, since 1981.

³ “Hard to forecast end to U.S. housing crisis: Shiller,” Reuters, February 20, 2009, www.reuters.com/article/2009/02/20/businesspro-us-usa-economy-shiller-idUSTRE51J5SO20090220.

Each cyclical savings peak was lower than the previous one—21.4 percent of GDP in 1981, 19.0 percent in 1998, and 16.4 percent in 2006. Each cyclical trough was also lower than the one before—14.2 percent in 1992, 13.6 percent in 2003, 10.2 percent in 2009.

A small cyclical recovery in U.S. saving took place, from the 10.2 percent of GDP trough in the third quarter of 2009 until the second quarter of 2010 at 11.8 percent, and it is this which stalled in the third quarter of 2010.

Even more striking is that the third quarter of 2010 is the 10th consecutive three-month period in which U.S. net domestic savings (i.e., gross domestic savings minus capital consumption), has been negative. The last time U.S. net savings were negative was during the Great Depression in 1931–1934.

To put it in deliberately provocative, but accurate, language, this means that the world's number 1 capitalist economy has for the last 10 quarters not produced net capital—U.S. capital creation is less than U.S. capital consumption.⁴

Ross underscores two implications of the drop in the U.S. savings rate:

Rapid U.S. growth cannot take place without a sharp recovery in fixed investment—which in turn must be financed by savings. If U.S. domestic savings remain depressed, then either U.S. fixed investment will remain low, which implies a slow U.S. upturn, or the United States must finance a new higher level of investment from abroad; that is, there must be a new widening of the U.S. balance of payments deficit.⁵

In light of the collapse in U.S. savings and fixed investment, which is apparent even in heavily gamed official statistics, the U.S. economy is destined for stagnation, or even long-term decline in the future.

⁴John Ross, "New deterioration in the US savings rate and its implications," Key Trends in Globalisation, January 3, 2011, <http://ablog.typepad.com/keytrendsinglobalisation/2011/01/new-deterioration-in-the-us-savings-rate.html>.

⁵Ibid.

Far from expecting the U.S. economy to double within the next 40 years, I expect it to perform no better than Great Britain did after it was unseated as the world's leading economy early in the last century.

In other words, if the United States stays on its current path, (probably a bright scenario compared to what will happen), in 40 years' time, it will no longer be the world's richest large economy. The estimate for U.S. GDP in 2010 is \$13.1915 trillion. Far from ballooning to \$38 trillion in 2050, the U.S. economy will be lucky to attain half that level. If the United States follows in the footsteps of the UK, which more or less extends the current five-year growth rate for 40 years, that would make for real U.S. GDP of about \$19 trillion in 2050. Half of the conventional projection. I think even that is optimistic.

John Ross points out that the relatively rosy predictions of near-term economic growth put forth by conventional economists would still leave the average U.S. growth for the current business cycle stuck below 1 percent annually:

A recent *Wall Street Journal* survey of economists revealed an average prediction of 3.2 percent U.S. GDP growth in each quarter of 2011. . . . The implications of 3.2 percent growth to the end of 2011 are that U.S. GDP would have grown at an average of only 0.9 percent in 4 years of the current business cycle—substantially below trend to an equivalent point in previous post-World War II cycles. Such a 3.2 percent growth rate, even maintained for a 4 year period, would not reverse the U.S. economy's long term deceleration.

Therefore, unless there is a sharp acceleration of U.S. growth above current projections, the trend of long term slowdown of the U.S. economy will continue.⁶

Indeed, the situation is even grimmer than Ross suggests. First, actual U.S. GDP growth in 2011 was not 3.2 percent, but barely half

⁶ John Ross, "Average economist predictions for US GDP would mean only 0.9% annual average growth over business cycle to end 2011," Key Trends in the World Economy, January 17, 2011, http://ablog.typepad.com/key_trends_in_the_world_e/2011/01/average-economist-predictions-for-us-gdp-would-mean-only-09-annual-average-growth-over-business-cycle-to-end-2011.html.

Table 1.1 Private Sector GDP (in millions)

Year	GDP	Government Spending	Net GDP
2001	11,371.3	2,056.4	9,314.9
2002	11,538.8	2,188.6	9,350.2
2003	11,738.7	2,303.3	9,435.4
2004	12,213.8	2,377.7	9,836.1
2005	12,587.5	2,486.0	10,101.5
2006	12,962.5	2,578.5	10,384.0
2007	13,194.1	2,570.1	10,624.0
2008	13,359.0	2,753.3	10,605.7
2009	12,810.0	3,210.8	9,599.2
2010	13,191.5	3,470.0	9,721.5

Source: From a reader submission to Mish's "Global Economic Trend Analysis," <http://globaleconomicanalysis.blogspot.com/2010/09/why-statistical-recovery-feels-bad.html>. Posted September 29, 2010.

that: 1.7 percent. Even worse the private-sector component of U.S. GDP has deteriorated significantly in recent years. Table 1.1 tells the tale. You can see that, net of increases in federal spending, today's U.S. economy has actually shrunk below where it was in 2004.

Table 1.1 shows the GDP numbers chained to 2005 dollars (in millions).

The only reason that the U.S. GDP has not fallen more than it has is that the federal government has raised its annual spending by more than \$1.3 trillion since 2004. It almost goes without saying that this surge in government spending, financed out of an empty pocket, cannot continue indefinitely for decades into the future. With the private sector getting skinnier and government getting bigger, another amber light is flashing a caution about future U.S. growth prospects.

Not only is a bigger government a negative for economic growth, but even the overdue effort to trim excess government spending will weigh on growth, as we have seen in Europe. The unwelcome requirement to avoid an insolvency trap with austerity may compound the long-term slowdown in U.S. real growth.

The picture would appear even more grim if you tracked the advance in poverty in the United States, as measured in growing chronic unemployment and food stamp use, much of it due to the impact of

surging energy prices on suburbs designed in the 1950s when gasoline cost 30 cents a gallon. One in every seven Americans now participates in the food stamp program. Neither austerity nor Keynesianism will cure what ails us, as the twin pincers of debt-deflation and rising energy costs are destined to impoverish the former middle class.

Squandering Prosperity

Decades of remorseless fiscal and monetary profligacy have squandered most of America's inheritance of prosperity. My generation and the older ones that held power failed to heed the prophetic warning delivered more than half a century ago in President Dwight Eisenhower's farewell speech on January 17, 1961:

As we peer into society's future, we—you and I, and our government—must avoid the impulse to live only for today, plundering, for our own ease and convenience, the precious resources of tomorrow. We cannot mortgage the material assets of our grandchildren without risking the loss also of their political and spiritual heritage.⁷

Unhappily, we did precisely what Eisenhower warned against. We “plundered the precious resources of tomorrow” for “our own ease and convenience.” Now, tomorrow is dawning.

The trailing generations of Americans, who came along too late to enjoy the boom financed by easy money, inherit the diminished prospects and the unpaid debts that will weigh upon economic growth and living standards in the United States during their lifetimes.

Up next, we delve into the American Dream and how it is—and will soon be even more so—alive and well in Brazil.

⁷ Dwight Eisenhower, “Farewell Address” (1961), www.ourdocuments.gov/doc.php?flash=true&doc=90&page=transcript.

<http://www.pbookshop.com>