

## **If Wishing Could Make It So**

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Every pundit, politician and economist has spoken the same litany for the past two years: this economy will grow strongly, employment will be up and prosperity restored by 2005. They look to the declining price of energy, rising corporate profits, expansion plans by American business and the continued stimulus of tax cuts to pull the economy out of the doldrums.

Well, here we are at the dawn of that deadline year and very little of the above has come true. The growth rate of GDP, the yardstick of good times has declined and shows no real sign of turning up. Employment is sluggish with each month bringing fewer new jobs than the experts expect. The Federal deficit continues to grow, the trade deficit shows no let up and interest rates are rising. Every piece of good news (gas prices are falling) is met with a bit of bad (so are retail sales). So, what gives?

I think there are three issues that are holding back the economy.

- Income is polarized. The gains in income that we have seen have been largely concentrated among upper income individuals. By and large, middle class (and lower) workers have shared little in the growth that has occurred. This has a dampening effect on economic growth since the higher your income, the less of that extra dollar you will spend. Since consumption is two-thirds of the economy, distribution of income will affect growth. Part of the reason for this has been technological; change that has provided greater rewards for more highly skilled workers, but part of the responsibility lies with the 2003 tax cuts which disproportionately favored upper income households. In any case, we have seen a polarization of income and thus less GDP bang from the income growth buck.
- Productivity is declining. The boom of the Nineties was largely fueled by the tremendous gains in productivity generated by new technologies. More output per worker led to more growth in income led to more growth in GDP. This phenomenon has carried over into the new century but is beginning to tail off. With productivity growing more slowly, we become less competitive in the world economy and lose jobs to emerging economies like China and India. This means slower employment growth and economic stagnation.
- The twin deficits are killing us. The terrible fiscal condition of the United States government has driven down the value of the dollar abroad. The lack of competitiveness of the United States economy has led to the outsourcing of numerous functions and the persistence of a large trade deficit. Between the two of these, growth in the United States economy has been dragged

down and the potential most experts feel the economy does have has been largely unfulfilled. The result is slow growth.

Can any of these retarding elements be removed from the economic environment during this year? The short answer is “no”. The declining value of the dollar will make American products cheaper abroad, travel to the U.S. more attractive and investment in the United States more profitable. All these will help ameliorate the trade deficit. Technological change is likely to slow and higher paying, more skilled jobs will continue to be lost to countries with populations more technologically skilled.

The tricky part is the Federal budget deficit. It will get worse if the 2003 tax cuts are made permanent. On top of this, the administration’s proposals to divert part of Social Security taxes into private accounts will balloon the deficit over the next five years. Under these circumstances, our public finances will resemble those of the most comical banana republic imaginable.

With all this in play, I fail to see how 2005 (and 2006) can be anything but a mediocre year. We will grow, but not by much. We will create more jobs, but not many and not very attractive ones. In short, we’re stuck in a rut that is neither terrible nor satisfying. This is not a very good place to be. And why are the experts singing the same tune? Even a stopped clock is right twice a day!