

When Success is Not Good Enough*

Dániel Felcser

Dietrich Vollrath:

Fully Grown: Why a Stagnant Economy Is a Sign of Success

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A beérett gazdaság – A stagnálás mint a siker jele

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Economic growth is often examined in the economic literature. Nevertheless, from time to time, new, thought-provoking approaches are used. This is what happened in ‘Fully Grown’, a book by Dietrich Vollrath. The author discusses a topical issue as he searches for the reasons for the slowdown in economic growth, examining its components one by one. The professionally sound analysis is complemented with the careful use of statistical data and the vivid presentation of economic concepts, while remaining within a relatively simple methodological framework. This helps the author support his arguments with examples that are easy to understand and follow, described in accessible language. According to one of the main conclusions, the slowdown in economic growth is partly attributable to the success in raising living standards. This is supported by a well-reasoned argument.

In the wake of the global financial crisis, the growth rate of the US economy plunged to less than half of the average in the earlier decades. Annual GDP growth averaged 2.25 per cent between 1950 and 2000, after which the average growth rate declined to 1 per cent. This slowdown was characteristic of many advanced economies. Although living standards in the USA continued to rise, an even higher level could have been achieved had economic growth not faltered. From the perspective of the factors of production, physical capital explains only a small part of this process. The expansion in physical capital declined much earlier, in the 1970s. The fairly muted economic growth was basically due to the development of human capital and productivity, and therefore the author takes a closer look at these two factors.

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

Dániel Felcser is a Head of Department at the Magyar Nemzeti Bank. Email: felcserd@mnbb.hu

The slower growth in human capital explains a major part of the economic slowdown. In terms of the components of human capital, the impact of its size is far greater than education, experience or hours worked. In particular, there were two dominant aspects within the size of human capital. One of them, the ageing of society, was clearly reflected in the shrinking share of the working age population within the total. Even though the population continued to increase, the number of elderly also rose considerably, partly on account of longer life expectancy. The other effect, the fall in the fertility rate, is linked to rising living standards. Based on data from almost two hundred years from the United States, income and fertility are negatively correlated. In addition to analysing economic developments, the author also points out that in advanced economies the size of the remaining labour reserves is questionable.

Just like with human capital, any slowdown in productivity (which is not the same as technology) growth has a detectable effect. The author refutes the usual explanations (statistical or measurement errors, increasingly costly innovations), and demonstrates that most of the slowdown can be attributed to the shift in consumption patterns towards services. In itself, this process points towards moderate growth in productivity, because productivity in the service sectors typically increases more slowly than in manufacturing. This constraint arises from the nature of services, because if firms devote less time and attention to consumers, the demand for their services declines. The share of spending on services started to climb in the mid-20th century, but the economic weight of services had increased so much by the 21st century that the slower growth in productivity became apparent throughout the entire economy.

To a smaller extent, the rise in market power and the less dynamic adjustment of the economy may also have played a part in this. Companies' market power drives innovation on the one hand, because the advantage derived from patents compensates them for the resources necessary for innovation. Nevertheless, too much market power can be a double-edged sword. Stronger concentration is reflected in a drop in investments, since companies have fewer incentives for innovation when competition is muted. At the same time, this can also reflect the shift in consumption towards the firms with higher market power, which shows that the development of economic data can be attributable to various factors. Looking ahead, a shortfall in investments can lead to fewer innovations and thus slower productivity growth. It can also be observed that the flow of labour between different jobs and production locations has decelerated compared to earlier decades, and there are also fewer new and closing businesses. Moreover, geographical mobility has also declined, which may reflect a change in preferences or rising housing costs in certain areas. All of this provides fewer opportunities to

improve productivity. Establishments are taken over by more productive firms less and less frequently, and fewer and fewer workers switch to higher-productivity jobs.

With other factors, the impact on economic growth seems negligible. The author shows that even though changes in taxation and regulation and inequalities can have considerable distributional effects, these are not the factors that determine the slowdown in economic growth, just as no major impact can be detected in connection with trade with China. It seems that taxes and regulations have no marked effect on economic growth, which may be because the markup and the scale are more important for firms' profits. The change in income inequalities is also often cited as a reason behind the slowdown in growth. In the lower part of income distribution, people can invest less in education due to their stagnant income, which limits the growth in human capital, and the greater concentration of incomes may have accelerated the shift towards services. Finally, it should be noted that China became a full member of the World Trade Organization (WTO) in 2001. Research has shown that Chinese imports have significantly reduced employment in the US manufacturing industry, which may have contributed to the deceleration in economic growth. However, these effects all seem too small to have any major explanatory power.

The author identifies the less dynamic expansion in human capital and moderate productivity growth as the main reasons behind the slowdown. According to the results, the slowdown in economic growth is mostly linked to the shrinking size of families and the ageing of society. Together with the shift towards services in consumption, this accounts for approximately three quarters of the slowdown. The author views these as two success factors arising from growing prosperity, the result of a conscious decision. The fertility rate declines as living standards rise. The change in consumption patterns is also the result of the success in increasing prosperity. As product prices fall and the necessary quantities are purchased, consumption turns towards services, while the productivity of service sectors is relatively lower.

If certain factors can be considered successes, the author believes that people should ask themselves what they are prepared to forgo for faster growth. Would they sacrifice some of their living standards for faster population growth? The impact of technological progress (3D printing, artificial intelligence) is also not straightforward: the production of goods is becoming more efficient, but the shift towards services is accelerating, which may further check productivity and thus also economic growth. According to the book's approach, moderate growth is the result of the success in increasing prosperity, as society adjusted to the higher living

standards. This also limits the opportunities for accelerating growth in the future. However, success does not mean that the results cannot be improved any further. Growth may continue to fall short of the rate seen in the 20th century, but the ways to ensure sustainable economic growth also have to be explored. However, this will have to be done in another book.