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# Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

Last week, a client sent me an email asking my thoughts on a Washington Post article by former Treasury Secretary Lawrence Summers about something called 'secular stagnation.' Summers has been very vocal and visible regarding the subject, and his probable case scenario due to said stagnation would be most people's worst case. Does it and he have merit?

For those not familiar with the concept, let me just cut and paste a workable definition from The Financial Times' website:

> "Secular stagnation is a condition of negligible or no economic growth in a market-based economy. When per capita income stays at relatively high levels, the percentage of savings is likely to start exceeding the percentage of longer-term investments in, for example, infrastructure and education, that are necessary to sustain future economic growth. The absence of such investments (and consequently of the economic growth) leads to declining levels of per capita income (and consequently of per capita savings). With the reduced percentage savings rate converging with the reduced investment rate, economic growth comes to a standstill – i.e., it stagnates. In a free economy, consumers anticipating secular stagnation, might transfer their savings to more attractive-looking foreign countries. This would lead to a devaluation of their domestic currency, which would potentially boost their exports, assuming that the country did have goods or services that could be exported.
>
> Persistent low growth, especially in Europe, has been attributed by some to secular stagnation initiated by stronger European economies, such as Germany, in the past few years."

Kind of makes you feel a little uncomfortable, doesn't it? I mean, that doesn't sound too far off what we have been experiencing in our own economy, right? But is there another way of defining secular stagnation, a way that is, um, more pleasing to the ear? Okay, how about secular stagnation is what happens when a society/economy quits playing to win, and starts playing not to lose? You know, kind of what happens when a team gets up by a few touchdowns, and then tries to sit on the lead.

Of course, the team in the lead ordinarily wins, although sometime the proverbial 'prevent defense' prevents them from winning, but that is more the exception than the rule when the lead is large enough. However, what happens when the winning team shifts gears from 'pounding the other team in the dirt' and into 'let's just keep from getting hurt'? That's right, the game loses intensity and gets kind of boring.

So, what happens when a society/economy gets far enough ahead it decides it wants to kind of lock in the gains? While we might not want to admit we would or could or even have done such a thing, the numbers suggests perhaps we have, to a degree.

In 1968, the year of my birth, total government expenditures as a percentage of GDP were 29.6%. In 2013, the last year the 2015 Federal budget tracked, they were 32.3%. That might not sound like a lot, but when you are discussing roughly a $17 trillion (nominal) economy, that differential works out to be about $459 billion, which is a lot of money.

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So, clearly, the government (all levels) has grown substantial over the last, well, 47 years. However, we all knew that already.

What I have found interesting in the data is the amount of money the Federal government now shells out to individuals, either directly or through grants, etc. In 1968, Washington dispersed $49.849 billion out to the people. This was equal to, get this, 28% of total Federal outlays. Direct payments to individuals were 24.6%. When adjusted for inflation, and using constant 2009 dollars, Washington forked over $248.5 billion in total, and $218.2 billion in direct payments.

Now, let's fast forward to the estimates for 2014, shall we? In that year, 70.4% of total Federal outlays went to 'individuals,' with 58.7% going out directly. These were equal to 14.8% and 12.4% of GDP. When adjusted for inflation, using those same constant 2009 dollars, Washington spent $2,356 billion on individuals, with $1,966 billion going to directly to folks. For kicks, in nominal terms, the nominal total was $2,570 billion.

What's more, "total investment outlays for major public physical capital, research and development, and education and training' were equal to 6.4% of GDP in 1968 and 2.7% in 2014. They were 32.1% of total government outlays back then, and only 12.8% in 2014. Adjusting for the Vietnam War, non-defense outlays in this line item were 13.0% of Federal outlays in 1968 and equal to 2.7% of GDP. In 2014, the numbers were 8.2% and 1.7% respectively.

For grins, had Washington spent the same amount on non-defense investment in 2014 as it did in 1968, as a percent of GDP, it would have spent an additional $156.132 billion on such things. That is about $500 per every American. Add those type of yearly numbers up over decades, and you have a real decrease in investment. This is kind of mind boggling when you remember (from the first page) the government has grown significantly as a percentage of GDP.

In essence, we are spending more, but investing less.

Put another way, the government has become a giant money transfer mechanism. Clearly, as payments to individuals account for the vast majority of total Federal outlays. This means the Federal government has significantly less money, as a percent of budget, to spend on procurement and infrastructure. In other words, the government has less money in its coffers to invest in the future. It is spending its money on the here and now, which means it is, arguably, locking in some level of standard of living….or at least setting a floor for the standard of living in the country.

That would certainly seem to be the case. After all, 70.4% of government outlays are to individuals, and government expenditures are equal to approximately 32.3% of GDP. As such, government 'checks,' and this is an amazing number, to individuals (for whatever reason) are equal to 22.7% of US Gross Domestic Product. Going back to 1968 once again, they were 8.3% back in the day.

When you see these numbers, is it any wonder our economy has been as blah as it has been? After all, basically, 22.7% of C in the C+I+G equation is nothing more than taking from C to run through G to get back to C. If you think this is frictionless; that the government is an efficient generator of wealth, and the most effective allocator of resources, this would or should be additive or beneficial to the US economy. If you think isn't, you can reasonably intuit this isn't all that stimulative….quite the opposite actually.

## *Disclosure*

## *Something to Think About Cont.*

Admittedly, this is nerdy math, and the kneejerk reaction to it might be: “the government has to quit doing this!” To that, I would ask: “how, exactly?”

Budgeted ‘mandatory’ payments (Social Security, Medicare, Medicaid, and other so-called entitlements programs) plus the service on the Federal debt were equal to roughly 13.7% of GDP in 2014. Now, due to our overall indebtedness and aging demographics, in 2025, these budgeted payments (Table S.4 of the Administration’s 2016 budget) will be equal to 16.6% of GDP (assuming 2.5% real GDP plus 2.5% inflation = 5% nominal GDP growth). A slip to 4% nominal growth will take the percentage to 18.5% in 2025. 3% nominal growth would take us to 20.5%. For grins, mandatory payments and the debt service will be 77.5% of the Federal budget in 2025. In 2014, they were, only, only, 68% (budgeted).

These are hefty sums, and don’t include a single dime for the national defense and/or the actual running of the government. This is just paying interest on the debt and making transfer payments. Clearly, this doesn’t really leave a lot of money left over for the government to actually stimulate growth by investing in its citizens and infrastructure. That is unless people want to spend up, i.e. pay more taxes, to do so.

Who has the appetite for that? Who in the halls of power has the courage to promote such a thing? Let alone get it passed into law? I will venture a guess on all: very few, if any.

But, hey, this has been years in the making. Unfortunately, the folks that make the spending laws couldn’t be bothered with taking a look at things like ‘live births’ per year to ascertain we were eventually facing a pretty serious demographic problem. Even so, there are many in the country who want to expand our ‘mandatory’ programs even as they are choking the government’s budget and ultimately its ability to invest in the economy. As Bernie Sanders has said: “We should not be talking about cutting Social Security benefits. We should be talking about expanding benefits to make sure that every American can retire with dignity."

Hey, the heart is definitely in the right place here. I don’t begrudge anyone for wanting to set a standard of living floor for seniors. That is what you should want to do in a perfect world. However, you have to understand there will be an economic tradeoff, as expanding Social Security is nothing more, again, than taking money from C….running it through G just to get back to C. If you are able to raise taxes enough to pay for this, it is basically an economic wash, at best, unless the person receiving the higher Social Security check is more efficient with the marginal increase than the taxpayer who paid for it.

If the government can’t raise taxes enough to expand ’mandatory’ programs, for whatever reason, one of two things will happen (or a combination): 1) the G portion of the equation will have less money to spend on infrastructure, education, R&D, employee training, etc., or; 2) the government will have to borrow the money, and the higher transfer payments will have to stimulate the economy at a faster rate than the rate where the Treasury borrowed the money.

Frankly, I am part of a society, and if the society wants to set a floor for living standards, that is fine by me. This will impact future economic growth, as more money is ‘invested’ in setting the floor as opposed to growing the economy through necessary public investment. If that is what we want, so be it. As long as we all know the rules in advance and what the desired outcome is, we can play the game accordingly. If 2% is the target, whether we appreciate it or not, that is okay.

The US will maintain a high standard of living, just as the Japanese have since the early 1990s. However, there are folks like Lawrence Summers frothing at the mouth about lower long-term rates of economic growth, claiming we need to do this that or the other thing. We can’t be complacent, and we need to think outside the box to avoid this pernicious trap. All of that is well and good, but, you know, if slower economic growth is the price we have to pay to make sure everyone can have some minimal standard of living, perhaps I can adjust to that. Besides, this demographically charged secular stagnation isn’t permanent.

The numbers start to turn over in 2027. In that year, the number of people turning 65 (retirement age) will start falling and will continue to fall for well over a decade. What’s more, the number of folks turning 22 will start to exceed them. Think of it as an actuarial table, and no reason to get too worked up.

The US will continue to grow, albeit a little slower. Folks will still but stocks, and the sun will rise in the East.