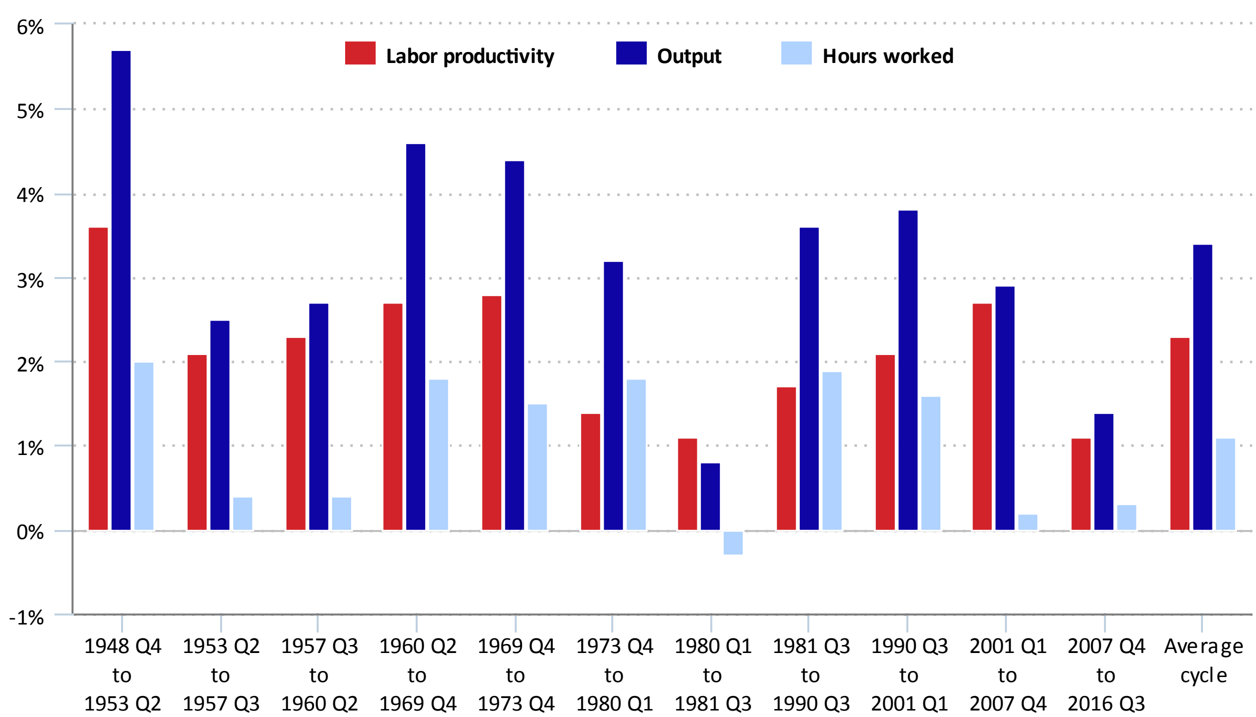
Why the Economy Cannot Grow, By Richard Morey, August 14, 2018

I recently saw the chart below which shows how our economy has performed since 1948, or the last 69 years. The numbers are disturbing. Other than a short, 21-month cycle which began in early 1980, the last ten years have been, by far, the weakest period in our economy since 1948. From the fourth quarter of 2007 through the third quarter of 2016, our economy grew at an average rate of 1.5% per year, versus 3.4% a year on average for the entire 69-year period from the end of World War II through 2016. (Note: All the numbers in this chart are calculated from the beginning of the previous recession, so the comparisons between previous periods and today are fair.) There are clear, fairly obvious reasons why growth has been so poor during this time period. Unfortunately, the key causes are not only still in place but are, in some cases, increasing in severity.

We begin with the accounting identity that GDP equals the growth in productivity plus the growth in the number of hours worked. Accounting identities are wonderful things when doing economic research. Once established, the researcher only has to solve for the validity of the data input. When you solve for an accounting identity you are no longer expressing an opinion but a fact as to the status of the economy.

For someone focused on the most accurate data to help us determine the current and likely future state of the economy, the chart below is particularly valuable. It contains the growth rates for productivity and hours worked since 1948. Combined, this gives us actual economic growth or GDP over this time period. The U.S. Bureau of Labor Statistics tends to accumulate reliable data over long time periods. Over time, such as the entire business cycles for which they are giving results below, they should be the best source of data on the broad economy.

Chart 1. Labor productivity, output, and hours worked: average annual growth rates during business cycles, nonfarm business sector, 1948–2016



Click legend items to change data display. Hover over chart to view data.
Source: U.S. Bureau of Labor Statistics.

Causes of This (Under) Performance

As mentioned above, in this analysis we are looking through the "lens" of the accounting identity that economic growth equals growth in the number of hours worked plus growth in productivity. We therefore must look at these two inputs to see if we can account for the dramatic economic slowdown in the United States over the last ten years. If we can spot the culprits, we then need to determine if those economic problems have been removed. If the problems have been solved, this might give us confidence the economy could strengthen. Unfortunately, the exact opposite has occurred. We have been watching the culprits since they were first "hatched" as policies to pursue. They were large when the slide began, and some are significantly larger today.

Growth in Hours Worked

First, let's see if we can figure out why growth in the hours worked in our country has only contributed .3% to our nation's economic growth over the last decade, which is only one-quarter of the 1.2% yearly growth since 1948. The largest problem is easy to spot. Our employment to population ratio has gone down 6.8% over the last 17 years. As a result, we are essentially missing approximately 10 million full-time jobs (given our current civilian labor force of $154 million). They are out there eligible to work, between the ages of 18 and 55, yet they aren't working. To put it simply, it's very hard to get the hours worked part of GDP up much when millions of your eligible workers have decided to no longer work.

Unfortunately, the only way to change this would be to pay them more money. But companies have been practically waging a war to keep wages down, and they have been winning – for well over three decades.

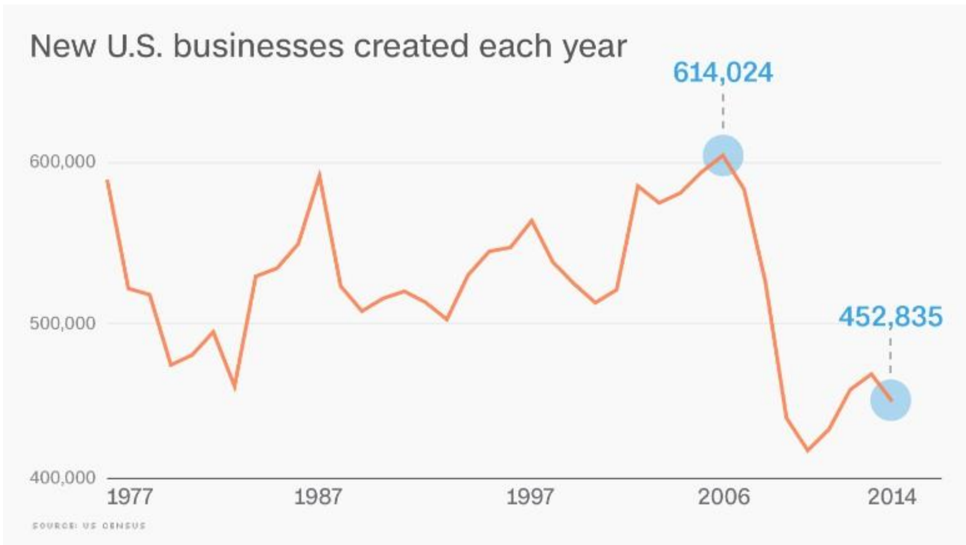
Instead of using their money for wages, our corporations are using the bulk of their money to buy back their own stock, a practice which was illegal before the 1980s. This means the remaining shareholders each own a larger piece of the company. They are removing the company's resources to increase their ownership of the company rather than re-investing their profits back into their own companies or paying their employees more of the earnings. Keep in mind it looks as if stock buybacks will shatter previous highs this very year, an example of a factor holding back growth which has not only not been corrected but which continues to deteriorate further.

I don't know how they are surviving without a job, but all those millions of 18 to 55 year-olds who don't have a job and aren't looking for one at this time, won't be going back to regular employment unless or until they get paid a lot more. Companies aren't going to do this, so there will be no large growth in hours worked for the foreseeable future. Over time we could see 10% a year of them become employed, or perhaps more. This would give us approximately 83,000 new jobs a month from this source. Combined with our very small population growth, it's possible we might manage to see employment growth contribute .3% a year towards GDP going forward, i.e. remain at today's low level without falling further. That's the best-case scenario. However, a serious spike upwards is almost impossible from here, with, I suppose, one exception.

If we had large growth in small business formation, hours worked would go up. We would still be facing some headwinds from the current corporate sector's preference to have as few full-time employees as possible. But small businesses have always been the backbone of the economic growth in this country and could overcome much of the negative effects of larger corporate behavior if they were thriving.

Once again, the news is not at all good. In this case it's terrible. As you can see in the charts below, new business creation is only modestly above its lowest level since they started collecting this data in 1977.

When healthy, small business formation is either the largest contributor to new jobs, or close to the largest. For several years recently we had negative growth, meaning more companies went out of business than were started by entrepreneurs. This was the first time this had occurred since they began collecting the data in 1977. The "small half" of our economy not only isn't healthy but is more endangered than at any time since the Great Depression.



This data comes from the Census Bureau, and it should be highly reliable. Unfortunately, it takes two years before they release the results. For example, last September they made their most recent announcement on business formation, which was that a total of 414,000 new businesses were formed in 2015. This continued to put small business formation at a low enough level as to seriously undermine both hours worked and productivity, i.e. the economy.

Please note you can now find in-depth, up-to-date data on new business formation, and the Bureau of Labor Statistics itself is now putting out a monthly number. The numbers from these shorter-term calculations have shot up since the end of 2015, i.e. the time period through which the Census Bureau has definitive numbers. According to them, small businesses are doing great again.

There are two problems with this perspective, one involving their methodology, and the other their mistaken focus upon short-term economic movements. In terms of their methodology, they are using data such as the number of new EIN numbers applied for each month. Track that and you know all you need to know about the health of the small business community.

That data doesn't even tell you how many actual businesses are being created. I'm sure the correlation is quite high, but the Census Bureau data is on a completely different level. Last month my company was on their list to interview. They gather a great deal of serious information that shows exactly how many people we've hired, what they do, what our immediate and future plans are for business expansion, etc. That's the quality of data we base our views upon. Yes, it comes with a two-year time lag. But when you have it you have a precise view of the economy two years previous. You then anchor your understanding with those facts, expanding on the view with more recent data. But when in doubt, the real numbers from two years ago win.

Of course, we also don't ignore the views from the shorter-term calculations. And we have been expecting a surge in small business creation. Everything peaks right before the next recession, and small business formation is one of the most cyclical areas of the economy.

However, having hit an all-time low five years into this “recovery,” and with the most recent, reliable data showing it continuing to be 50% below its longer-term average, clearly small businesses are experiencing roadblocks which needs to be removed if our economy is going to grow.

The number of new entrants into the small business world over the last few quarters or months is both entirely predictable and completely unsustainable. Those movements are simply new company formation moving with the huge wave connected to a debt binge and asset bubble. The culmination of the debt binge and asset bubbles would almost by definition lead to a large surge in new businesses. The fact that the last reliable data shows it still historically weak seven years into this recovery is, again, evidence as to how slow our growth has been. Again, it has been the slowest in 69 years at a minimum. That’s the bottom line on the fact-based health of small business formation. It surely has gone up in the last two years, but in the next recession it will be in deeply negative territory.

By focusing first and foremost on the data we know is reliable, i.e. the two-year old data, we can ignore the cacophony of short-term noise that is usually loudest near economic turning points, at which time the loudest voices of the short-term views are fully contradicted. If you remove that focus, you can look at the real data and see the larger stream of economic growth, or difficulties. When you do this, you see we’re in a very difficult patch, and it doesn’t look to get any easier any time soon.

When you remove the cyclical portion from small business formation, i.e. it had to go up at least fairly dramatically as we approached the end of this debt binge/asset bubble, you see the exact same problems which have brought it down are fully operating today. They have gotten some regulatory relief, which is good for small businesses. But the entire legal structure of commerce in our country hasn’t changed at all, and it is carefully designed to thwart small business formation and success. It’s called competition, but instead of competing in the marketplace the competition was settled in Congress. The largest corporations “won” this battle long ago, so we have the system most advantageous to their profitability. This means small businesses are essentially the enemy. As seen above, they are losing this battle, or more precisely they have already lost.

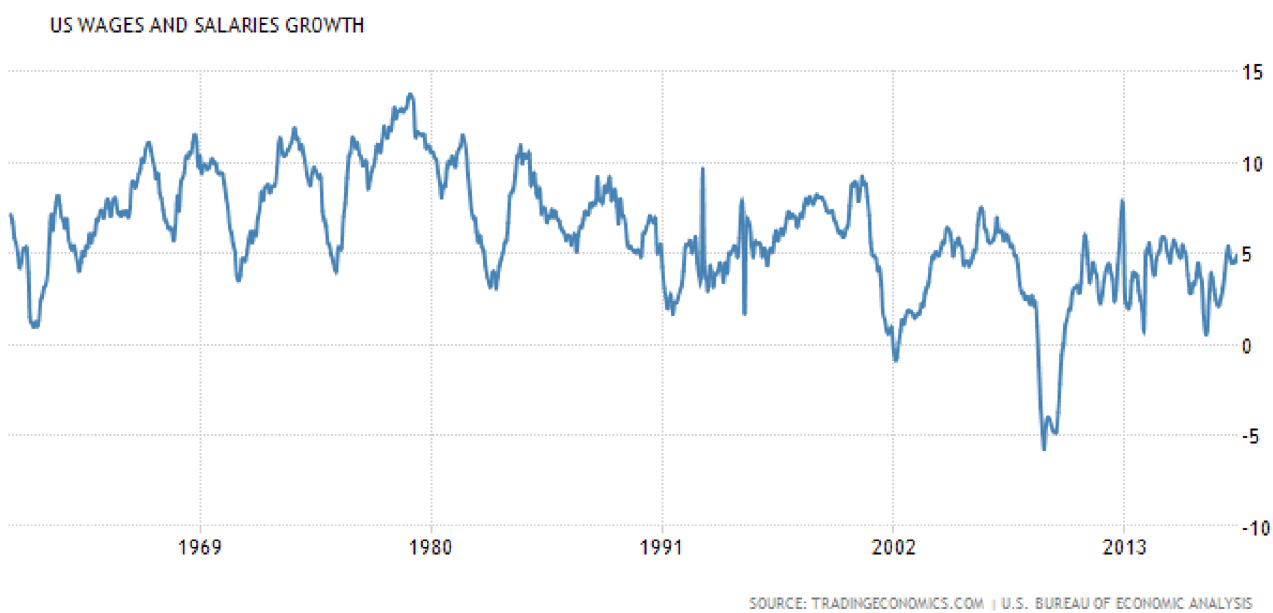
Then we have another engine for hiring, which is by the larger corporations. We define those as the roughly 1,000 corporations in this country with over 10,000 employees. But those companies are shoveling nearly all their profits out the backdoor to the owners. I continually see huge companies who are taking over 90% of their profits to return to the owners of the company through stock buybacks. With many companies the total is far above 90%, as they will even borrow money, weakening what’s left of the company after the withdrawal is made. Large corporate America certainly doesn’t appear to be very interested in investing in our country, but only in removing profit from our companies. We see this in the fact workers’ share of corporate revenue has plummeted since the 1990s.

This actually makes perfect since. You cannot expect a multi-national corporation to be concerned with benefiting the citizens of one country versus another. Therefore, these are not “our” companies, and they simply treat every country as either an opportunity into which to invest, a fear to avoid, or a safe place to protect and grow their assets. For the most part, the multi-national corporations have decided the United States is not an attractive place to grow a business at this time. I’m sure they recognize our diminishing middle class doesn’t offer the potential return on investment they can get in faster-growing economies. As a group, they are removing assets from our companies and re-investing into other regions, mostly Asia. They then simultaneously, for all practical purposes, determine the legislation which affects their remaining operations in our country. Those laws put the lowest tax on their future earnings. Over the last several decades they have enlisted Congress to write a few hundred thousand pages of laws regulating commerce, all designed to make sure the largest companies never again have to face that pesky thing called competition. And all I heard was the sound of silence as our nation's core engine of growth, which has been the spirit of entrepreneurship which led to what we thought would be a never-ending stream of great new businesses being created, retreated for the first time in our country.

Please note this is not in any way an indictment of the people working for multi-national corporations in our country. Their job is to make money for their company, and they have done a great job. Corporate profits are right at an all-time high, having exploded higher. Lower wage growth and higher profits are working very well for the owners of multi- national corporations.

One might think this scheme of "our" largest companies using their outsized influence to structure our laws in such a way that their after-tax profits would be highest and their companies would be protected from competition, would draw some pushback. Not so fast. Keep in mind the same group of companies also owns every single large media outlet, financial and otherwise. Every single one.

My purpose will certainly not be fulfilled if dismissed as some kind of conspiracy theorist. But even if you put the obvious ties between government and the largest corporations aside, the core numbers remain to be answered by those who believe the status quo represents viable economic policy. Those who maintain the core structure of corporate America is sound have, to me, a very high hurdle to overcome. Their first job is to explain how their economic policies can be considered anything but an abject failure when wage growth in our nation has fallen by over 50% in the last 41 years, a process that continues. As I write this in August of 2018, real wage growth has most recently fallen to zero.



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At this time, it is not possible to write about the largest forces which control and define the national economy without traveling far into the realm of politics. This is an unfortunate fact which necessarily follows when corporations are enabled to exert an unusually high amount of political influence. When your largest corporations are allowed to exert a great amount of direct influence on our laws, the end result is that they pay less of their profits in taxes, impediments to their ability to reap the greatest profit, regardless of any societal impacts or competitive fairness, are swept away, and the wages in the nation are kept at the lowest possible level. That describes our current status. This is an amazing statement, yet it certainly appears to conform to all the numbers we have on economic growth, from World War II to the present.

If we weren't allowed to speak of class warfare, I would have to say the upper class is winning, in a big way. Their income and assets are exploding while the average person sees a steady erosion of income relative to basic expenses. Personally, I believe the answer is not for the government to try to control the outcome of fair business competition. But the government does need to at least stop doing the bidding of the large companies, one of whose chief goals is to stop new competitors from taking their market share. In other words, to destroy the competitive framework of our economy. Again, I do not want to sound sensational in any way. I am simply describing our current political economy.

Our current political economic system is presently represented by the term "crony capitalism." This is "an economy in which businesses thrive not as a result of risk, but rather as a return on money amassed through a nexus between a business class and the political class. ... (from Wikipedia)."

The problems mentioned above are not changing anytime soon. Millions of our people who "should" be adding to GDP through work are choosing not to do so and are likely to continue that practice. New business formation is in a near non-stop plunge that has already lasted for forty years and went negative recently for the first time in many decades, and the bulk of corporate laws and regulations have been settled in favor of large businesses versus new competitors.

We also have the coming wave of retirees later in the next decade who will require resources and will not be adding to hours worked. Finally, there is immigration as a way to boost hours worked. We also know this is getting more difficult in the United States, which reduces hours worked some unknown amount.

We'll be lucky to get a .3% contribution from growth in hours worked over the next ten years. And a jump to an even average level of employment growth, which would be four times what we have "achieved" over the last decade, is quite close to impossible.

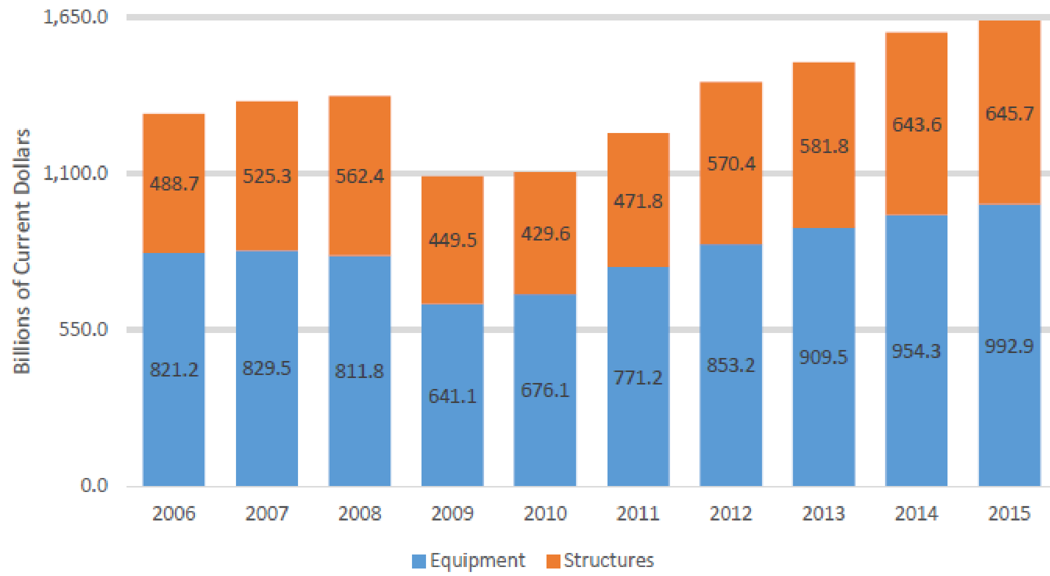
Productivity Growth

Now let's look at productivity growth. As you can see on the graph on the first page, this has dropped from an average of 2.3% a year over the last 69 years down to 1.2% over the last 10 years. This is a drop of 48%. I think it's fairly easy to find the culprit here. Corporations have, as mentioned above, been strip-mining their operations for quite a few years now.

When considering increases in productivity, you first look in exactly one place, and this is total capital expenditures used to upgrade or expand business operations. First, let's look at total capital expenditure growth over the recent decade from 2006-2015. It shows growth from $488 billion to $645 billion over 10 years. This is an increase of 32% over 10 years. This is a very low number, specifically 25% lower than average capital expenditures growth from 1960 to the present (data from the World Bank, through 2016). I'm not sure how they all do their accounting, but this likely is barely keeping up with depreciation. This means that, over the last ten years, little new investment has been made in the businesses in the United States.

Chart 1. Total Capital Expenditures by Type for All U.S. Businesses: 2006 to 2015

Source: Annual Capital Expenditures Survey, 2017 Capital Spending Report



Whatever growth there is in capital expenditures is apparently coming from the tech sector. Here near Silicon Valley where I'm writing, very large companies are expanding daily. However, one should keep in mind that this sector tends to be highly volatile. But even with a tech resurgence, like we've been seeing growing for some years now, overall capital expenditures have basically been adding nothing to the capital of corporate America. They've been replacing some things, but serious expansion is not even on the minds of most companies.

Today business expansion in our economy means mergers and acquisitions. The size and number occurring in this category in recent months and years is very troubling for our economy, as it leads to a drop in both productivity and employment, i.e. hours worked. Mergers and acquisitions as a category pull GDP down. Through the first six months the highest number of mergers and acquisitions ever were announced, totaling $2.5 trillion worldwide, dominated by U.S. companies at $1 trillion – for six months. That is one huge "bubble" that basically never gets mentioned, but a little research would easily prove it drives down employment, both the number of hours worked and the wages paid. Social Security employment data shows this clearly. This is, again, one-half of the equation which defines economic growth.

The manner in which mergers and acquisitions bring productivity down is more complex. Changes in productivity of the company after a merger or acquisition may be difficult to determine. Then we have the impact on productivity in the entire economy when smaller companies are purchased by the larger companies.

The main problem involves the lack of competition that results from mergers and acquisitions. When new, highly productive companies are competing with larger companies, it drives everyone to improve to stay in the business. But if, instead, you simply buy your smaller competitor, you don't have to improve your productivity to maintain your profit margins. Fair competition is the driver of productivity. Anyone who doubts this need only study productivity in the Soviet Union after Stalin.

The fact we see far over a trillion dollars a year change hands as companies purchase each other, and the fact you can prove this drives down economic growth, might lead some to question the wisdom of our current path.

Some would make a case, dreamily, as to how technological advances will somehow reverse these economic problems. They said the same thing in 1999, but back then their premise at least had some economic facts to support it. Productivity in many fields skyrocketed as a result of the introduction of computers throughout corporate America. Having what is essentially a super-computer on every workers' desk had to have been one of the greatest boons to productivity in the century. Other software-based products, Google comes to mind, and Quickbooks, and online payroll, have further elevated office work productivity.

Unfortunately, our new wave of technological breakthroughs seems to be focused more on entertainment than the work place. Facebook is a prime example. This company is now considered a key tech company, yet its product clearly reduces productivity in our nation, by some not unsubstantial amount.

As a side note, personally, I doubt the tech companies will have a collapse like they did in 2000-2002, dropping 83%. By the year 2000, the largest tech companies were way more overpriced than the basket of our largest tech companies is today. This doesn't mean our largest tech companies aren't overpriced (though you could certainly make that case for Apple and, to a smaller extent, Google), as most are absurdly over-valued today. But by early 2000 our big tech companies were overpriced like nothing ever seen. The very big difference today is that now our average company is being valued like it was a tech leader in early 2000. God help us all.

What we do know for sure is that whenever another recession emerges we will find the tech companies doing close to zero in new capital expenditures. And we are unlikely to see them unleash another capital spending spree for a number of years thereafter.

Again, even with a boom in technology company capital expenditures, total spending cannot get productivity growth even near the 2.3% a year, 69-year average rate. We're essentially stuck not far above 1%. Companies outside the tech sector are not interested in investing in expanding their U.S. operations. Tech companies are, although while the rest of corporate America would like to maintain their share of the U.S. market, they are not jumping at the opportunity to expand in our country. Their goal is to inexpensively maintain their market share in the U.S. They increase their ownership amounts of their U.S. companies through stock buybacks, then they turn their companies to focus resources dedicated for growth on international sales. This may make perfect sense from their company's future profit perspective, but it doesn't look very rosy for productivity, or employment, growth in our country. It does, however, help explains how we've achieved our worst economic performance in 70 years.

The only way to change this would be to do the opposite of pretty much everything our government has been doing for a very long time. We need to "rig" the system in favor of small businesses, yet nearly all our new laws benefit primarily, and often exclusively, the largest corporations. Our trade agreements are specifically designed to assist in this effort, as are the bulk of regulations. The more regulations, the easier it is for large companies to comply and the more onerous it is on smaller companies. In addition, Congress regularly passes new laws designed to assist specific larger corporations with their needs. Small businesses barely have a voice, at all, in Congress. Both parties always do lip service to them, but I have followed this topic in Congress closely for 20 years, and I can guarantee you Congress massively favors large corporations versus small in nearly every instance. The favoring of large versus small companies in terms of government interference proceeds today with nothing slowing it down.

Despite some efforts by the new administration to reduce new regulations affecting all companies, I would say this is another roadblock to growth which not only isn't being corrected but is indeed getting worse. Large corporate influence in Congress must be at or near an all-time high. They win every single time in Congress, and small businesses are the biggest losers. Yet small business growth is the largest engine of economic growth in our country. This obviously presents a serious impediment to growth, to say the least.

So, there we have it. Neither productivity nor hours worked have a pathway forward to escape our nation's decade-long economic malaise. The status quo of weak employment and productivity growth will continue until the next recession mysteriously arrives and derails it entirely. Of course, these factors will fluctuate, and at times they have been near or even above average levels - for a quarter or even two. But "take-off" is impossible given all the barriers discussed in this report.

You may notice I did not even bring out the "big gun" called debt in this entire discussion. For example, the interest payments on debt reduce the money that could go into business expansion, so over-indebtedness lowers productivity. Over-indebtedness is also disastrous, in the end, for employment growth.

I doubt we've ever seen a picture so bleak for our economy when we weren't already in a full-fledged recession. Personally, even though I know it is going to be historically difficult for most people, I would really like to see the recession get going, to clean out all the mistakes that have been building since 2000 which have never yet actually been addressed.

We will continue to update this data over time. It tells us the economy has indeed been growing historically slowly, and it points directly to why this has been the case. Unfortunately, looking at the financial world we see the causes of low employment and productivity growth are in full effect today. If anything, they have become more pronounced, such as booming stock buybacks and the mergers and acquisitions frenzy taking place today.

In summary, the U.S. economy is mired in a situation in which growth will not be able to average over 1.5% a year, .3% from employment growth and 1.2% from productivity growth. This number could certainly be lower but will not be substantially higher over the longer-term. We essentially have a "lid" on our economy's growth potential, a lid we appear to be in no hurry to remove.

Our leaders aren't even addressing the key factors needed to understand our economy, namely the growth rate in the number of hours worked, productivity growth, capital expenditures growth, and wage growth. The data on these factors referenced in this report – the factors which define economic growth - all came from from the government's own Bureau of Labor Statistics, the Bureau of Economic Analysis, FRED Economic Data from the St. Louis Fed, the Census Bureau, and the World Bank. Every number in this report came from one of those sources.

Yet I rarely hear anyone ever mention these actual facts which show the difficult state in which we find ourselves as an economy. Given the views of the mainstream, one would have to say there is no way out, other than to finally have the bottom fall out. It certainly appears investors will never face reality and demand the necessary changes until the markets are giving them acute suffering. It will, though that is a difficult way to learn.