3. The Truth about the Growth Slow-down

To understand the growth slow-down we need a theory. The economy has to maintain successive changes from one satisfactory short term situation to another: both demand and capacity must expand repeatedly and in balance. The government is responsible for expanding demand, the private sector for expanding capacity. For that, the private sector needs confidence in the government.

If actual growth is slower than required to sustain the labour market, a slow-down in productivity may be induced. If so, in place of a growing physical gap between the supply of and demand for labour, there may be growing employment at low wages.

Slow growth may induce low productivity in a number of ways; direct and indirect, temporary and wage-related. Low wages may reduce productivity by imparting a labour-intensive bias to new investment, or by attracting workers into low-value-added sectors of the economy.

It follows that to answer the question of whether the growth slow-down was or was not demand-related we need to look for statistical evidence of induced productivity slow-down. One way to begin is to separate the statistical record of manufacturing from non-manufacturing. It is also necessary to consider the potential influence of other events or factors which have affected historical productivity, including so-called ‘catch-up’ effects and the effects of ‘exogenous’ shocks such as the energy-price shocks of the nineteen-seventies.

The chapter follows this trail in four countries for which good data are available – France, Germany, the UK and the US – first looking at the general background of actual GDP growth rates, working hours and manufacturing productivity, then moving to the crucial comparison between productivity trends in manufacturing and non-manufacturing. Given that (as seen in Chapter 2) real wages fared markedly worse in the US than in the UK, and that in the UK they did less well than in France and Germany, I expected to find strongest evidence for induced productivity slow-down in the US, weakest in France and Germany, with the UK in between. In a series of figures, the prediction is confirmed.

Why did it happen? Why did actual growth slow down? The general answer is fear of inflation provoked by the traumas of the seventies and early...
eighties. But maybe inflation was already accelerating in the nineteen-sixties? The question cannot be answered conclusively, but it is likely that if the shocks had not occurred, inflation could have been brought down without the heavy cost in lost growth that we eventually suffered.

The shocks caused an adverse shift in the relationship between demand pressure and inflation (making more inflation for given pressure), persisting into the middle eighties. Then came a more benign relationship, which should have encouraged governments to promote growth with less fear of inflation. But slow growth continued. The basic cause was low priority attached to growth by governments. The result was reinforced on the demand side by high long term real interest rates, perverse expectations in the money markets and, on the supply side, by excessive take-over activity. In turn, the high interest rates and perverse expectations were the combined outcome of, among governments, a ‘monetarist’ view of the inflationary role of the money supply, public-sector deficits partly caused by slow growth itself and by the desire to rely heavily on short term interest rates for the purpose of macroeconomic management. This last had the effect of destabilizing bond markets and raising long term interest rates relatively to expected future short rates. It also turned good news for the real economy into bad news for the markets, creating potentially chronic pessimism among real-economy businesses.

The logical framework

Growth and Keynes

I have already noted that the economic theory of long term growth was a consequence of, but not an immediate part of the ‘Keynesian revolution’ in economics. Keynes’s original theory was essentially concerned with slumps. More precisely it was a theory to explain how an economy containing a given amount of human and material capital could have a low-level equilibrium where both were underutilized. Starting perhaps from a position of high production, something happens to depress the flow of monetary demand, causing producers to reduce output, causing their incomes to decline, causing a further decline in demand. The downward spiral continues until some built-in opposing factor, of one kind or another, halts it. Government intervention, however (of one kind or another) should in principle be able to correct or forestall the process and maintain a continuous regime of good utilization and relatively weak cycles.

At the cost of some oversimplification one can say that the theory of growth begins where the theory of cycles ends. Suppose we do