**Wake up America! This Is The Real Problem With The US Economy**

*Forbes Magazine* - [Greg Satell](http://www.forbes.com/sites/gregsatell/) – October 29, 2016,

It’s a political season, so we’re hearing a lot of the usual arguments the economy. Should we raise taxes or lower them? Negotiate trade agreements or abandon them? These are important questions, but they are not the central economic issue that we face today. Productivity is.

As economist [Robert Gordon](https://en.wikipedia.org/wiki/Robert_J._Gordon) explains in [*The Rise and Fall of American Growth*](http://amzn.to/2eI9XiZ), productivity growth soared between 1920 and 1970, but has sputtered since then. What’s more, he predicts that the productivity picture will get even worse in the decades to come, making it even harder to raise living standards.

To be clear, this is not a recent problem, nor can be laid at the feet of one President or one political party. It is also not a distinctly American challenge, but a global trend. So rehashing decades old arguments will get us nowhere. The truth is that the productivity problem is unlike anything we’ve faced in the last century and we’ll have to come up with new solutions for it.

**Slowing Innovation While Fighting Headwinds**

Try to imagine what life was like before 1920. Few people had cars, indoor plumbing or electricity. Ordinary chores, such as washing clothes or cooking a meal, required families to carry heavy loads of wood and water. Without refrigeration, food spoiled regularly. Women, consumed with household labor, rarely worked outside the home and few people had higher education.

So it’s not surprising that as homes became automated, productivity soared. That’s one reason why Gordon argues that low productivity levels are here to stay. Today, despite some comparatively narrow improvements in digital technology and entertainment, life hasn’t changed much since the 1970’s. Education levels are also unlikely to raise much from present levels.

Recommended by Forbes

But that’s not all. At the same time that innovation has slowed, Gordon argues that there are [six headwinds](http://realmoney.thestreet.com/articles/10/10/2012/6-headwinds-apocalypse) — namely demography, education, inequality, globalization, climate change and the overhang of consumer and government debt — that will be barriers to faster growth. To understand his point, let’s look at just a few of them in combination.

As the baby boomers retire, the growth of the working force slows and the increase in retirees rises. At the same time the leveling off of the rate at which people attain higher education, combined with supply side pressures from globalization and higher levels of both public and private debt will make for a smaller economic base from which to finance retirement.

Former Treasury Secretary Larry Summers argues that the confluence of these factors leads to [secular stagnation](http://larrysummers.com/2016/02/17/the-age-of-secular-stagnation/), an economic condition that features excess saving and diminished investment, demand and economic prosperity.

**Bill Gates’ Barber And The Baumol Effect**

Another factor dragging down productivity is the composition of the economy. Since the 1950’s, manufacturing has [fallen](https://www.minnpost.com/macro-micro-minnesota/2012/02/history-lessons-understanding-decline-manufacturing) from about 35% of the labor force in the US to about 20%, while at the same time services has soared from just over half of the labor force to nearly 80%. That’s a dramatic shift.

To understand how this affects productivity, think about Bill Gates and his barber. Over the last 30 years, technology has gotten thousands of times more powerful, making people like Bill Gates far more productive. His barber, on the other hand, still cuts the hair on only one person’s head at a time. Still, because Bill Gates has gotten richer, the price of haircuts has gone up.

This is known as the [Baumol effect](https://en.wikipedia.org/wiki/Baumol%27s_cost_disease) and it is having a measurable impact on industries, like healthcare and education, that depend on highly skilled professionals to provide service. Not coincidently, costs in both of these sectors of the economy have ballooned over the past few decades without a corresponding increase in productivity.

So instead of spending more money on things that will improve our quality of life, an increasing portion of American incomes are going to things like health insurance premiums and paying down student loans.

**Technology Tipping Points?**

The seeds for the transformation that took place in the 1920’s were actually sown long before. Edison opened the first electrical power plan in the US, [Pearl Street Station](https://en.wikipedia.org/wiki/Pearl_Street_Station), in 1882 and Faraday [invented the dynamo](https://en.wikipedia.org/wiki/Dynamo) 50 years before that. The [internal combustion engine](https://en.wikipedia.org/wiki/Internal_combustion_engine) was invented in 1876 and Henry Ford [introduced the Model T](https://en.wikipedia.org/wiki/Ford_Model_T) in 1908.

So it’s not quite clear whether innovation has hit a wall or is merely in hiatus. Gordon argues, accurately, that the [impact of digital technology has been narrow](http://www.digitaltonto.com/2016/is-digital-technology-really-making-us-any-better-off/), but there are indications that we just haven’t seen its full effect yet. To be sure, it is beginning to power new technologies, such as [genomics, nanotechnology and robotics](http://www.digitaltonto.com/2016/the-3-big-technologies-to-watch-over-the-next-decade-genomics-nanotechnology-and-robotics/), that may be far more pervasive.

To understand the impact that these technologies can have, consider the case of solar energy, which relies on nanotechnology. Since 2009, the price of solar panels [has dropped by 70%](http://news.nationalgeographic.com/energy/2015/10/151002-solar-energy-sees-eye-popping-price-drops/). That’s made them competitive with fossil fuels, but not transformative. Now consider the fact that solar efficiency [improves by about 20%](https://en.wikipedia.org/wiki/Swanson%27s_law) for every doubling of volume and you can see the potential for the future.

It’s not just solar panels either. The same trends hold for a variety of exciting new technologies, such as [energy storage](http://www.digitaltonto.com/2016/why-energy-storage-may-be-the-most-important-technology-in-the-world-right-now/) and [genetic sequencing](http://www.digitaltonto.com/2011/the-ultimate-code/). Advances in artificial intelligence also have the potential to automate many service jobs. To take just one example, 2000 cases of beer were recently [delivered by a self-driving truck](https://www.technologyreview.com/s/602725/ottos-self-driving-18-wheeler-has-made-its-first-delivery/).

Unfortunately, we won’t see the true impact of these new technologies [till after 2020](http://www.digitaltonto.com/2016/why-2020-is-shaping-up-to-be-a-pivotal-year/). So until then, we will just have to wait and see. But we can certainly improve our odds by investing in research that will make the advances we need more likely to happen.

**Shifting The Debate**

Consider the facts laid out above and it should be clear how irrelevant the political debate around economics has become. Things like trade and tax policy will have no more than a marginal effect on prosperity. What’s really important is improving productivity growth and that is a long term proposition that won’t lend itself to easy fixes.

Some things, such as the aging of baby boomers and globalization we have little control over. We can create programs to retrain older workers, who due to longer life spans can now have second or even third careers. We can also design programs to support people who’ve been put out of work by international competition and automation. But those are merely band-aids.

The truth is that [if we want to win the future, we have to invest in it](http://www.digitaltonto.com/2014/you-can-only-win-the-future-if-you-invest-in-it/) and that means that we have to improve our technological capacity. Unfortunately, many politicians seem hell bent on doing just the opposite, waging a [war on science](http://www.digitaltonto.com/2015/the-war-on-science/) and [cutting research budgets](http://www.aaas.org/sites/default/files/RDGDP%3B.jpg) to post-war lows as a percentage of GDP.

And consider this. The gap in federal research investment amounts to less than 0.5% of GDP — and a mere 0.2% of GDP if you count only non-defense research. So the price for securing our future amounts to only a small fraction of pennies on the dollar. Is that really too high a price to pay?

Yet still, the issue of investment in infrastructure and research just doesn’t seem like something politicians want to talk — much less do — anything about. Never has the future depended on so little from so few. How are we coming up short?

**Data shows U.S. economy strengthening on eve of Trump presidency**

*Business News* - [Lucia Mutikani](http://www.reuters.com/journalists/lucia-mutikani) – November 23, 2016

New orders for U.S. manufactured capital goods rebounded in October, driven by rising demand for machinery and a range of other equipment, the latest indication of an acceleration in economic growth early in the fourth quarter.

The brightening economic outlook received a further boost from other data on Wednesday showing a jump in consumer sentiment this month following the election of Donald Trump as the next president. Consumers embraced the business mogul's victory, which they viewed as positive for their personal finances and the economy's prospects.

While the number of Americans filing for unemployment benefits rose from a 43-year low last week, the trend in jobless claims remained consistent with a tightening labor market.

The data reinforced expectations the Federal Reserve would hike interest rates at its December meeting and minutes of the bank's November policy meeting showed rate setters appeared confident that a rise would come "relatively soon".

"Everything seems to be moving in the right direction in the economy," said Joel Naroff, chief economist at Naroff Economic Advisers in Holland, Pennsylvania. "The weak links are recovering and the strengths are staying strong. The Fed is not going to continue doing nothing."

The Commerce Department said non-defense capital goods orders excluding aircraft, a closely watched proxy for business spending plans, rose 0.4 percent after declining 1.4 percent in September. These so-called core capital goods orders have now increased in four of the last five months.

Shipments of core capital goods rose 0.2 percent last month after a 0.4 percent gain in September. Core capital goods shipments are used to calculate equipment spending in the government's gross domestic product measurement.

A 12 percent surge in demand for transportation equipment buoyed overall orders for durable goods, items ranging from toasters to aircraft that are meant to last three years or more, which jumped 4.8 percent last month. That was the biggest rise in a year and followed a 0.4 percent increase in September.

Even as the economy has regained momentum after stumbling in late 2015 and early 2016, business spending remained weak as companies struggled with the impact of a strong dollar and lower oil prices on profits. Business spending on equipment has declined for four straight quarters, weighing heavily on manufacturing, which accounts for 12 percent of the U.S. economy.

With core capital goods orders steadily increasing in tandem with rising gas and oil well drilling activity, there is cautious optimism that business investment on equipment will rebound in the fourth quarter.

But gains are likely to be modest amid renewed strength in the dollar. The greenback's rally had appeared to run out of steam for much of the year. Still, the rise in both core capital goods orders and shipments mirrored data on industrial production and surveys in showing a nascent recovery in manufacturing.

"Activity in the manufacturing sector is getting a little better, but is still far from robust. The recent strengthening in the dollar does pose a renewed risk to growth in the industrial sector," said Michael Feroli, an economist at JPMorgan in New York.

In a separate report, the University of Michigan said its consumer sentiment index rose 8.2 points from the pre-election reading to 93.8. That put the index 6.6 points above the October reading. UMich said the post-election surge in optimism was widespread, with gains recorded among all income and age subgroups and across all regions of the country.

BULLISH ECONOMIC SIGNALS

The reports joined bullish data on housing starts, home and retail sales, as well as firming inflation in painting an upbeat picture of the economy at the start of the fourth quarter.

The Atlanta Federal Reserve is forecasting GDP rising at a 3.6 percent annual rate in the fourth quarter. The economy grew at a 2.9 percent pace in the July-September period. The data suggest Trump will inherit a strong economy from the Obama administration.

"Trump is the first president looking back to the early 90s to inherit an economy that is at full employment," said Chris Rupkey, chief economist at MUFG Union Bank in New York. "The irony is he became president by playing on many voters fears that the economy was rigged against them."

Against the backdrop of the improving economy, the Fed is likely to hike interest rates at its Dec. 13-14 policy meeting. The U.S. central bank raised its benchmark overnight interest rate last December for the first time in nearly a decade.

The dollar rose against a basket of currencies to a more than 13-year peak, while U.S. stocks were little changed with the Dow near a record high. Prices for U.S. government debt fell, with two-year note yields hitting 6-1/2 year highs.

In another report on Thursday, the Labor Department said initial claims for state unemployment benefits increased 18,000 to a seasonally adjusted 251,000 for the week ended Nov. 19.

Claims have now been below 300,000, a threshold associated with a healthy labor market, for 90 straight weeks. That is the longest run since 1970, when the labor market was much smaller.

The four-week moving average of claims, considered a better measure of labor market trends as it irons out week-to-week volatility, fell 2,000 to 251,000 last week.

Labor market strength is bolstering domestic demand, which in turn is feeding through to the manufacturing sector.

Solid domestic consumption and President-elect Donald Trump's plan for a massive infrastructure spending program could spur business investment on equipment. It would boost companies like heavy machinery maker Caterpillar, which last month lowered its full-year revenue outlook for the second time this year. A fourth report from the Commerce Department showed new home sales declined 1.9 percent in October. Sales, however, rose 17.8 percent from a year ago

**Consumers, exports give U.S. economy muscle in the third-quarter**

Business News - [Lucia Mutikani](http://www.reuters.com/journalists/lucia-mutikani) – November 29, 2016

The U.S. economy grew faster than initially thought in the third quarter, notching its best performance in two years, buoyed by strong consumer spending and a surge in soybean exports.

Gross domestic product increased at a 3.2 percent annual rate instead of the previously reported 2.9 percent pace, the Commerce Department said in its second GDP estimate on Tuesday. Growth was the strongest since the third quarter of 2014 and followed the second quarter's anemic 1.4 percent pace.

Output was also lifted by upward revisions to business investment in structures and home building, underscoring the economy's solid fundamentals that further bolster the case for the Federal Reserve to raise interest rates next month.

Data ranging from housing to retail sales and manufacturing suggest the economy retained its momentum early in the fourth quarter even as exports appear to be faltering amid a reversal of the soybean boost. The Atlanta Fed is currently forecasting GDP rising at a 3.6 percent rate in the fourth quarter.

The economy could also gain more muscle next year if president-elect Donald Trump succeeds in pushing through Congress a fiscal stimulus plan that includes massive infrastructure spending and tax cuts, analysts say.

"Couple that with an increasingly enthusiastic consumer supported by stronger wage gains and the economy appears well-positioned to remain on a growth path heading into 2017," said Jim Baird, chief investment officer at Plante Moran Financial Advisors in Kalamazoo, Michigan.

Economists had forecast third-quarter GDP growth being revised up to a 3.0 percent rate.

When measured from the income side, the economy grew at a 5.2 percent clip amid a rebound in corporate profits. That was the fastest pace of increase in gross domestic income in nearly two years and followed a 0.7 percent rate of expansion in the second quarter.

The average of GDP and GDI, which economists consider to be a more accurate measure of current economic growth and a better predictor of future output, increased at a 4.2 percent rate in the third quarter, the fastest pace in two years.

That followed a 1.1 percent rate of increase in the second quarter and likely exaggerates the economy's strength.

The dollar initially hit a session high against a basket of currencies after the data, before surrendering gains to trade flat. Prices for U.S. government bonds fell, while stocks on Wall Street rose modestly.

FAVORABLE GROWTH PROFILE

The third-quarter revision showed a much more favorable growth profile for the economy. The boost from inventories was not as big as previously estimated, which suggests that businesses are not sitting on piles of unwanted goods.

This means they will have more scope to place new orders, which augurs well for economic growth in the coming quarters. The sharp acceleration in GDP in the last quarter should quash any lingering fears that the economy was at risk of stalling after growth averaged just 1.1 percent in the first half. That together with a labor market that is near full employment and steadily rising inflation could leave the Fed comfortable to hike interest rates at its Dec. 13-14 policy meeting. The U.S. central bank raised its overnight benchmark interest rate in December for the first time in nearly a decade.

The Commerce Department said consumer spending, which accounts for more than two-thirds of U.S. economic activity, increased at a 2.8 percent rate in the third quarter and not the 2.1 percent pace reported last month. That was still a slowdown from the second quarter's robust 4.3 percent pace.

With a tight labor market lifting wage growth and boosting household sentiment, consumer spending is likely to gain further momentum for the rest of the year and in 2017. Rising house prices are also likely to keep consumption supported.

A separate report from the Conference Board showed its consumer sentiment index surged in November, climbing back to pre-recession levels. Consumers were upbeat about the labor market and current business conditions. Another report showed house prices increased 5.1 percent in September from a year ago. Spending on nonresidential structures, which include oil and gas wells, was revised sharply higher to show it increasing at it fastest pace since the first quarter of 2014.

Business spending on equipment, however, fell at a steeper rate than previously reported, declining for a fourth straight quarter. With after-tax corporate profits rising at a 7.6 percent pace last quarter there is scope for business investment to rebound. Corporate profits declined at a 1.9 percent rate in the second quarter.

"The return to positive growth in corporate profits at least satisfies what is probably a necessary, but not sufficient, condition for a rebound in business fixed investment," said Andrew Hollenhorst an economist at Citigroup in New York.

Exports grew at their quickest pace since the fourth quarter of 2013, driven by a surge in soybean exports after a poor soy harvest in Argentina and Brazil. Trade contributed 0.87 percentage point to GDP growth and not 0.83 percentage point as reported last month. Businesses increased spending to restock after running down inventories in the second quarter, but just not as much as previously reported. Businesses accumulated inventories at a $7.6 billion rate in the last quarter, almost half of the $12.6 billion pace reported last month.

That means inventory accumulation contributed 0.49 percentage point to GDP growth and not the 0.61 percentage point reported last month.