Economic growth

Patience: the big virtue

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ECONOMIC growth in the developed world has been sluggish for a while. In a fascinating and thought-provoking speech, Andy Haldane, the Bank of England's chief economist, says that advanced economy growth has averaged just 1% a year since the crisis, compared with 3% in the decade before it. And the problem may be much more deep-seated as the graph in this blog shows.

The big question is whether growth will be sluggish going forward; secular stagnation in the jargon. The answer to this question requires us to understand what got growth motoring in the first place, after the stagnation that marked much of human history. As Mr Haldane remarks

Since 1750, it has taken around 50 years for living standards to double. Prior to 1750, it would have taken 6000 years.

Or, to put it another way

If the history of growth were a 24-hour clock, 99% would have come in the last 20 seconds.

Economic statistics from the pre-1750 era are sketchy but a similar result is found when one looks at the data on life expectancy or the heights of skeletons; as Hobbes said, life was "poor, nasty, brutish and short."

So what caused this change in the economic outlook? Mr Haldane details two explanations; the "neoclassical" approach and the "endogenous growth" approach. (Economists and plain English are doomed never to meet.) The neoclassical approach requires people to postpone consumption, so they can accumulate savings that can be invested for the long term; an economic version of the marshmallow test. Technological innovation then comes along and uses that capital more productively; this generates the growth. This technological change comes from outside the system, it is exogenous in other words. There was a whole burst of technological innovation in the 18th century that schoolboy historians may remember; the steam engine of James Watt; the spinning jenny of Hargreaves and so on.

The contrasting view is that growth comes from inside the system; it is endogenous. Growth requires several things to happen simultaneously. There must be a degree of trust among savers, for example, that their money will not be wasted, stolen or seized by governments. The quality of institutions is important, as detailed by Acemoglu and Robinson in their book "Why Nations Fail". 18th century Britain, where the Industrial Revolution took off, had shaken off the rule of absolute monarchs and was reliant on financial support from the merchant classes. The skills of the workforce also matter; adult literacy had improved dramatically in the run-up to 1750. The Enlightenment had led to a surge in scientific knowledge; this was an era where great advances in physics, chemistry, biology and medicine. Advances in agriculture productivity made it possible to free workers from the land and move them into mopre productive industry.
In other words

The seeds of the Industrial Revolution were sown much earlier, and scattered more widely, than a Neo-Classical account would suggest. And sociological transformation was at least as important as technological transformation in catalysing the lift-off in growth.

Despite this, Mr Haldane thinks the neoclassical focus on patience is highly useful, and may give us an indication of the road ahead. One measure of patience is the level of interest rates.

The lower the discount rate, the higher the value of future cashflows in today's money. Or looked at another way, the greater the trust of investors that they will get the benefit of future cashflows. On that basis, things are looking very good indeed; interest rates are at record low in nominal terms in the developed world and are low in real terms too. Equity investors are happy to fund companies like Twitter or Amazon, where the cashflows may not arrive for years.

The alternative explanation is that rates are low because central bankers like Mr Haldane have forced them lower, reflecting their worries about, yes, secular stagnation. They may also be low because there is an excess of desired saving over desired investment; there are not enough profitable projects for companies to invest in. Low rates have not provided the boost to capital spending that might have been hoped for; in Britain, R&D spending has been falling for a decade.

And if we look at other measures of patience, the news is less encouraging. The tenure of chief executives has been falling steadily, as has the holding period of stocks. Investors hold Twitter not because they are patient but because such stocks are more volatile and thus have a greater chance of achieving a quick, outsize return.

The technological changes that offer the best hope for the future may also be working against us. As Herbert Simon said

an information-rich society may be attention-poor

Anyone stuck in a business meeting will notice that their colleagues spend much of their time gazing obsessively at their smartphones for e-mail updates and Twitter feeds. The pace of mass entertainment - films, TV programmes - has increased; watch even a popular show from the 1970s and you will see how slowly it moves by modern standards. Mr Haldane notes that

Psychological studies have shown that impatience in children can significantly impair educational attainment and thus future income prospects. Impatience has also been found to reduce creativity among individuals, thereby putting a brake on intellectual capital accumulation.

At the societal level, we seem to have become less patient too; spending on infrastructure in the developed world has been steadily declining for three decades. The rapid advances in educational attainment seem to have stalled. There has also been a worrying rise in what might be called pre-Enlightenment attitudes to science; the scientific consensus is ignored whether the issue is vaccines, genetically-modified food or climate change. Right and left are both to blame. All this may place a limit on progress at a time when demographic forces are constraining growth; it may have already subtracted 1% a year from the trend growth rate with further falls to come. Another measure, trust, may have deteriorated; faith in our political leaders is very low. This may be circular; slow growth erodes trust which weakens growth further.

The key, then, is which measure of patience is the best clue to the future; low interest rates or the "attention deficit disorder" displayed in financial markets and popular culture. Mr Haldane doesn't come down on one side or the other, perhaps because it's too difficult to tell. But the answer to the question should determine whether you are a long-term optimist or pessimist.