

# BEYOND THE NEW NORMAL

## A NEW ERA OF GROWTH

BY BRET SWANSON

The United States is mired in the slowest economic recovery since the Great Depression. Worse, we are told by many economists and policymakers that things are not going to get much better. We are experiencing, they say, the “New Normal,” a permanent downward departure from America’s historic 3% growth rate. New Normal projections are an understandable response to the trauma of the financial panic, the European debt crisis, deleveraging, and downtrending demographics, summing to a suggestion of slower growth—maybe 2% per year—as far as the eye can see.

Indeed, with existing policy and leaders telling us to prepare for slower growth ahead, the New Normal is probably an accurate prediction. The New Normal, however, assumes we are powerless to do anything about it. Its fatalism runs counter to the American ethos. The great leadership challenge of our time is to show the future is still possible and to chart a path of economic resurgence.

We’ve seen this play before. Forty years ago, things also looked bleak. Inflation was starting to break out. Vietnam had dragged on for nearly a decade. Watergate was bubbling. Oil prices were beginning a dramatic climb. We had entered what the Club

of Rome asserted in its famous 1972 “Limits to Growth” report was a long state of decline. It was time to downgrade expectations, rein in ambitions, and hunker down for the lean decades ahead.

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At first, the stagflationary 1970s seemed to vindicate this projected scarcity.

In the late 1970s and early 80s, however, the United States (along with the UK and China) said “enough.” This downgraded future was not acceptable. The United States stood up and chose a bold, new, distinct path across a range of policies, unleashing waves of growth and technology not only in America but across the globe.

In the 1980s and 90s, the United States was one of the freest economies on earth. It consistently ranked, for example, among the top four nations in the Fraser Institute’s annual World Economic Freedom report. Economic growth averaged 3.4%. In the 2000s, however, regulation and spending accelerated. The quality of our legal environment and monetary policy declined. Combined with growing freedom around the globe, America’s relative competitiveness plunged.

By the 2012 World Economic Freedom report, the United States had fallen to 19th. Noting scholarship linking economic freedom with

economic growth, the Fraser Institute's latest ranking "implies that, unless policies undermining economic freedom are reversed, the future annual growth of the U.S. economy will be half its historic average of 3%."

Such an outcome would dramatically downgrade the possibilities for American workers, investors, families, retirees—and, crucially, federal and state budgets. Economic growth is the force that provides opportunity for the young, ensures security for the old, and allows America's diverse families and communities to pursue their idea of the American dream.

Consider the disaster the New Normal implies. Annual GDP growth of 2% over the next 30 years, compared to a continuation of the recent 3% growth trend, would result in an economy some \$13 trillion smaller (in 2005 dollars) in 2042. Such an America would be a qualitatively different place.

A great challenge for leaders today is to explain this vast gulf in possible American futures—and to show how we might reinvigorate America's growth engine.

Nearer term, the New Normal will continue to place a lid on employment.

At today's feeble 2% growth rate, we might add a hundred or two hundred thousand jobs each month. Over the next five years, that's around seven million jobs—barely enough to keep up with population growth. Three percent growth might yield around 10 million net new jobs.

Yet a 3% growth rate itself is slower-than-usual recovery speed; it is not an ambitious objective. Emerging from the current slump, we should grow at 4, 5, or 6% for several years, as we did in the mid-

1980s. (Many cite the argument by Kenneth Rogoff and Carmen Reinhart that it takes economies longer to recover from a financial crisis than might otherwise be the case in a normal downturn. However, Michael Bordo and Joseph Haubrich took a closer look and found that the U.S. economy actually tends to grow faster after a financial crisis—that is, once growth arrives.) A strategy for implementing 4% growth for the next five years could add 14 million net new jobs—meaning that in 2017 seven million more Americans would be working compared to today's plodding 2%. For jobs, budgets, and broad opportunity, economic growth towers over every consideration and should inform every policy debate.

So how do we spur such a growth track?

A simpler, flatter, more efficient tax code that rewards rather than punishes investment and entrepreneurship would divert capital from gold and Treasuries into new businesses and bring home trillions in foreign sourced earnings and global capital. Unfortunately, some in Washington and the states are proposing higher tax rates, new carve-outs, and favors that will make real tax reform impossible.

Washington can't keep consuming an ever greater share of the economy. Harvard's Alberto Alesina, looking at nations across the globe, shows robust negative effects on growth as a government's share of the economy expands. Sadly, the federal government-economy ratio has jumped from 20% to 24%, and the current budget path makes this ratio worse over time. Does anyone believe the sprawling U.S. regulatory apparatus promotes economic growth? In each of the last two years, the Federal Register has grown by more than 81,000 pages. Rather than reforming or refining



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existing regulations to keep pace with the times and circumstances, Washington is busy draping vast new blankets of regulation over finance and health care and finding dozens of ways to interfere with our energy economy—a sector poised to deliver explosive growth in coming years. Federal Communications Commission micromanagement of broadband and mobile networks, meanwhile, could slow growth at the margins or, depending on regulatory whim, disrupt an entire innovation ecosystem.

A chief duty of America's leaders will thus be to explain why we can't afford these ever-expanding layers of taxes and regulation. For an economy like the United States that operates at the technological frontier, experimentation and entrepreneurship are essential. New firms, new products, and new ideas are the essence of growth.

Innovation, however, requires agility, investment, and deep commitments of time and energy to pursue ambitions whose outcomes are unknown. Too often regulations and taxes cement in place the current way of doing things; predetermine the structure of entire industries, and protect the status quo while deterring or prohibiting provocative upstarts.

In many cases, the benefits of regulation are negligible while the costs to American citizens are enormous. No estimate of regulatory costs can precisely gauge the impact of all our governmental rules in a dynamic economy, yet in a 2010 report the government's own Small Business Administration estimated annual federal regulatory costs of \$1.75 trillion.

Another way to look at it: if misguided regulation slows economic growth by just half a percent per year, the 2042 American economy would be \$5 trillion

smaller (in 2005 dollars). It is difficult to justify the bulk of today's regulatory state against a possible \$5-trillion-per-year dividend to our generation's children. Real leaders—policymakers, yes, but also businessmen and entrepreneurs—need to show that with the right policy framework that supports entrepreneurship and investment, we can relight America's lamps of innovation. In addition to comprehensive tax reform, a top-down regulatory rethink, and shrinking the government-to-GDP ratio, a pro-growth agenda should include:

- The promotion of international trade, thus expanding markets for American firms and keeping prices low for American consumers.
- Facilitating legal immigration, which is the source of so many new ideas and entrepreneurs.
- Reversing the trend of big government decisions through regulation that channels capital according to political influence, creates too-big-to-fail firms, and deters real entrepreneurship. A complex and shifting regulatory framework; increased regulation at the local, state, and federal levels; and a rise in litigation surrounding this regulatory trend is overwhelming business as well as those assigned to do the regulating. As *CFO Magazine* reported, “understaffed and overwhelmed regulators—at the Securities and Exchange Commission, the Federal Reserve, the Commodity Futures Trading Commission (CFTC), the Federal Deposit Insurance Corp. (FDIC), the Office of the Comptroller of the Currency, and elsewhere—had finalized only 110 of the 398 regulations they were tasked with crafting” after Dodd-Frank was passed into law. This regulatory juggernaut has implemented just 30% of the required rulemaking for Dodd-Frank,

but has generated more than 8,000 pages of additional rules and regulations, according to a report by the law firm of Davis, Polk & Wardwell.

- Stabilizing U.S. monetary policy, so that American firms, consumers, and the global financial system can count on a predictable value of the dollar.

Some look to the Federal Reserve to pump up nominal GDP with never-ending zero interest rates. Do these actions create real wealth? More likely, it steers money directed by big government to businesses, thus creating winners and losers, diverting attention from the real fiscal and regulatory obstacles, and possibly fueling the next financial mishap or even crash.

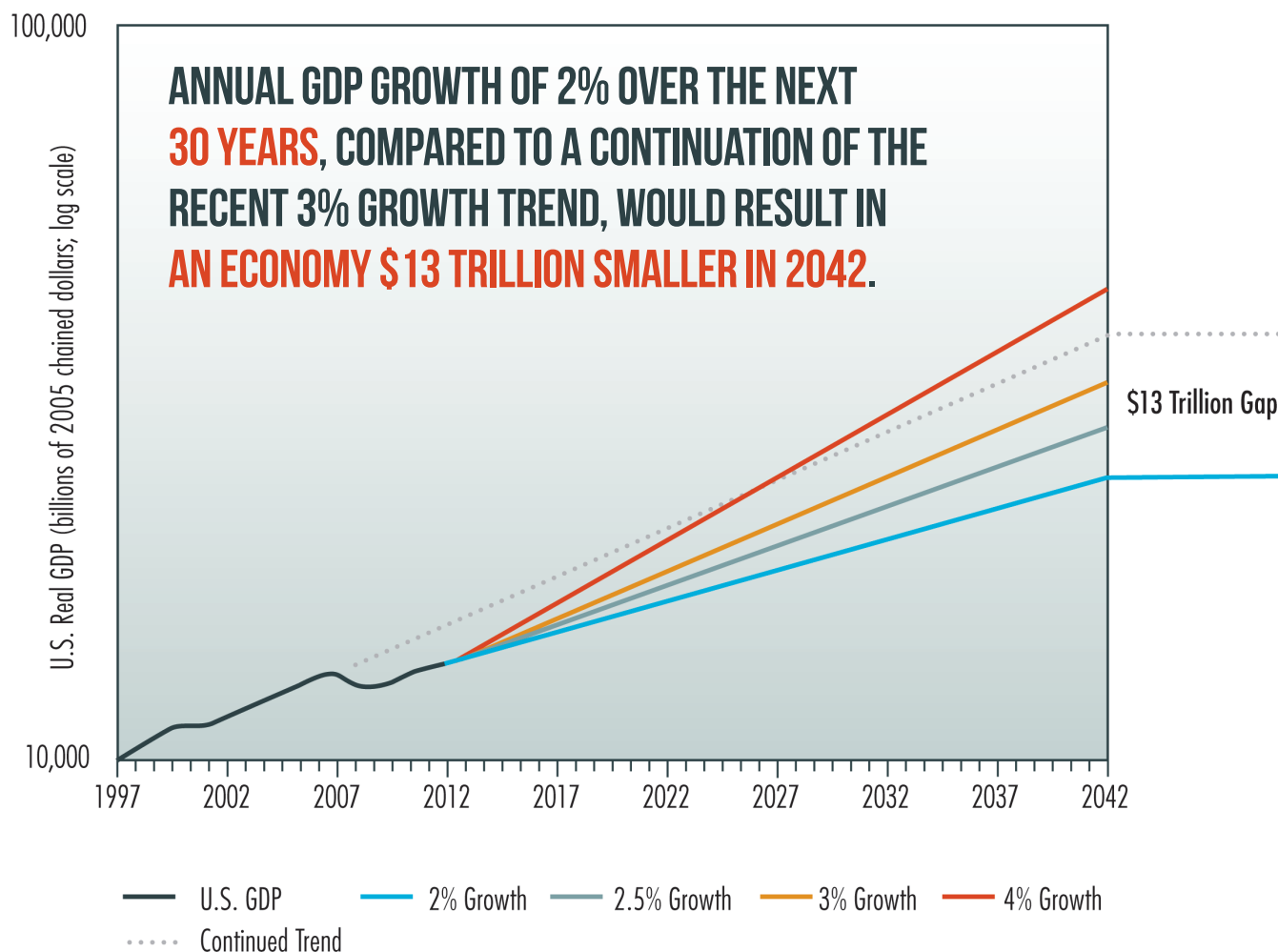
Might real factors beyond our control result in a potential growth rate lower than we've enjoyed these last few centuries? Sure. The converse, however, is also possible.

What if today's relatively freer, more connected world allows good ideas to be created and shared at an even faster pace than before—at an even larger scale—resulting in a higher top-end growth potential?

What if we choose to unleash, rather than tie down, America's deep human capital assets?

What if we reinvest, rather than draw down, our deep reservoirs of wealth?

What if growth greater than 3% is attainable? We don't know the answer, but what we can do is set the levers within reach for “full speed ahead.” If we max out at 2.5%, that's far better than the 1.5% that could result with today's unacceptable “limits to growth” policies. Matt Ridley, author of *The Rational Optimist*, surveyed



economic history going back thousands of years and persuasively showed that, well, optimism is rational—that progress surprises to the upside.

Progress, however, requires freedom, flexibility, experimentation, and a constant reexamination of our institutions. Those who think we can achieve great things by continuing to dig deeper holes are deluded. Likewise, the New Normal pessimists can probably achieve a self-fulfilling prophecy. A “rational optimism” that acknowledges hard realities and rebuilds the foundations of innovation and invention, however, can obliterate the New Normal and relaunch another American era of growth. ■



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