Global Economic Trends

I am going to be more optimistic than I have been in some time. My optimism is for the near- to medium-term, say 1 to 5 years out. Longer-term there are definitely problems that must be addressed.

Basically, the global economy is expanding. All developed economies are expanding, and many developing economies are experiencing economic growth. This is sometimes called synchronized economic growth. As one global business contact said to me, the "stars are aligned" for economic growth in all regions.

There are special stories in particular countries or regions. In Asia, there is a growing middle class who want all the consumer goods, from cars to washing machines. They are both the product of economic growth and drivers of it. The rise of China has been followed by the rise of India, and other countries. Asian countries are able to grow without China's help.

Long a laggard, Japan has been growing for 8 quarters.

Many countries are in early stages of growth, which augurs well for sustained global growth. Well into a long period of economic growth, the United States shows signs of being in the early stages of a growth spurt. Jamie Dimon, CEO of J. P. Morgan Chase, recently announced that the "animal spirits" have been unleashed.

How do we explain what one observer has termed "The Trump Growth Machine."[1] Richard Epstein, a well-respected law professor and economic commentator, focused on the

[1] Richard A. Epstein, "The Trump Growth Machine," *Defining Ideas* (Hoover Institution, January 29, 2018).

role of regulations. Some regulations and laws can foster economic activity. He gave the example of requirements that certain business transactions be written down and recorded. These add stability to those businesses. Many regulations, however, block or distort business transactions without providing any gain. As an example, Epstein cited the Dakota Access Pipeline. After the project had met all requirements, President Obama tied it up in an environmental review process that ensured it would never see the light of day. By Executive Order, President Trump undid this and the Dakota Access Pipeline is going forward.

The Dodd-Frank Act (DFA) has done great damage to economic growth since its enactment. Researchers found that DFA increased the fixed regulatory compliance costs of making loans and operating a bank. DFA disproportionately reduced the incentives of all banks to make very small loans. It also reduced the viability of small-sized banks; these small banks have a disproportionate share of small-business loans. Since 1993, the small-business share of Commercial and Industrial loans has fallen by 24 percentage points. They found that fully one-half of this decline is linked to the Dodd-Frank Act.[2]

This kind of thing has happened hundreds of times over under President Trump. While campaigning, candidate Trump promised that he would require government agencies to eliminate two existing regulations for every new one enacted. I thought, at the time, this might be the best economic idea had had conceived. Would he do it if elected? Well, he was and he did. That policy helped reignite economic growth in America.

[2] Michael D. Bordo and John V. Duca, "The Impact of the Dodd-Frank Act on Small Business Lending." Unpublished Paper, July 17, 2017.

About two years ago, I spoke to a group of CFOs on the economic outlook. I was asked about the secular stagnation thesis, the idea that the U.S. must accept permanently lower growth rates for a variety of macroeconomic reasons. I totally disagreed with it, and said that a good dose of economic deregulation would go a long way to jump start the U.S. economy. I referenced the moves to deregulate the transportation industry, surface and air, begun under President Carter and continued under Carter and Reagan in the 1970s and 1980s.

I repeated my call for deregulation in a *Wall Street Journal* opinion piece after the 2016 election ("At Long Last, the Fed Faces reality," December 15th). I believe events have proved me correct. We are **not** caught in the gripes of secular stagnation, and deregulation fosters more rapid economic growth.

Now to tax reform. Washington has talked about tax reform forever. On cutting the corporate income tax, there was consensus among Democrats and Republicans that it needed to be done. No administration was able to accomplish it. Trump spurred Congress to enact tax reform in a matter of weeks at year-end.

I will just focus on the importance of the cut in the corporate tax rate from 35% to 21%. It had immediate and dramatic effects in terms of immediate bonuses for workers, pay raises, new investment projects, etc. Just to name one example, Apple is promising to return $350 billion of money, currently being held overseas, to invest in American plants and jobs. No one should be surprised, though few – including myself – thought events would happen as quickly as they did.

By global standards, the U.S. had a very high corporate income tax rate. That drove global capital flows into countries with lower tax rates. The consequence was less capital invested per worker here, which lower labor productivity and slower wage growth. By dramatically lowering the corporate tax rate, Congress reversed the process. Plans to return capital to the U.S. were announced immediately. Workers instantly turned from something to be shed in corporate reorganizations to precious assets to be retained. Hence, the bonuses and already announced pay hikes. Capital investment forces firms to compete for workers.

For those who remember their Econ. 1, the burden or incidence of the corporate income tax falls not on owners of capital but on workers. The economic researcher who has done the most empirical work on the issue in the last decade is Kevin Hassett, who is now Chairman of the Council of Economic Advisers. I am sure he is responsible for convincing the President to cut the corporate rate.

I credit Trump for the good things he has done, and also for not implementing some of his bad ideas. He has not actually torn up any trade agreements, not started a trade war with China, etc. At least not yet.

The risks to the global economy do not at the moment seem to be economic (recent stock-market volatility to the contrary notwithstanding). In my view, they are mainly the potential for military conflicts.

On the politics of all this, I agree with Brett Stephans that "hysterical opposition to the Republicans tax bill was fool's game for Democrats that could only help Donald Trump."[3] Talking down a strong economy is poor political strategy.

There are any number of long-run problems that could upset the economic applecart. Big deficits and a large accumulated national debt top the list. There will be a debt crisis at some point, and its timing will likely surprise economic pundits. I seriously doubt there will be any political will to address the problem until there is a crisis. And there is no guarantee that the political response will be a good one (e.g., the aftermath of the financial crisis).

The U.S. also faces demographic challenges that compound our fiscal problems. They are not as great as for some other countries, like Japan, but they are there.

I would add one more problem that is going to limit economic growth in the long run – our broken public school system. With some conspicuous exceptions, it cannot hope to keep with the educational demands of the information economy.

Thank you.

[3] Brett Stephens, "Clueless Versus Trump," New York Times, January 19, 2018.