

The next imperative — Revitalizing U.S. economic growth



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Key takeaways

U.S. economic growth has been in a gradual decline for 50 years, and entitlement costs are surging.

In spite of an aging population, we have the resources to create sustainable growth and reduce deficits.

Political action — not rhetoric — on taxes, workforce, and immigration will drive solutions.

The greatest challenge ahead for the United States is taking action to spur faster, more equitable economic growth — and by so doing, restore faith in our government and re-boot America’s can-do spirit.

Unfortunately, we have just passed through a troubling presidential election cycle focused predominantly on frustration, anger, and the expression of a sense of betrayal by government. The underlying causes are complex economic and cultural trends that need to be addressed constructively if we, as a nation, rather than as Democrats and Republicans, expect to achieve our common goals.

In order to determine a new path forward, we must begin by looking at the huge gap between official data and popular perception. The headline data* on the national economy of the past seven years are relatively strong:

- 15 million net new jobs
- Unemployment drop of nearly 50%
- Federal deficits down more than 50% since 2010
- House prices largely recovered nationally, and better in many areas
- Inflation nearly flat
- The S&P 500 has more than tripled since March 2009
- U.S. gross domestic product is trending up

* Sources: Bureau of Labor Statistics, White House Office of Management and Budget, S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index, Congressional Budget Office, S&P 500 Index, Bureau of Economic Analysis.

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However, despite the positive numbers, popular perceptions are shaped by the fact that the growth we've just experienced is the weakest economic recovery since World War II.

Gallup polling shows a steady, secular drop since the year 2000 in the share of Americans satisfied with the way things are going — down from 70% at the turn of the century to barely 27% today.

The Great Recession and the weak recovery are not enough to fully explain this decline in public opinion. The disconnect between headline data and the public mood has deep roots. In fact, trust in government has been trending down for decades. In the era of Presidents Eisenhower, Kennedy, and Johnson, roughly 80% of Americans trusted our government to do what's right “most of the time.” Today, it's less than 20%. It's perhaps surprising that it took so long for this angry, anti-establishment

insurgency to present itself, and clearly, it is not just the musings of a younger, idealistic, and perhaps unrealistic generation. It includes all demographics across major and minor political parties.

Drivers of discontent

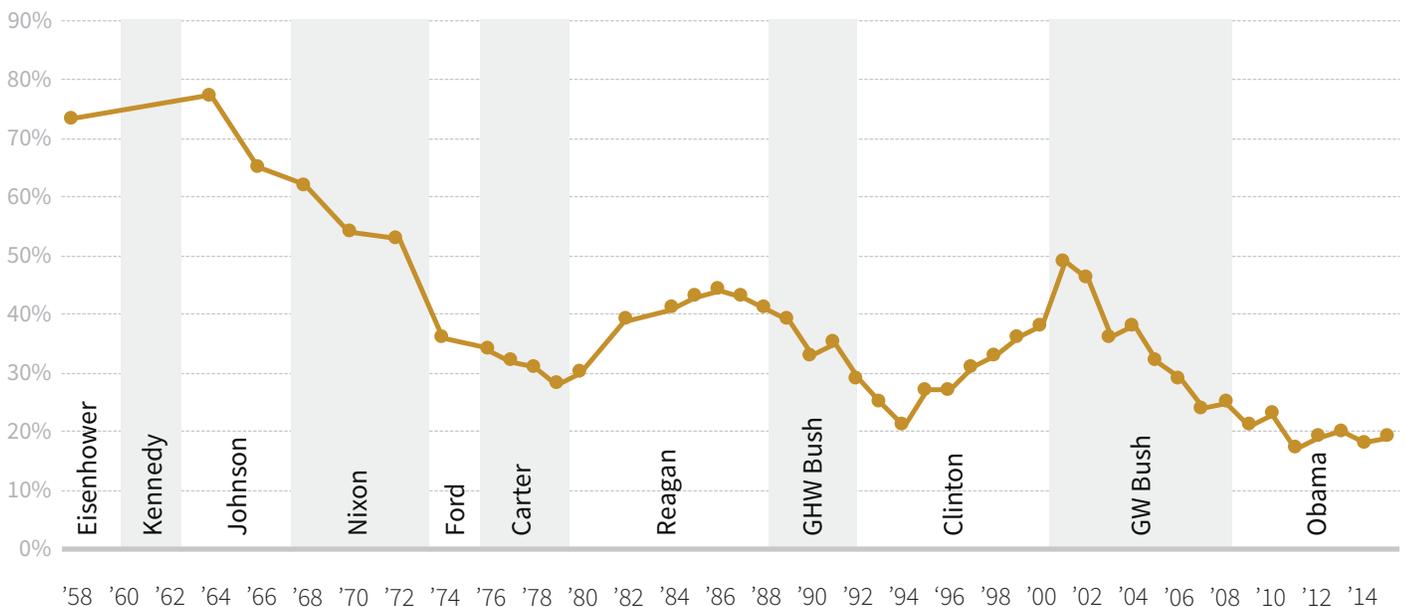
What drives this deep anxiety and loss of trust? There are multiple causes. Clearly, the financial crisis of 2008–2009 — the worst since the Great Depression — is still being felt. Millions of workers, consumers, investors, and business people lost jobs, homes, home equity, investments, and most importantly, their sense of stability, fair play, and optimism — core elements of the American Dream itself.

The federal bailout that prevented a total collapse caused many people to believe the financial system was rigged against them. Even many well-to-do people who have fully recovered in the market rebound since 2009 still feel

FIGURE 1

Public trust in government has room to improve

Percentage of Americans who trust the government in Washington to do what is right “always” or “most of the time”



Source: Public Trust in Government: 1958–2015, Pew Research Center, November 23, 2015.

anxiety. They wonder how “real” this market recovery is and how much it depends on a policy of near-zero interest rates from a Federal Reserve that seems to be pushing on a string.

Business confidence — and access to credit — have been undermined by a tidal wave of disruptive regulation, raising uncertainty and stymieing new investment. It’s no wonder that peoples’ faith that government can accomplish good things for them has nearly evaporated.

Worsening every problem we face is the long-term decline in America’s economic growth rate. We’ve become trapped in what former Treasury Secretary Larry Summers calls “secular stagnation” and some in financial services call “The New Normal,” suggesting that we should just get used to low growth and even lower expectations.

In fact, America’s economic growth rate has been falling for decades, from 4.5% a year in the 1960s, to about 3.5% in the 1980s, to less than 2% in the first decade after the year 2000. Since 2010, our economy has been growing about 1.4%. That is only slightly faster than America grew in the 1930s — the decade of the Great Depression.

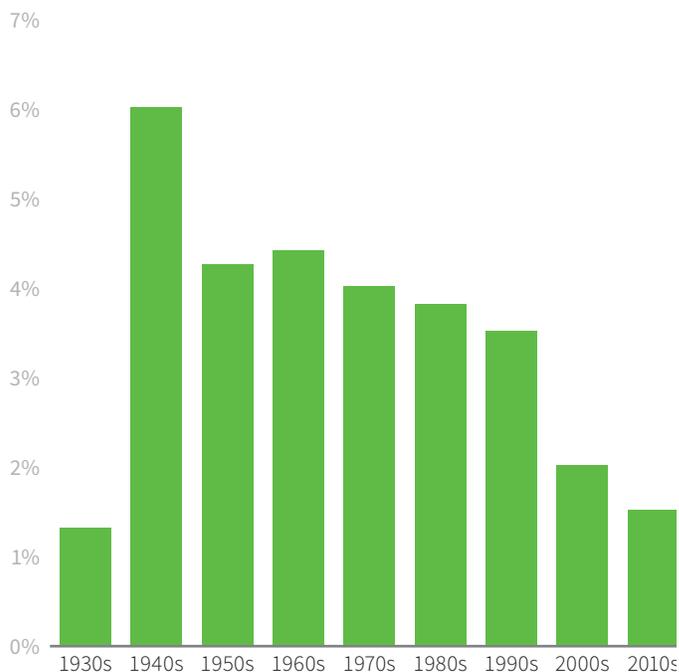
As with interest rates, growth rates compound. A difference of 1% up or down makes a huge difference over time in peoples’ lives. At 1%, it takes 72 years — a lifetime — to double gross domestic product (GDP). At 3%, GDP doubles in 24 years, just a generation. And economic growth does far more than just raise standards of living. As Professor Ben Friedman of Harvard wrote in his great book, *The Moral Consequences of Economic Growth*, a rising economy smooths social progress, strengthens toleration, and even spurs concern for the environment. Rapid growth made it much, much easier for millions of women, minorities, and legal immigrants to join the U.S. workforce from the 1960s to the 1990s.

Slow or negative growth, by contrast, makes everything worse for families, household and business balance sheets, federal deficits, and national morale. Culturally, slow growth raises racial, ethnic, and class tensions, and causes demagogues from the left and right to blame scapegoats: illegal immigration, trade deals, other countries, Wall Street bankers, and “the 1%.” This poisoned thinking drives the politics of “secular stagnation.”

FIGURE 2

U.S. GDP growth has been in decline for 50 years

Average growth rates by decade



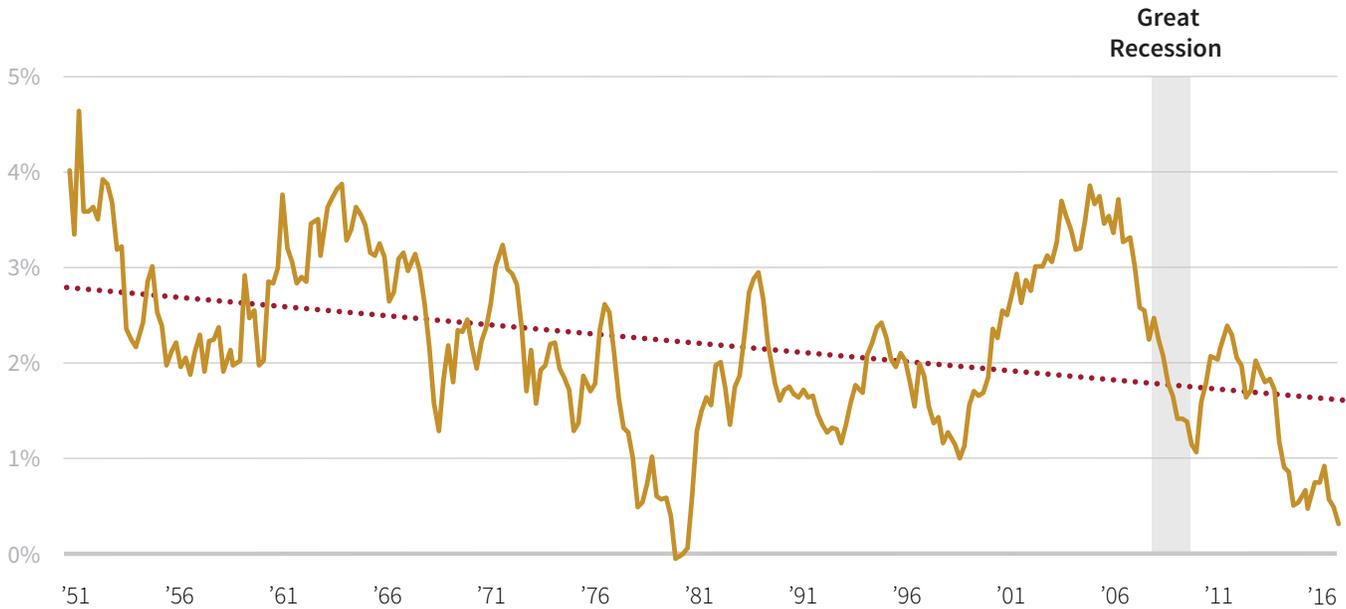
Source: Oxford Analytica.

Strengthening U.S. growth is the most critical issue the President and Congress must come to grips with. And to lift America’s growth trajectory, we need to first understand what has been dragging growth down and then find ways for policy to push against that.

FIGURE 3

Productivity growth has not increased with the recent economic recovery

U.S. non-farm business labor productivity, 4-year rolling average of annualized quarterly growth, 1951–Q2' 2016



Sources: Porter, Rivkin, Desai, and Raman: *Problems Unsolved and a Nation Divided*; *The State of U.S. Competitiveness 2016*, Harvard Business School, September 2016; Bureau of Labor Statistics; author's calculations.

Falling productivity growth

Despite some notable spikes upward, U.S. productivity — measured by our ability to produce output from inputs of capital, labor, and skill — has also been trending down for a long while. The formula for overall national growth is productivity times the number of workers and hours worked, with a bonus for higher skills. The United States is not alone in facing this downturn. Productivity has dropped even more in the United Kingdom, France, Germany, Japan, and Canada from 2005 to 2015 compared with the previous decade, and the United States is actually seeing slightly higher productivity than these trading partners.

Contrary to myth however, America's rising productivity has enabled us to more than double total manufacturing output — from \$1.5 trillion in 1975 to over \$3 trillion by 2010 and still rising. Deloitte's 2016 survey of global manufacturing actually projects that the United States will pass China by 2020 to again become the world's most

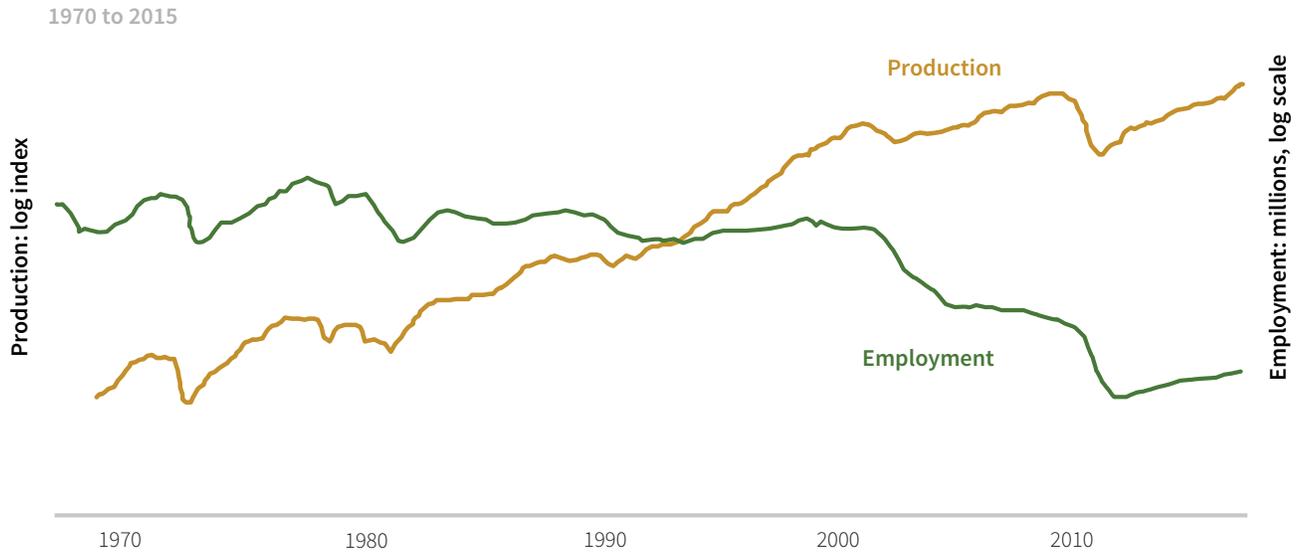
competitive manufacturer. Americans clearly still know "how to make things." But this rise in manufacturing output has come with the loss of over 6 million manufacturing jobs. Many of those laid off have fallen on very hard times.

Even more troubling is the divergence between workers' productivity, which has risen roughly 140% since 1980, and average wages, which have risen just 9% in real terms over that time. Median household incomes have risen over the same period in constant dollars, but they've dropped off sharply since 2007 and only showed their first real uptick in 2015. Real income gains since 1990 have been strongly tilted toward the upper third of the earnings scale, with workers below the 40th percentile actually losing ground.

Considering all these trends, it isn't surprising we're seeing angry political insurgencies. And there is no easy fix. America's job-creation "machine" — one of the glories of this country — has slipped back into low gear. We used to increase net new jobs by over 2% a year according to Bureau of Labor statistics, but in this recovery, the rate of

FIGURE 4

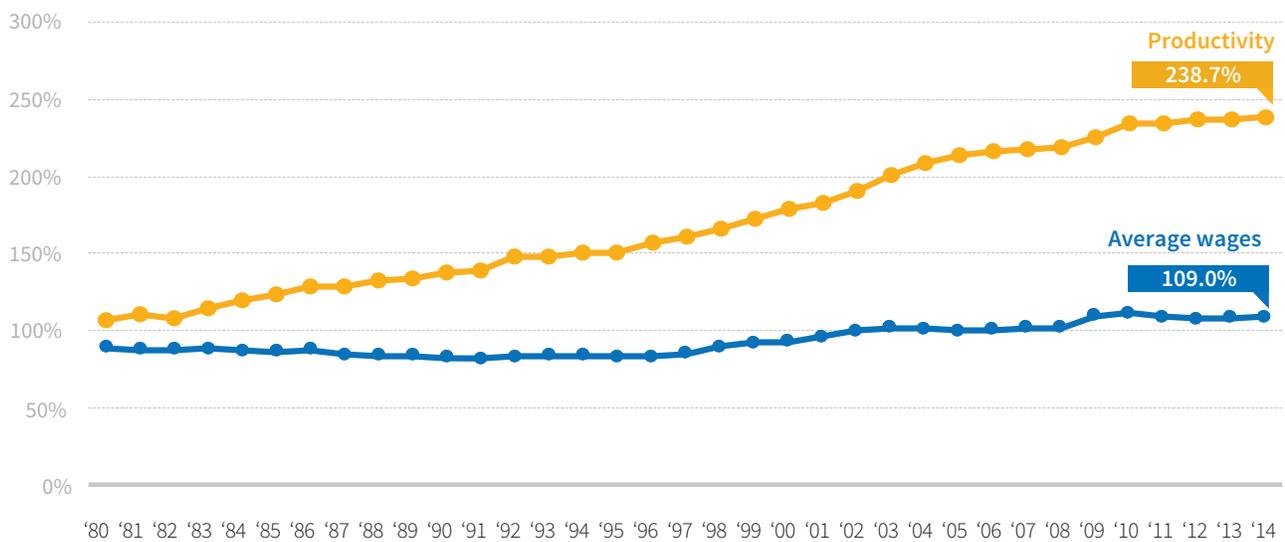
U.S. manufacturing output has actually risen, but with millions fewer manufacturing jobs



Sources: Federal Reserve, Bureau of Labor Statistics; and Reshoring or Offshoring: U.S. Manufacturing Forecast 2015–2016.

FIGURE 5

Productivity and wages have diverged



Source: *Raising America's Pay*, Economic Policy Institute, June 2014. Data from BLS Labor Productivity and Costs program.

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annual new job creation has yet to reach 1%, and while official unemployment is down, that’s not the whole picture. Workforce participation has also fallen back to levels last seen in 1982. Many millions of Americans of working age have just dropped out of the workforce.

The share of new businesses in the economy has fallen as well. Start-ups, once about 13% of all companies in the 1980s, represent approximately 8% today, according to a study by the Economic Innovation Group. This matters, and not just because new and growing companies account for most job growth. Some of these companies grow to become giants like Facebook. A healthy rate of start-ups drives innovation and keeps existing companies on their toes. New businesses, in other words, are a prime driver of productivity — directly and indirectly.

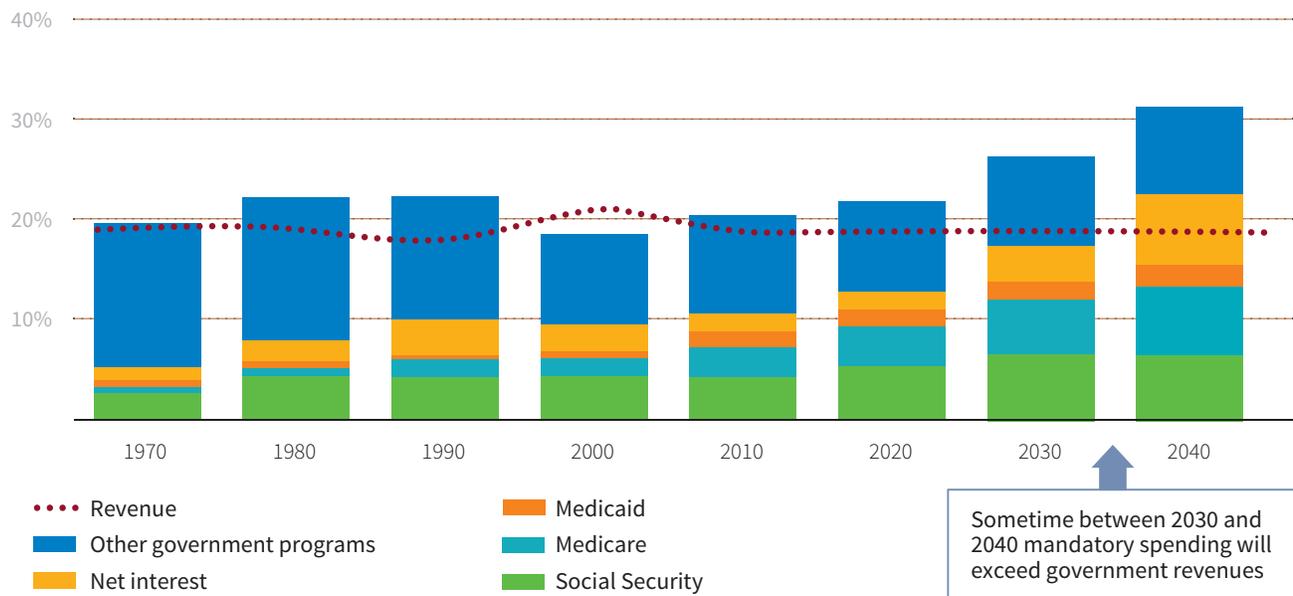
Why is net new business formation in America plunging? A likely key factor is the wave of post-crisis regulation and curbs on credit and risk-taking. Heavy, intrusive regulations actually favor large established companies and stymie innovation and entrepreneurs.

Entitlement reform

So far, we’ve examined just one side of a two-pronged pincer that threatens America’s future. The other pincer — well known but lacking attention in recent political debates — is the steady rise in federal entitlement spending for social insurance programs such as Medicare, Medicaid, and Social Security, along with net interest on the debt. On their current track — unreformed — these “mandatory” spending obligations will absorb all projected federal revenue sometime between 2030 and 2040, forcing huge tax hikes or deep benefit cuts, or both, assuming we still want to fund the U.S. military, National Public Radio, or the National Institutes of Health. And 2030 is not far away. Entitlement spending is already crowding out resources for any form of discretionary investment by the federal government, such as for roads, bridges, science, medical research, space exploration, education, and even defense.

FIGURE 6

Entitlement spending has surged as a % of U.S. GDP



Source: GAO Citizen’s Guide to the fiscal year 2007.

Since 1972, the July 2016 IMF World Economic Outlook notes, entitlement costs have risen to well over 45% of today's federal budget, three times more than the money the federal government can direct to public investments. This crowding out of federal investment is itself a major cause of our long-term growth slowdown. Absent reform, federal debt will soar to all-time highs as a share of GDP over the next generation.

Our best hope

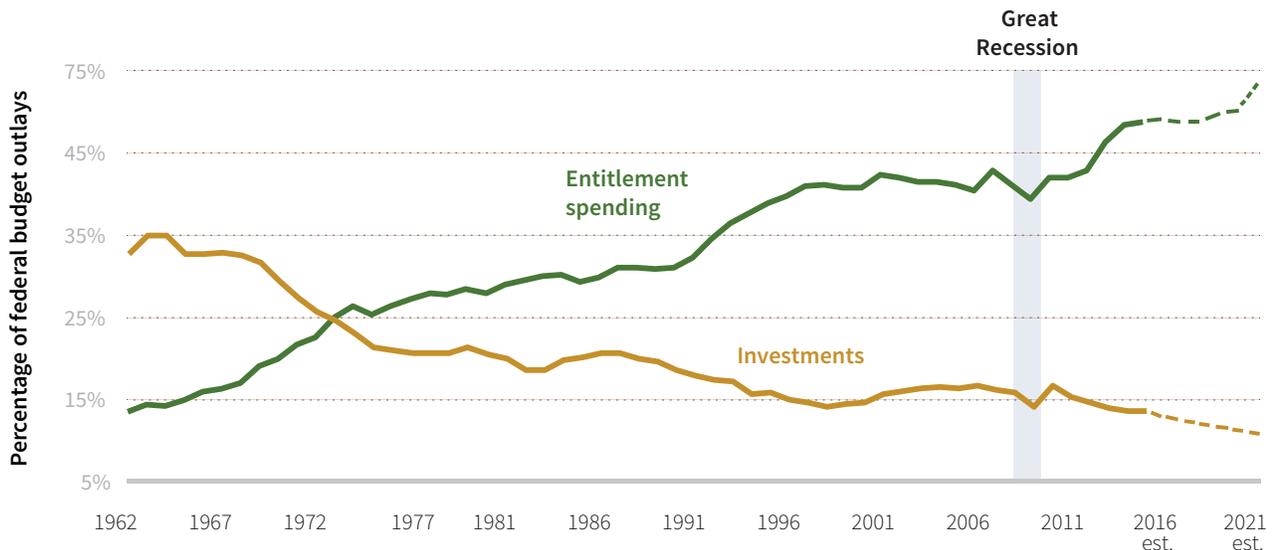
On the brighter side, there is historical precedent for optimism. Government debt right after World War II was over 100% of GDP, then fell for more than 30 years to roughly 25% of GDP by the 1970s, according to the Congressional Budget Office. Actually, our national debt in 1975 was twice as large in raw dollars — \$533 billion — as the \$258 billion dollars we owed in 1945, but that debt was barely a quarter as large as a percentage of U.S. GDP.

How? America's national economy grew much faster than the national debt. Stronger, sustained economic growth to outgrow our debt may not be our only hope, but it is our best hope. And while private enterprise is — and always should be — this country's prime engine for innovation and jobs, government has an indispensable role in getting the country moving again.

Gridlock, inaction, kicking the can down the road, and politicians refusing to compromise are all making government itself one of the greatest threats to our future. Gallup polling finds members of Congress have just an 8% rating for honesty and ethics. This dysfunction has to change, and businessmen and women must take the lead in asking the new Administration and Congress to focus laser-like on practical strategies to help restart U.S. growth.

FIGURE 7

Crowding out investment potential for federal investments



Source: IMF, World Economic Outlook, July 2016; IMF staff calculations.

There is work to do

Infrastructure spending can make a major contribution. The interstate highway system, for example, probably lifted America’s long-term growth potential by nearly 1%. State and local governments should be getting plans “shovel ready” because this is one policy shift that has an excellent chance of happening. At the same time, let’s be sure we pick wise, strategic investments and budget for the long term.

We must also address the “skills gap” between employers who need trained staff and unemployed workers who need training. We should consider significant tax credits for worker training and even relocation provided directly to companies who need those workers. Just \$10,000 or more would make a real dent for many small business. We should delegate the decisions on who gets what training directly to firms and to workers who know their own needs. Sound expensive? It is. So is the skills gap itself. And a training grant program would be far less costly than President Obama’s most recent “Jobs Act” that proposed spending \$646 billion to create 2.1 million jobs, a proposed cost of \$235,000 per job.

We should also double our investment in science and medical research over the next decade, as Newt Gingrich has proposed. The breakthroughs we could score against cancer and Alzheimer’s alone would likely cover the costs.

Workforce participation and wages

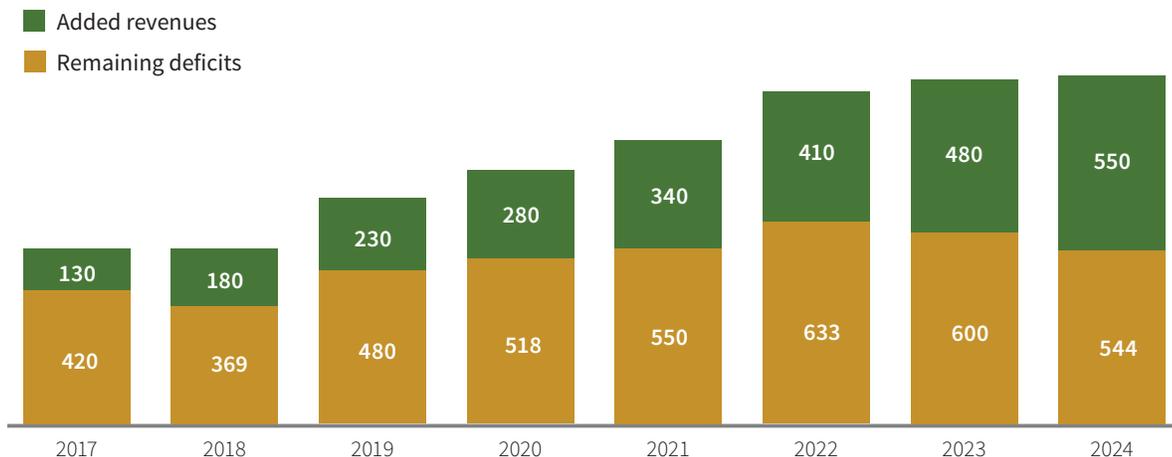
There are practical solutions to many of our workforce issues. To begin with, we need to significantly raise the earned income tax credit. It is a much more efficient alternative to a huge hike in the minimum wage, and much less likely to cause young people to lose opportunities.

Additionally, it is essential that we lighten the payroll tax burden placed on companies that hire American workers or give their workers a raise. We can do this by rebating a large share of any increased FICA taxes that any company pays from one year to the next. After all, those taxes only go up when companies hire more U.S. workers or give their people a pay hike. This is exactly what we want to see happen, and it makes no sense to punish these actions.

Lastly, the wretched rhetoric of the past campaign must be replaced with an effort to pass real immigration reform, especially to accommodate highly skilled and entrepreneurial immigrants. We need the energy, the vision, and the commitment that these talented job-creators bring to our country. And we should all be inspired by the way these people believe in America so much that they’re willing to bet their futures on this great dream we all share.

FIGURE 8

Just 1% more growth could cut future deficits nearly in half



Source: Congressional Budget Office, 2016.

New business formation and tax reform

It's time to move boldly to re-ignite entrepreneurship and to remove capital gains taxes on venture and angel capital, and on initial public offerings. Not all capital gains are created equal — gains scored fueling new business creation are more dynamically valuable to our economy's future than gains from trading existing assets.

There are many good reasons to pare back the overregulation of our capital markets and especially of small and community banks, thousands of which have gone out of business or been absorbed in the past 10 years. This can help to free up capital for investments in start-ups and local companies, and counter the concentration of banking we've seen since Dodd-Frank was adopted.

Above all, we need a new tax code that helps build this nation's future by encouraging and rewarding the following:

- Work itself
- Savings and investment in America
- Family formation and child-rearing
- Education and skill-training for students and workers
- Business development that creates new jobs and spurs innovation

Our reformed tax code should do as much as possible to foster these positive activities and lay as light a burden as possible on the people busy building America's future.

Business men, women, and associations should step up and press the new administration and Congress to act on as broad a growth agenda as possible. The risks posed by slow growth are too serious not to act. As millions more Baby Boomers retire and draw on Social Security and Medicare, the recent decline we've seen in federal deficits will reverse and they will nearly double to over \$1 trillion a year by 2020. However, a 1% increase in GDP growth could have a huge, positive impact on federal revenues, lifting federal tax receipts by \$550 billion a year by 2024, even with no increase in tax rates.

There is no single, silver bullet to score these gains. But I would argue that each of the initiatives is worthy in its own right. Taken together, they would surely push this country in the right direction. Purely as a business proposition, the potential gains from higher growth strike me as too rich not to go for. Economic growth is the single most powerful variable in shaping our future; let's reach for it now. Let's speak out to our political leaders in Washington, ask for their help, and offer them our own.

The 4-Point Plan: Moving on multiple fronts to reboot faster growth



Productivity

- Smart infrastructure investment
 - Worker training tax credits to fill the skills gap
 - Major increases in basic science and NIH research
-



Workforce participation and wages

- Raise the earned income tax credit — far better than raising the minimum wage
 - Rebates to companies that pay more FICA taxes year-on-year
 - Immigration reform for highly skilled and entrepreneurial workers
-



New business formation

- Zero capital gains taxes for new businesses
 - Pare back overregulation of capital markets and community banks
 - Free up capital for investment in start-ups
-



Pro-growth tax reform to incent

- Work
- Savings and investment in America
- Education and skills training
- Entrepreneurship

Conclusion: Betting on America

America's future — our democracy's future — really does depend on us, as citizens and as businessmen and women. We need to support political leaders who appeal to our hopes, not our fears. We have to find, and back, leaders who will seek ways to lift up economic growth and raise working Americans' standard of living from the bottom up. We need to recover the can-do spirit that helped America grow so very well from World War II into the 1980s.

As Americans, we're known for our history of technological and industrial innovation and our willingness to take on big challenges. Americans cured polio, built the transcontinental railroads, walked on the moon, and built the Interstate system and the internet.

When Americans work together, we're stronger, and I also believe that together, we can — and we will — restore the levels of growth and productivity America was built on.

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