

Structural Changes of the U.S. Economy: Implications for the U.S. Mid- to Long-Term Growth Path and the Korean Economy

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The outcome of the recent U.S. presidential election came as a surprise to the world economy. President Trump has tried to set his own policy agenda, including a trade policy based on protectionism. These actions are leading to great changes in world economic conditions, including trade conditions. Beyond the changes in U.S. policy agenda, the U.S. economy is also undergoing long-term structural changes such as aging. Under these circumstances, a natural question arises: How are we to follow the U.S.'s medium- and long-term growth? The purpose of this study is to present an analysis of long-term structural changes in the U.S. economy and to examine their implications on U.S. economic recovery after the financial crisis and mid- to long-term growth in Korea.

I. The current status of the U.S. economy

As shown in various data, during the 2008-2009 financial crisis period, the real GDP of each country recovered slowly after a sharp decline, but is recovering differently in each country. In the case of the United States, it

shows a rapid recovery compared to Japan and Europe. One thing to keep in mind is that the recovery rate from the financial crisis period until 2011 is not much different among the U.S., Japan and Europe, but the recovery of Europe and Japan has stagnated since 2011. As a result, in the U.S., GDP in the first quarter of 2015 is about 10% higher than in the first quarter of 2007, but in Japan and Europe, GDP in the first quarter of 2015 is only about 1-2% higher than the first quarter of 2007. On the back of this recovery, the U.S. is trying to normalize its monetary policy by moving away from a zero interest rate. However, other developed countries such as Japan and Europe are still trying to stimulate the economy through easing monetary policies such as quantitative easing.

Despite the rapid recovery compared to other developed countries, there are still many people who harbor doubts regarding the mid- to long-term growth path of the U.S. economy. In the mid-to-long term, the growth potential of the U.S. is limited to the mid-1% range, and renowned economists such as Larry Summers and Paul Krugman are questioning the U.S.'s long-term growth by insisting on its secular stagnation. Their analysis suggests that the

United States' mid- to long-term growth prospects are not so bright due to U.S. structural problems such as its aging population and low productivity.

The U.S. mid- to long-term growth path will have a crucial impact on the future growth of the global economy in light of the U.S. weighting in the global economy. Especially, in the case of Korea, export is still a large part of the economy and the mid- to long-term growth of the global economy accounts for a large portion of Korea's mid- to long-term growth. Aside from this, the United States is the second largest export destination of Korea after China, and it is highly likely that U.S. economic growth will directly affect Korea. In addition, the rapid recovery of the United States relative to other advanced countries after the financial crisis is highly suggestive of Korea's growth and economic deregulation policies. Korea has been experiencing a steady decline in growth rate since the financial crisis, and its potential growth rate has also been falling. In this situation, it is important to find a way to accelerate economic recovery through benchmarking of U.S. growth policies.

II. Evaluation of U.S. long-term growth path

We use the growth accounting method to diagnose whether the U.S. will grow in the medium-to-long term. Growth accounting is a method for analyzing the effects of supply side factors such as labor supply, total factor productivity, and labor quality on mid- and long-term growth, and is particularly appropriate for analyzing the impact of trend growth decline. The results of the analysis are as follows. According to labor supply factors, such as the degree of population aging, the quality

of education and productivity, the U.S. economic potential growth rate is found to range from 1.4% to 2.9% on average by 2060 unless the effects of the aging of its population are reduced or there is a rapid increase in productivity due to the recent 4th industrial revolution. Especially, in the case of population aging, the average annual growth rate is reduced by about 0.17%p.

III. Background of U.S. recovery after the financial crisis

In spite of the not-so-great mid- to long-term growth path of the U.S., why is the U.S. recovering faster than other developed countries after the financial crisis? One important reason is active monetary and fiscal policy. During the financial crisis, the U.S. Fed cut its policy rate to zero and conducted quantitative easing. Furthermore, the American Recovery and Reinvestment Act (ARRA) was enacted by the Obama administration to carry out a huge-scale fiscal stimulus package to boost the economy. In addition to these monetary and fiscal policies, supply side policies such as R&D investment played an important role to support the fast recovery. Based on the macro-economic model that we build, we examined the impact of the decline in trend growth on the economic recovery and searched for the reasons of the rapid recovery of the U.S. Productivity is recovering faster in the U.S. than other countries after the financial crisis. The results of the model analysis show that the recovery of productivity reduces the decline of trend growth, and this better trend growth is positive for current consumption and investment as it improves expectations for future income increase. This rapid U.S. productivity recovery can be attributed to the large-scale

national R&D initiated during and after the financial crisis. In addition, continuous policy implementation is important when attempting to increase the aggregate demand through the management of trend growth or fiscal policy through investment of national R&D. If these policies are suspended or canceled in the middle, it is likely this will have a huge negative impact on the economic recovery.

IV. U.S mid- to long- term growth and its policy implications for Korea

The policy implications suggested in this paper can be divided into two major categories. The first is about the establishment of foreign policy based on the mid- to long-term growth of the United States. The second is about the establishment of Korea's growth policy, which is based on the fast recovery speed of the U.S. First, the implications for the mid- to long-term foreign policy are as follows. The U.S. is Korea's second largest export market and has a large impact on the global economy. The Korean economy is still highly dependent on exports. Considering this point, we need to diversify our export markets, increase export unit price through development of high value-added products, and develop core goods that are less affected by economic fluctuations. Also, it is necessary to reduce the export dependency of the Korean economy through revitalization of the domestic market. Those policies could also possibly mitigate the adverse effects caused by recent protectionist actions by the U.S.

In addition, Korea's mid- to long-term growth strategy suggestions are as follows. As a result of supply side analyzing of the growth rate of

Korea, the recent decline in growth rate is caused by productivity decline, decrease of capital accumulation, and low contribution of labor supply. Therefore, it is necessary to implement investment promotion policies similar to productivity improvement and innovation-related policies actively promoted by the Obama administration. In addition, the low contribution of labor supply to GDP, despite the long working hours among the OECD countries, is an urgent task to be solved.

Finally, the implications for national R&D policy for mid- to long-term growth are as follows. Korea's R&D spending is quantitatively the top among OECD countries. However, the uncertainty of its R&D spending is much higher than in the U.S. Uncertainty as a result of increased volatility in R&D expenditure may result in lower efficiency of R&D spending by hindering stable research. In the U.S., efforts are being made to secure the permanence of R&D by enacting the Protecting Americans from Tax Hikes (PATH) Act of 2015. In Korea, it will be important to benchmark such a system to ensure the sustainability of R&D investment and raise efficiency. **KIEP**