Economic growth is no longer enough

By Manuel Muñiz

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As new technologies subject the world's economies to massive structural change, wages are no longer playing the central redistributive role they once did. Unless the decoupling of productivity and wages is addressed, the political convulsions many countries are experiencing will only intensify.

Macroeconomic data from the world's advanced economies can be mystifying when viewed in isolation. But when analyzed collectively, the data reveal a troubling truth: without changes to how wealth is generated and distributed, the political convulsions that have swept the

Consider, for example, wages and employment. In the United States and many European countries, average salaries have stagnated, despite most economies having recovered from the 2008 financial crisis in terms of GDP and job growth.

Moreover, increases in employment have not led to a slowdown or a reversal of the decline in the wage share of total national income. On the contrary, most of the wealth created since the 2008 crisis has gone to the rich. This might explain the low levels of consumption that characterize most advanced economies, and the failure of extremely lax monetary policy to produce an uptick in inflation.

Employment, too, seems to be performing in anomalous ways. Job creation, where it has taken place, has followed a different path than history suggests it should. For example, most employment growth has been in high-skill or low-skill occupations, hollowing out the middle. Many of the people who once comprised the Western middle class are now part of the middle-lower and lower classes, and live more economically precarious lives than ever before.

Productivity growth has also become polarized. According to the OECD, in the last decade, productivity within "frontier firms" – defined as the top 5% of firms in terms of productivity growth – increased by more than a third, whereas the rest of the private sector experienced almost no productivity growth at all. In other words, a smaller number of companies have made greater efficiency gains, but there has been relatively no diffusion of these benefits into the broader economy.

It is unclear why these trends are occurring, although the impact of new technologies and related network effects is certainly part of the reason.

At the macro level, aggregate US productivity has increased by more than 250% since the early 1970s, while hourly wages have remained stagnant. This means that productivity growth has not only been concentrated within a narrow set of firms, but also that productivity and market labor income have decoupled. The fundamental consequence of this is that wages are no longer performing the central redistributive role they have played for decades. Simply put, gains in capital productivity are not being translated into higher median incomes, a breach of the social contract on which liberal economies rest.

It should be evident by now that many of the world's economies are undergoing some form of structural change, and in the wake of that change, the "jobs-productivity-income" distribution triangle has gone askew. This paradigm shift has led to the erosion of the Western middle class and the rise of the *precariat*, a new socioeconomic class comprising not just those who cannot find a job, but also those who are informally, casually, or otherwise insecurely employed.

We now have abundant evidence linking the perception of economic insecurity in the West with anti-elite sentiment, political radicalization, and attacks on minorities. It is impossible to explain the recent rise of populist politics without considering the effects of these economic pathologies on average workers in the US and Europe.

To understand why the deviations from expected economic trajectories have occurred, one need look no further than the impact of technology on jobs. Advanced technologies, particularly advanced computing and robotics, have enabled productivity gains to occur without a corresponding increase in wages. The greater wealth generated by higher productivity goes instead to the owners of these technologies.

Automation of fairly sophisticated routine jobs is driving the polarization of the labor market. What remains are either hard-to-automate tasks that require little or no skill, or hard-to-automate tasks that require very high skills. The latter jobs are much smaller in number than the former, and they happen to be in frontier firms that are leveraging the effects of technology to outperform direct competitors, and to expand into new markets.

This brings us to the central question of our era: How can leaders address the externalities produced by rapid technological change, and thereby ensure economic and political sustainability? Put another way, how can we construct a new social contract for the digital age?

Remedies are harder to come by than diagnoses. It is unclear, for example, if applying old economic treatments would reverse current trends. Pushing "structural reforms" and designing narrow macroeconomic policies aimed exclusively at increasing productivity might force Western workers to compete with technology to an even greater extent, exacerbating precariousness. Perhaps our current economic arrangements can produce growth only at the aggregate level, while driving down most people's living standards.

The debate about solutions has only just begun. Reducing economic inequality will require reforms of education and taxation, with the tax burden shifting decisively from labor to capital. Western countries will also need to create new redistributive mechanisms to supplement the declining role of wages in their economies.

The data make an overwhelming case for such reforms. If Western leaders are to contain, and ultimately quell, the political convulsions that their countries are now experiencing, they have no choice but to respond by crafting new, inclusive growth models.

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