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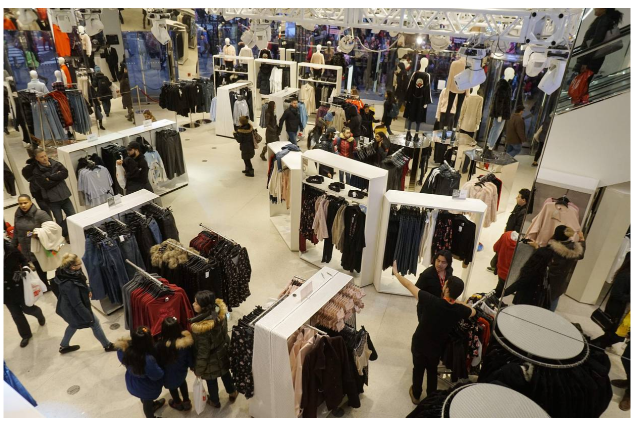
ECONOMY | THE OUTLOOK

Economists Stick With Long View for Slower U.S. Growth Despite Recent Uptick

Tax cuts may spur investment and spending, but not enough to upend projections for output growth to ease from past decades



Christmas shoppers packed a store in New York in December. The U.S. economy picked up pace last year, but economists aren't budging much from their projections that growth will slow from its historical average in the years ahead. PHOTO: RICHARD B. LEVINE/ZUMA PRESS

By Ben Leubsdorf

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U.S. economic growth picked up last year and that could continue into 2018 if tax cuts enacted into law last month spur business investment and consumer spending, as many forecasters expect.

But economists who study the long-run outlook—many of whom were gathered this weekend for the annual meeting of the American Economic Association—aren't budging much from their projections that output growth will remain far slower than its historical average in the years ahead.

The economy grew at a 3.1% annual pace in the second quarter and a 3.2% annual rate in the third quarter, according to the Commerce Department. That was well above the postrecession pace of near 2%.

The government will release official numbers for the fourth quarter on Jan. 26. Most see the economy again outperforming the expansion average, but perhaps not as much as in earlier months. The Federal Reserve Bank of Atlanta estimates a 2.7% growth rate in the final three months of 2017, while forecasters at Macroeconomic Advisers project a 2.3% pace.

"This is not enough to establish a new trend, by any means," Harvard University economist Dale Jorgenson said.

It wouldn't be the first time in recent years that growth accelerated for a time before easing again; output grew at impressive annual rates of 4.6% and 5.2% in back-to-back quarters during 2014 before settling back into a subdued pace.

The tax-code changes enacted by Congress in December could boost growth for the next couple of years, Mr. Jorgenson said. That leaves the longer-term outlook "maybe a bit more optimistic than you were before we got two good quarters and the tax cut, but not in the range of 3%," Mr. Jorgenson said.

Taxes and the outlook were hot topics in icy Philadelphia this weekend during the AEA annual conference.

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Kevin Hassett, chairman of the White House Council of Economic Advisers, noted during a Saturday presentation that professional forecasters have been revising up estimates for near-term U.S. growth, consistent with an improving outlook tied to lower taxes.

Other economists in Philadelphia were skeptical the tax cuts will produce a meaningful boost.

Historically, "tax cuts aimed at the top of the income distribution have had very little stimulus effect," said University of Chicago economist Austan Goolsbee, who had Mr. Hassett's job during the Obama administration.

Glenn Hubbard, dean of the Columbia Business School and former top White House economist under President George W. Bush, said the legislation isn't as worrisome as critics suggest, nor as positive as advocates claim. "It's not going to raise us off to 4% GDP growth," Mr. Hubbard said. "But it's not going to kill 10,000 people a year."

In the long run, economists believe the economy's maximum sustainable growth rate is determined by two forces: how many people are working, and how productive they are.

Annual growth in inflation-adjusted potential output averaged 3.2% between 1950 and 2016, according to estimates from the nonpartisan Congressional Budget Office. But many forecasters think those days are gone.

Demographics are set to hold down workforce participation as baby boomers retire. Meantime productivity growth in the U.S. has sagged since an information technology-fueled surge in the late 1990s and early 2000s. Tax cuts could spur productivity by incentivizing business investment in new equipment, but the effects are uncertain.

The CBO last summer estimated potential gross domestic product growth would average 1.8% over the ensuing decade. Estimates by Federal Reserve officials in December for longer-run GDP growth ranged from 1.7% to 2.2%, with a median projection of 1.8%. Private-sector economists surveyed by The Wall Street Journal last month had an average longer-run GDP forecast of 2.2% a year.

To be sure, economists have been wrong about the shifting long-run outlook before. They largely failed to predict the productivity pickup in the 1990s and the subsequent slowdown last decade.

Massachusetts Institute of Technology economist Erik Brynjolfsson said the current consensus about growth is too pessimistic, but not because of anything happening in Washington. Instead, he said the adoption of machine learning and artificial intelligence technologies will boost productivity and transform the economy, much as the adoption of electricity did in the past.

He thinks the U.S. is now seeing the early stages of a sustained pickup in economic growth.

“No doubt there’ll be ups and downs, and I’m not someone who tries to predict quarterly growth,” Mr. Brynjolfsson said. “But when I look at the longer trend, I’m optimistic.”

Northwestern University economist Robert Gordon said the U.S. is due for a pickup of long-depressed productivity growth that will help the economy maintain growth around 3% a year—but only for a year and a half, perhaps two years. He said that wouldn’t change his thinking about the subdued underlying trend.

With the jobless rate at 4.1% in December, his thinking goes, the economy can’t sustain above-trend growth indefinitely.

“That potential growth ceiling on growth will eventually start to bite as we run out of workers,” Mr. Gordon said.

Federal Reserve Bank of San Francisco economist John Fernald said at a panel in Philadelphia that the slower-than-usual recovery from the 2007-09 recession reflected broad trends that were under way before the downturn —and may not dissipate.

“The headwinds to a substantial pickup in growth are fierce,” he said.

Write to Ben Leubsdorf at ben.leubsdorf@wsj.com

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