

America's extraordinary economy keeps defying the pessimists

Both Donald Trump and Joe Biden have ideas that
endanger it



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You have to marvel at America's economy. Not long ago it was widely thought to be on the brink of recession. Instead it ended 2023 nearly 3% larger than 12 months earlier, having enjoyed one of the boomier years of the century so far. And it continues to defy expectations. At the start of this year, economists had been forecasting annualised growth in the first quarter of 1%; that prediction has since doubled. The labour market is in rude health, too. The unemployment rate has been below 4% for 25 consecutive months, the longest such spell in over 50 years. No wonder Uncle Sam is putting the rest of the world to shame. Since the end

of 2019 the economy has grown by nearly 8% in real terms, more than twice as fast as the euro zone's and ten times as quickly as Japan's. Britain's has barely grown at all.

America's expansion is all the more striking when you consider the many things that could have killed it. As the Federal Reserve has fought inflation the economy has endured the sharpest rise in interest rates since Jimmy Carter was in the White House. The covid-19 pandemic, an intensifying trade war with China and the fight against climate change have together reshaped supply chains, labour markets and consumer preferences. Wars in Ukraine and Gaza have aggravated geopolitical tensions and worsened the strains on the global trading system.

Can America's remarkable strength persist? Threats to growth still hang over the economy. The longer interest rates stay high, for instance, the more damage they could do. Although inflation has fallen, it remains sticky above the Fed's 2% target, meaning that the Fed may be unable to fulfil investors' hopes for interest-rate cuts starting in June. Geopolitical tensions, meanwhile, look likely to spur economic fragmentation. Yet the biggest threat of all stems from November's presidential election. Neither Joe Biden nor Donald Trump seems likely to nurture the economic expansion should they return to the White House. Instead, their plans would endanger it.

To understand this, consider the reasons for the economy's extraordinary performance. A key plank was generous pandemic stimulus, which at 26% of gdp was more than double the rich-world average. This largesse fuelled inflation but also ensured fast growth: consumers have yet to spend all the cash they received in "stimmy" cheques. Even as the covid crisis passed, the government continued to borrow away. The underlying deficit over the past year was nearly 8% of gdp. That supported demand even as rates went up.

Strong demand has been met by growing supply. America has 4% more workers than it did at the end of 2019, thanks in part to rising workforce participation, but mainly owing to higher immigration. The foreign-born population is up by 4.4m, a figure which may undercount those who arrived illegally. And the expanding workforce is being put to productive use. America's flexible labour market has almost certainly made it easier for the economy to adapt fast to a changing world.

Other long-standing strengths have made America enviably placed to cope with geopolitical tumult. Its vast internal market encourages innovation and means it depends less on foreign trade than smaller rich economies do. Because the shale boom of the 2010s made America a net energy exporter, it has in aggregate benefited rather than suffered from the high energy prices that hit the wallets of Europeans.

The trouble is that each of the ingredients for growth can no longer be relied upon. It may be tempting for politicians to extrapolate from America's recent success and juice the economy with further stimulus. But that is becoming unsustainable. Official forecasts show that America will this year spend more on debt interest than national defence. More borrowing risks building up financial perils in the future.

At the same time, both Mr Trump and Mr Biden harbour populist and protectionist instincts that will only harm America's growth potential. The sugar-rush of stimulus helped mask the damaging effects of such policies during each president's first term. This time, however, the damage will not be disguised.

Mr Trump poses the graver threat. He has entertained a blanket 10% tariff on imports, which some of his advisers see as a mere starting-point. That would triple America's existing levies on goods imports, worsen inflation and raise the cost of imported parts for manufacturers. At the same time, Mr Trump has promised the mass deportation of illegal immigrants. This goes well beyond trying to secure the border against new unauthorised entrants—a reasonable goal—and poses a risk to the labour supply: in 2021 America's 10.5m irregular migrants made up an estimated 5% of its workforce.

A Trump presidency would also threaten the Fed's independence. Mr Trump says he would not reappoint its chairman, Jerome Powell, whose term expires in 2026, and whom he often criticised when in office. A pliant Fed at a time of big deficits—which Mr Trump might increase with more tax cuts—could threaten America's macroeconomic stability.

A second Biden term promises nothing as potentially catastrophic. Mr Biden has let the Fed get on with fighting inflation, and wants to raise taxes to reduce deficits. Yet he is also an economic nationalist. His State of the Union address on March 7th was littered with protectionist promises

that the government would “Buy American”, and statist ideas about controlling the price of everything from housing to Snickers bars.

Muscle memory

Both Mr Biden and Mr Trump harbour a misplaced nostalgia for the 1950s and '60s, and justify their policies by painting today's economy as weaker than it is. Mr Trump thinks trade and immigration have made the country poorer; Mr Biden is deeply distrustful of big business. And where they do acknowledge America's strengths, both men attribute it to their own misguided interventionism. In fact, they are chipping away at the free markets which are the ultimate source of the country's wealth.

The truth is America has thrived as its companies and workers have innovated and adapted to a rapidly changing world. If the next president does not recognise that, America's pumped-up economy will eventually deflate. ■

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