TIAA-CREF Institute

Observations on the Macroeconomy and Higher Education

Summary of Presentation by
Peter Orszag, Citigroup, Inc.

About this Work

The U.S. economy is in a far better position than that of many other nations, but U.S. economic growth is being hindered by a number of factors, including slower growth abroad and political polarization at home. To help inform campus leaders about the direction of the U.S. economy, Peter Orszag, former director of the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) in the Obama administration, spoke about the macroeconomy at the Forum for the Future of Higher Education's 2015 Aspen Symposium. He detailed the negative effects of income inequality, and noted that constraining the rate of growth of healthcare costs will improve the United States' fiscal trajectory and enable investment in higher education, which in turn would beget more equal opportunity.

TIAA-CREF is a long-time partner of the Forum for the Future of Higher Education, and supports the Forum's annual Aspen symposia as well as its collaborations with the Council on Foreign Relations and the Brookings Institution.

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Executive Summary

Economic recovery and growth in the United States since the 2007-08 financial crisis has been slow and subdued, and the high growth rates in emerging and developing markets, most notably China, have slowed significantly over the past several years. At the Forum for the Future of Higher Education's 2015 Aspen Symposium, Peter Orszag, vice chairman of Corporate and Investment Banking and chairman of the Financial Strategy and Solutions Group at Citigroup, Inc., described the forces and trends holding back growth in the United States and elsewhere. He also noted a few positive trends, particularly the decline in the growth rate of U.S. healthcare costs. Orszag discussed ramifications of these trends for higher education, individuals, and American society.

Key Take-Aways

- Economic growth in the developing world is slowing, but continues at a far more rapid pace—about 5 to 7%—than in the developed world, where countries are growing at roughly zero to 3%.
- The U.S. economy is growing at a moderate pace and is in a better position than Europe or Japan. But while the United States is not still in crisis mode, its rather subdued growth has been persistent.
- State and local governments didn't boost spending during the most recent recovery as they typically have in earlier recoveries, which accounts for a roughly one-half percent per year decline in the U.S. growth rate.
- The United States also hurt itself unnecessarily by creating a significant amount of economic policy uncertainty. Political debacles over the debt ceiling and whether to extend tax cuts fed the uncertainty, which is harmful to economic growth.
- On the positive side, the shale revolution, allowing the United States to replace imported oil with domestic production, has had the effect of a tax cut for Americans as lower prices have significantly increased household disposable income.
- Further, estimates of exploding U.S. debt have been revised dramatically downward, primarily because projections for Medicare and Medicaid costs have been lowered substantially, year after year.
- However, political polarization has serious consequences for U.S. economic growth, as it makes it extremely difficult to govern and to adopt the kinds of policies needed to stimulate long-term economic growth.
- It has long been the case that higher income, better educated people live longer than lower-income, less educated people. What hasn't received enough attention is that the mortality gap between the two groups is rapidly increasing. Education itself may be a driving factor in the increase in life expectancy.
- Constraining healthcare costs will improve the United States' fiscal trajectory and enable investment in higher education, which begets more equal opportunity and improves individuals' lives as well as our society at large.

U.S. Economic Growth

Orszag prefaced his remarks by noting that the most important thing to realize when one is projecting an economic outlook is that it is incredibly uncertain. He called the tendency to focus too much on specific growth numbers an "illusion of certainty" and shifted instead to an in-depth review of underlying trends to assess their potential effects on future growth.

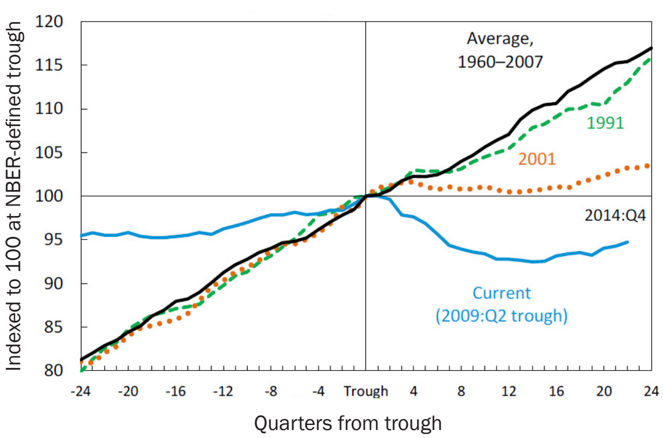
First, while the economic growth rate in the developing world is slowing, it continues to grow at a far more rapid pace—about 5 to 7%—than the developed world, where countries are growing at roughly zero to 3%. Orszag expects that differential to remain for the foreseeable future. There are significant differences within the advanced economies, however: The United States, for example, is growing at a moderate pace and is in a better position than Europe or Japan. But while the United States is not still in crisis mode, its rather subdued economic growth has been persistent.

Factors Affecting the U.S. Economic Growth Rate

Household net worth in the United States has been recovering and has begun to approach pre-crisis levels, and household debt-to-income ratios have reached pre-crisis levels. These factors open up the possibility for the growth rate to pick up. But those are not the only forces that have been holding back growth. Local, state and federal policies and spending are responsible too: In Figure 1 below, the black line shows the typical path of state and local spending following an economic downturn. The blue line, at the bottom, shows what happened during the current cycle. That difference accounts for roughly a half percent per year in growth that didn't happen in the United States because state and local governments didn't boost their spending as they typically did in previous recoveries. Given that, 2.5% growth could have been 3%, for example.

Figure 1

Real State and Local Government Purchases During Recoveries



Source: https://www.whitehouse.gov/sites/default/files/docs/20150310_questions_and_answers_nabe.pdf

Orszag noted that the United States also hurt itself unnecessarily by creating economic policy uncertainty. Several political debacles over the debt limit and whether or not to extend tax cuts fed the uncertainty, which is harmful to economic growth. Federal fiscal policy, too, was more controversial than it should have been. Orszag praised the 2009 federal stimulus package but said in retrospect it was a policy error to have it focused on just 18 months as opposed to for several years, as needed.

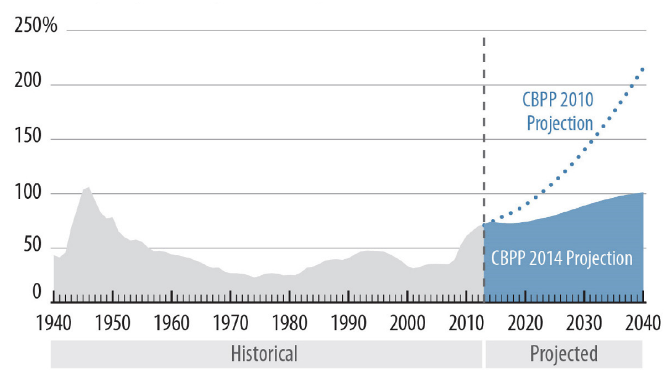
On the positive side, a few developments bode well for economic growth. Orszag said that the shale revolution, allowing the United States to replace imported oil with domestic production, has effectively been a huge tax cut for Americans as lower prices have significantly increased household disposable income.

Another major positive factor is the projected trajectory of the U.S. debt-to-GDP ratio. Figure 2 shows a 2010 projection by the nonpartisan Center on Budget and Policy Priorities (CBPP)—the kind of projection that led to alarming press in *The New York Times* and the *Wall Steet Journal*—showing exploding debt that in 2040 would be more than 200% of GDP. The CBPP 2014 projection, on the other hand, is very different.

Figure 2

Debt-to-GDP Ratio Virtually Flat Until Early 2020s, Then Rises Gradually

Debt held by the public as a percent of GDP, 1940–2040



Source: Historical data from the Office of Management and Budget; projections from CBPP based on Congressional Budget Office, Joint Committee on Taxation, and Social Security and Medicare Trustees data. http://www.cbpp.org/blog/our-new-long-term-budget-projections

The primary reason for this massive change is that projections for Medicare and Medicaid costs have been knocked down substantially, year after year. The biggest driver of the U.S. long-term debt is the rate of growth of healthcare spending per person. So, if you're worried about the debt, Orszag advised, then focus on the things that will help constrain the debt, namely, healthcare costs. If our national security depends on debt as some believe it does, and our debt basically depends on healthcare costs, then, Orszag said, it's ironic that our national security fundamentally depends on the rate of growth of healthcare costs.

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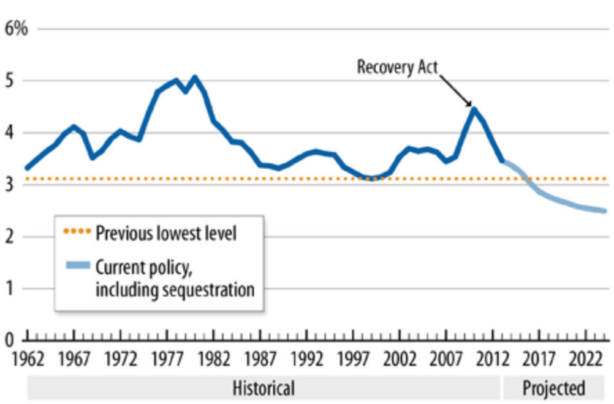
Despite improvement in the long-term fiscal outlook, both parties in Washington have signed on to deep cuts in the non-defense discretionary part of the federal budget. Figure 3 shows that unless some of the budget commitments are unwound, such spending will be far lower than the lowest level we've seen since the data began in the 1960s. Funding for higher education, NSF, NIH, research and development—all come from this part of the budget. Orszag warned that we are headed toward serious damage to many programs that matter to the future of the American economy and higher education.

Figure 3

The Context: Tighter Budget Constraints

Non-Defense Discretionary Spending as a Percent of GDP, 1962–2024



Source: Center on Budget an Policy Priorities based on Office Management and Budget and Congressional Budget Office data. http://www.cbpp.org/non-defense-discretionary-spending-falling-to-historic-lows

Potential Economic Growth Rates

Orszag noted stagnant U.S. growth rates, and wondered why the United States hasn't been able to get back to the kinds of growth rates it has seen historically. One big reason, he said, is that the U.S. workforce is growing at a much slower rate today than it has historically. Between 1960 and 2007, the prime-age workforce grew at about 1.6 to 1.7%. Today it's growing near zero, at about .1 or .2%. That's a 1.5% reduction in the growth of the workforce, which typically increases in productivity can't overcome. Similarly, the share of the population that has a job has declined for a number of reasons, including the aging of the population, but as a result of economic conditions as well. Further, recent data show that workers are less mobile across state lines than previously thought.

Putting all this together, Orszag said that is entirely plausible that the potential growth rate of the U.S. economy is under 2%. Indeed, a well-respected forecaster recently put the number at 1.75%, although official forecasts are higher than that [as of June 2015]. The point is, though, that the U.S. is nowhere near historical growth rates of 3.5 to 4%. And that's mostly due to demographics.

China's Growth Rate and Demographics

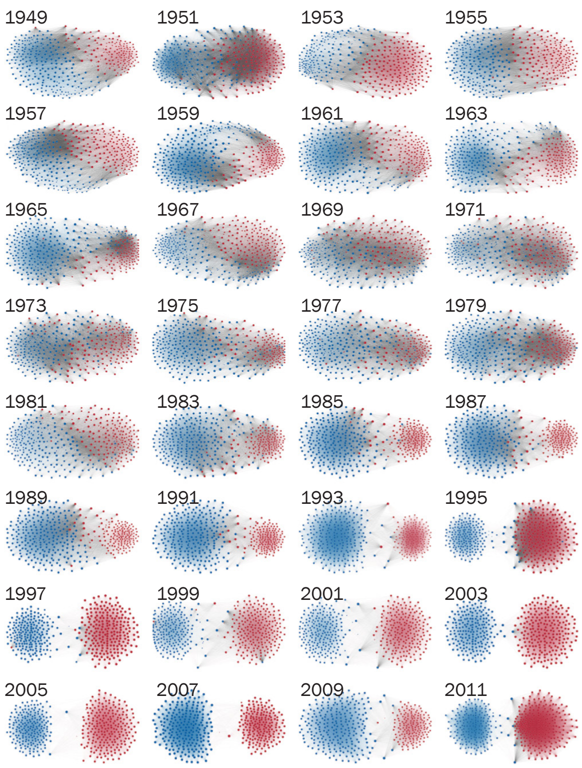
Demographics and movement of people also explain much of the decline in growth in China. For the past 20-30 years, China has benefitted dramatically as workers shifted from rural agriculture to manufacturing in coastal cities. Workers in manufacturing were six times more productive than the agricultural workers. But that productivity trend may have run its course (as predicted by economic theory). Further, the population is aging out of the workforce; the loosening of the one-child policy will help in that regard, but not for decades. And finally, empirical evidence across countries suggests that countries tend to revert to the mean: that is, simply, if an economy has been growing rapidly, it is more likely to grow more slowly in the future. Conversely, too, countries that have been growing very slowly over time tend to pick up steam.

Political Polarization

Another highly consequential development affecting U.S. economic growth is the polarization of our political system. Figure 4 illustrates the polarization of Congress over the past 65 years. It was created by matching each member of Congress with every other member and checking when they voted together. Then each member of Congress's dot—blue for Democrats, red for Republicans—was mathematically placed to locate it with the people they vote with. Thus, members who rarely vote the same are far apart and those in the same place always vote together.

Figure 4

Division of Democrat and Republican Party Members over Time



Source: http://journals.plos.org/plosone/article?id=10.1371/journal.pone.0123507

Given the current two, separate colored patches, Orszag said that it is no surprise that it is extremely difficult to govern and adopt the kinds of policies needed to stimulate long-term economic growth.

Gerrymandering is a common explanation for the polarization, but political scientists agree that that explains only about 10 to 20% of what's happened. The question is whether we, the people, are polarizing ourselves—and, indeed, that may well be the case. For example, the probability that you live in a county that votes 20 percentage points or more in one direction in a presidential election has more than doubled since the 1970s. We are surrounding ourselves with like-minded people from a political perspective. And given how we can now control our news feeds, we can readily shut out views that don't mesh with our own. Trying to govern a deeply divided society with a deeply divided government is proving to be painfully difficult.

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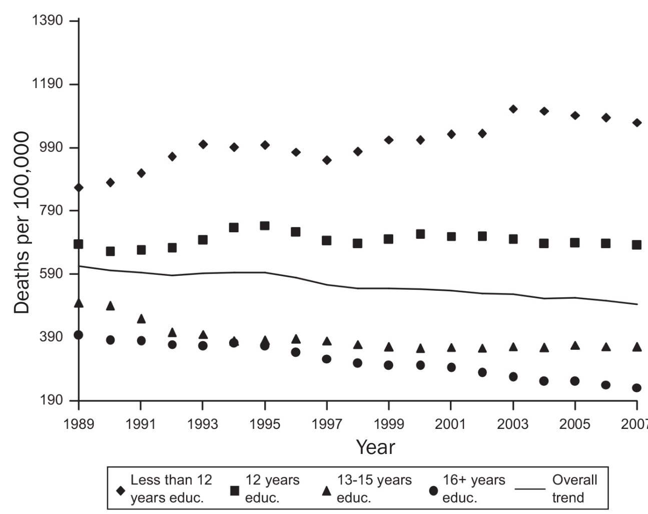
Unequal Opportunity

It has long been the case that higher-income, better-educated people live longer than lower-income, less-educated people. But what hasn't received enough attention, Orszag noted, is that the gap between the two groups is rapidly increasing: At the top of the income distribution, life expectancy is rising rapidly; at the bottom, it's either falling or rising very slowly. The same picture emerges when analysis is based on education rather than income. Figure 5 shows that mortality rates for college-educated people are falling steadily, and that for less-educated people, the rates remain higher and relatively stable.

Figure 5

Trends in U.S. Mortality Levels by Education for Individuals Age 40 to 64 Years, 1989 to 2007



This correlation is undoubtedly partly causal—that is, education itself appears to be driving part of the increase in life expectancy. That may be the result of higher incomes and access to better health care, as well as not being subject to the persistent stress that can affect the lives of low- and moderate-income workers. Much evidence suggests a strong correlation between stress and health outcomes, and there is a troubling strong correlation, too, between low income and feelings of worthlessness, hopelessness and sadness, which feeds back to health outcomes.

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Falling mortality rates have consequences for the costs of programs such as Medicare and Social Security. And as higher-income, better-educated people live longer and receive more lifetime benefits, the progressivity of Social Security declines.

One of the most damning indictments of opportunity in the United States, according to Orszag, is the fact that the smartest kids—with 8th grade test scores in the top 25%—in the lowest-income quartile complete college only at the same rate as the richest kids, from the top-income quartile, whose 8th grade test scores are in the lowest 25%. That simply shouldn't happen in a country that aims to have equality of opportunity.

Finally, Orszag discussed where the vast majority of low-income students go to college: that is, to public colleges and universities. Yet spending per student at public institutions has declined significantly relative to spending in the private sector, where a far higher proportion of higher-income students enroll. Again Orszag circled back to healthcare costs, noting that Medicaid has crowded out appropriations for higher education in state budgets and, consequently, led to a decline in the quality of public education. Today, just one public institution, UC-Berkeley, is ranked in the top 20 universities in *US News & World Report*.

Orszag concluded by reemphasizing the need to constrain healthcare costs to improve the United States' fiscal trajectory, national security, and to enable investment in public higher education.

Links of Interest

Thomas J. Kane and Peter R. Orszag, "Higher Education Spending: The Role of Medicaid and the Business Cycle," Brookings Institution Policy Brief #124, Sept. 2003, http://www.brookings.edu/research/papers/2003/09/useconomics-kane.

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Dana P. Goldman and Peter R. Orszag, 2014. The Growing Gap in Life Expectancy: Using the Future Elderly Model to Estimate Implications for Social Security and Medicare. *American Economic Review* 104(5): 230-233. https://www.aeaweb.org/articles.php?doi=10.1257/aer.104.5.230

About Peter Orszag

Peter Orszag is vice chairman of Corporate and Investment Banking and chair of the Financial Strategy and Solutions Group at Citigroup, Inc. He is also a contributing columnist at Bloomberg View, a Distinguished Scholar at the NYU School of Law, and an Adjunct Senior Fellow at the Council on Foreign Relations. He previously served as director of the Congressional Budget Office (CBO) and as director of the Office of Management and Budget (OMB) in the Obama administration. Orszag earned his AB in economics at Princeton University and his Ph.D. in economics at the London School of Economics, where he was a Marshall Scholar.