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Edited by David Leonhardt

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Why Is the Economy Still Weak? Blame These Five Sectors

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Neil Irwin

@Neil_Irwin

The economy keeps underperforming. Yes, new G.D.P. data last week were better than expected. But the United States is still producing around $800 billion a year less in goods and services than it would if the economy were at full health, and as a result millions of people aren't working who would be if conditions were better.

But why? Where is this gap coming from? To get at an answer, we needed a more basic question: What would the economy look like right now if it were fully healthy, and how is the actual reality of the economy right now different from that?

We started by examining how large a proportion of G.D.P. that various sectors have accounted for historically — over the two decades ending in 2013, to be precise. (Initially, we looked at the full history of G.D.P. data, going back to 1947, but the economy was sufficiently different in the immediate postwar period compared with today that it seemed more sensible to limit it to more recent history.)

Then we multiplied those percentages by the Congressional Budget Office's estimate of what the United States' potential output was in the second quarter of

this year. That gives us a sense of what output "should" be in each sector if we had a healthy economy and those historical proportions held.

As it turns, six of 11 sectors we analyzed are doing fine, with output that is either stronger than or not too much worse than our model predicts. For example, consumer spending on services is exceeding the projection by $63 billion, with spending on nondurable goods undershooting by $74 billion. (Those numbers, like others contained in this analysis, are annualized). Business spending on intellectual property is a bit stronger than you would expect in a healthy recovery, spending on buildings a bit weaker. Trade is holding its own.

The following, however, are the five pieces that are the major culprits in the nation's economic malaise, each vastly undershooting what they would look like in our model of a healthy economy: residential investment; consumption of durable goods; state and local government spending; business investment in equipment; and federal government spending.

Together their deficit adds up to $845 billion — in other words, if those sectors returned to their typical share of economic potential, the economy wouldn't just be doing well, it would be in an outright boom.

Let's take these five factors in failure one by one.

Housing is the biggest and least surprising, accounting for $239 billion in missing economic output. We examined this sector's continued underperformance earlier in the year, but the short version is this: Even years after the housing bust, the United States is building far fewer houses than would be expected given demographic trends. It may be that a broader shift is underway in the desire and ability of young adults to get homes of their own. Regardless, it is holding back construction and home sales activity.

State and local governments spent the years after the crisis cutting employees and trimming costs. The result: a $189 billion gap between what they were actually spending this spring versus what would be expected based on their historical share of the economy.

Durable goods consumption is $178 billion lower than it would be in our model of a fully healthy economy. This is most likely related to the same factors holding back housing. People aren't buying cars, furniture and other big-ticket items as past patterns would suggest, perhaps related to the overhang of debt from the boom years.

Business equipment investment has been another weak spot, with corporate America spending $120 billion less than the healthy economy model

would suggest. It suggests a continued lack of faith among executives about future demand.

Federal government spending is $118 billion below the level one would expect given longer-term trends. The spending cuts that were part of deals to trim expenditures emanating from the 2011 debt ceiling deal, combined with the winding down of the wars in Iraq and Afghanistan, mean that federal spending was 6.8 percent of potential G.D.P., down from 7.4 percent of actual G.D.P. from 1993 to 2013.

Some caveats to this analysis: There is no “right” answer to how big a share of the economy each of these sectors ought to occupy. Perhaps there are longer-term shifts underway that mean, for example, that durable goods should be a smaller chunk of G.D.P. than they were historically, or that business investment in intellectual property should grow and equipment spending shrink, or any other shift you might imagine.

But what you want to see is that even if one segment, say housing, shrinks in importance, something else rises to take its place. And what has happened in the last few years is that each of these major segments has shrunk relative to its usual role in the economy, and nothing else has increased enough to pick up the slack. It’s also possible that the C.B.O.'s estimate of the nation’s economic potential is too high, and that the elevated joblessness of the last few years is a new normal.

But if you think that the American economy is capable of humming along a good deal faster than it is, and that the pattern of where economic activity comes from the past couple of decades should still mostly apply, then it’s no mystery which sectors are to blame for the crummy economy.

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