

Dean Baker, J. Bradford DeLong, and Paul R. Krugman
“Asset Returns and Economic Growth”

Brookings Papers on Economic Activity, 1:2005, pp. 289-315

America is probably facing a slowdown in the rate of natural population increase and possibly a slowdown in productivity growth. We argue that, if these two factors depress the rate of future economic growth, one cannot assume that the past performance of asset returns is indicative of future results. Simple standard closed-economy growth models predict that a growth slowdown will likely lower the marginal product of capital and thus the long-run rate of return. Moreover, if current asset valuations represent rational expectations, simple arithmetic shows that it is almost impossible for past rates of return to continue through a growth slowdown. In standard models at least, only a large shift in the income distribution toward capital, or future current account surpluses that are larger and more persistent than those that nineteenth-century Britain sustained for generations, give promise for reconciling a future slowdown with a continuation of historical asset returns.

JEL codes: E21, E44, G12