Path-Dependence, the Covid Crisis, and Inequality in the United States

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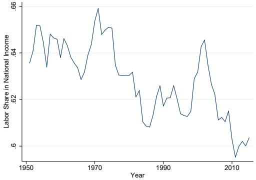
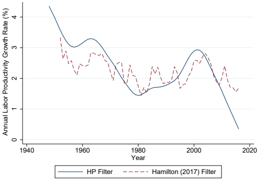
Roadmap

1. Secular Stagnation & Distribution
   - Piketty vs. Classical Political Economy
   - Wealth Concentration
2. Great Recession and Hysteresis
   - Classical-PK Explanations
3. Assessment
4. The Covid Shock & Relief Package
   - Top-Line Figures
   - CARES Act
5. Taking Stock
6. Conclusion

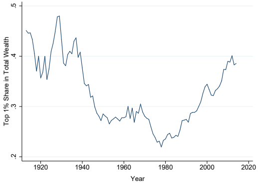
The "Before Times" – Secular Trends



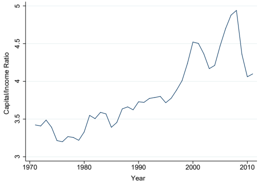
(a) US: Labor compensation share in GDP, 1950-2014 (Fed).



(b) US: Labor productivity growth, 1950-2016 (BLS).



(c) US: Top 1% share in total wealth, 1913-2014 (WID).



(d) US: Capital-income ratio, 1970-2010 (Piketty, 2014).

Secular Stagnation and Inequality

What did we learn about these trends?

- Piketty (2014): $r > g \Rightarrow \uparrow k/y \Rightarrow$ Rising profit share with EoS > 1
- Classical Political Economy alternative: "capitalists" vs. "workers."

Balanced Growth condition:

$$s^c u(1-\omega) = \gamma(\omega) + n \quad (1)$$

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  $$s^c u(1-\omega) = \gamma(\omega) + n \tag{1}$$

  where s^c is the capitalists' saving rate, $u = y/k$ ratio, ω the labor share, γ is the rate of labor-augmenting technical change, and n is the growth rate of the labor force.
- Technical change is *conflict-driven*: $\gamma_\omega > 0$. This has been shown to apply both to the "direction" and "intensity" of technical progress.

Secular Stagnation and Inequality (2)

- Neoliberal institutions & rising globalization have put downward pressure on the labor share.
- This increases accumulation, but the long run growth rate *has fallen*:
- Restoring balanced growth requires a decline in u, which implies rising k/y.

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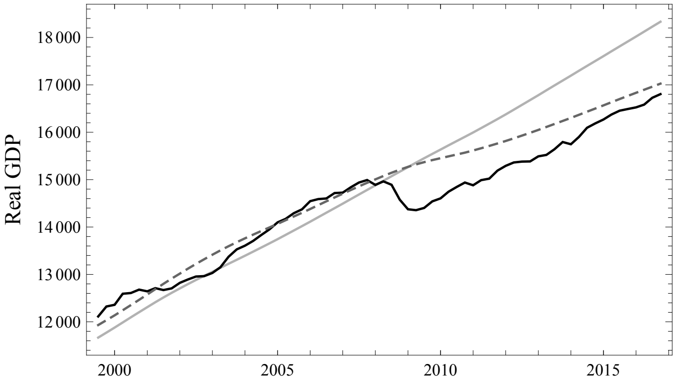
  - A two-class wealth distribution arises provided that $s^c(1-\omega) > s^w$ (empirically true for the US).
- Long-run, *inverse* relation between u and the capitalist wealth share ϕ.
  - Intuition: long-run u is inversely-related to the total savings-to-income ratio in the economy, which in turn increases in the capitalist wealth share ϕ (see also Ederer and Rehm 2020).

The "Before Times" – Great Recession & Hysteresis



Real GDP *vs.* CBO projection of potential GDP in 2007 *vs.* CBO potential GDP in 2017 (dashed).

Classical-Post-Keynesian "Irenics"

- Demand matters even in supply-driven models because it affects firm *beliefs* about the state of the economy.
- The ouptut/capital ratio u, in other words, is not only endogenous to income and wealth distribution.
- It also depends on firm beliefs and policy: it is path-dependent.
- Fiscal policy has a **coordination** role on the economy:
  - In a depressed economy, fiscal expansion has permanent *level* effects:

$$\begin{array}{ll} \uparrow & u \text{ i.e. higher "utilization"} \\ \uparrow & \omega \text{ i.e. higher labor share} \\ \downarrow & \phi \text{ i.e. lower capitalist wealth share} \end{array}$$

  - Temporary growth effects with Kaldor-Verdoorn technical change;
  - Permanent growth effects under conflict-driven technical change.

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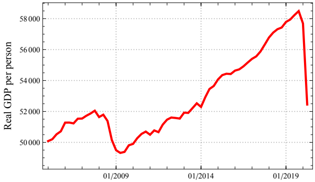
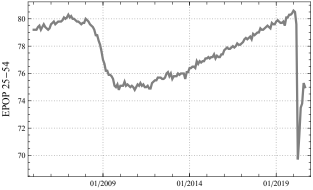
- Secular decline in the **labor share** & **labor productivity growth**;
- Secular increase in the **capital/income ratio** and **top wealth share**;
- Strong **path-dependence** (hysteresis) in the aftermath of the Great Recession:
  - Certainly in levels;
  - Possibly in growth rates, too.

Covid Shock: Top-Line Economic Numbers



(e) Source: FRED.



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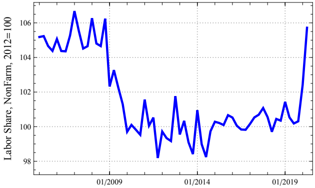


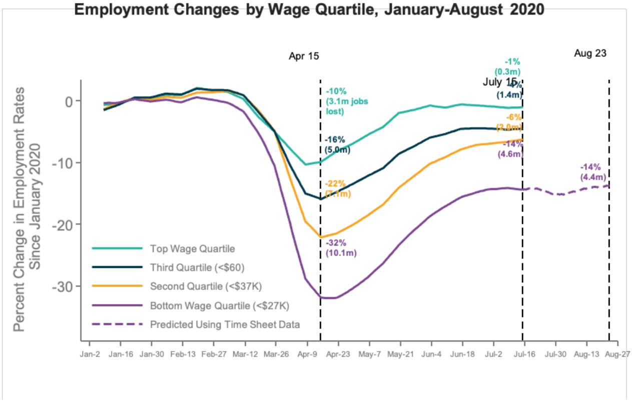
(g) Source: FRED.

(h) Source: FRED.

Note: all series start in January 2005 for comparison with the Great Recession.

What's going on with the labor share?

Increase appears due to *compositional effects*: job loss is concentrated in low-paying sectors & many workers dropped out of the LF altogether.



(i) Source: Chetty et al. (2020).

CARES Act: Transfers to Households

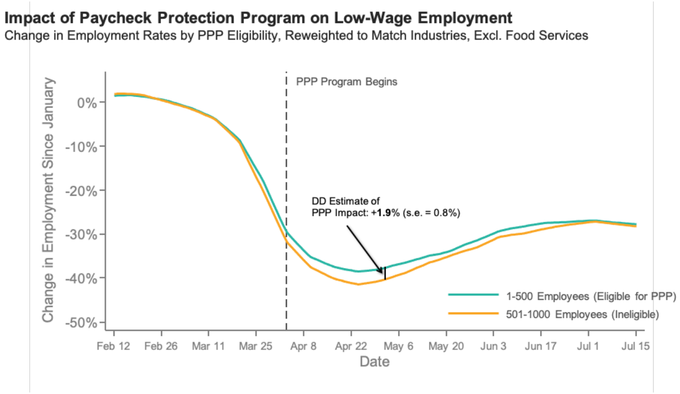
Direct payments to nearly 160M households: about $267B by May 31, most payments made on April 15 (All numbers below are from Chetty et al. 2020).

- Somewhat effective at restoring consumption spending for bottom income quartile households (from -30% in April to about -5% in June);
- Not very effective for spending of top income quartile households: still 20% below March levels as of mid-June.
- Spending in durable goods actually *increased* (about 21%) relative to pre-pandemic;
- But spending for in-person services was still about 60% lower than January as of end-of-April.

Guerrieri et al., 2020: If consumer spending directed at sectors where employment did not fall by much, the multiplier is going to be low.

CARES Act: Small Business Loans

Paycheck **P**rotection **P**rogram: loans to small businesses ($<$ 500 employees, with exceptions, about \$500B)



(j) Source: Chetty et al. (2020).

CARES Act: Unemployment Insurance

- Regular unemployment insurance (up to 26 weeks).
- Pandemic Emergency Unemployment Compensation (additional 13 weeks).
- Extra $600 in UI to ensure workers received 100% of their pre-pandemic salary (expired July 31).
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- Available evidence suggests UI is a very successful automatic stabilizer, and *it does not reduce incentives toward job search* (Chetty 2008).
- UI has high multipliers: up to 2 in a recession, according to the EPI (2020) and Urban Institute (2010).

Assesment: Short-Term Impact

- Direct transfers to households had limited effects at restoring employment.
  - HH eligible for full amount: up to $198,000 for married filing jointly;
  - Check: $1,200 per person plus $500 per child.
  - Transfers were independent of employment status.
  - High income HH's likely saved most of their relief checks.
  - Multiplier likely limited: people w/ health concerns don't go out spending in the service sector, the most affected by the pandemic.
- PPP seems to have had minor employment effects for the target firm population.
  - Most loans taken up by firms that were not planning to reduce employment by much (Granja et. al. 2020).
- UI appears to have been successful at reducing employment bleed out.

Taking Stock

- Unemployment rate (7.9% right now) is “artificially” low: lots of people are still out of the labor force
  - Hugely important: deeply concerning trends in women’s LFP rates especially because of partial, idiosyncratic school closures.
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- $>$ 220,000 Covid-deaths as of October 21, $R_t > 1$ in 41/50 states, and > 8.3 million infections.
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Table. Estimated Economic Cost of the COVID-19 Crisis

Category	Cost (billions), US$
Lost GDP	7592
Health loss	
Premature death	4375
Long-term health impairment	2572
Mental health impairment	1581
Total	16 121
Total for a family of 4	196 475
% of annual GDP	90

Abbreviation: GDP, gross domestic product.

(I) Source: Cutler and Summers (2020).

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- Back to the **coordinating role of fiscal policy**:
- Clear communication strategy by the White House to restore faith in the public about handling the pandemic, safety & effectiveness of eventual vaccine, plus:
- Meaningful relief —especially to state governments & unemployed— to minimize the lasting demand effects of the crisis.
- Expansionary fiscal stance will have beneficial distributive effects on both incomes and wealth.

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- The longer it takes for new, large, and properly targeted relief, the more the effects of the Covid Shocks are bound to be long-lasting.
- Without adequate fiscal policy the recovery will be slow, with **anemic demand, depressed wage share, and further wealth concentration**.
- These level effects can translate into growth effects if the decline in the wage share (that is inevitable without fiscal intervention) lasts enough to reduce labor productivity growth.

Thank you!