Secular stagnation in historical perspective

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The re-discovery of secular stagnation

Secular Stagnation

“There is increasing concern that we may be in an era of secular stagnation in which there is insufficient investment demand to absorb all the financial savings done by households and corporations, even with interest rates so low as to risk financial bubbles.” Boston Globe, April 11, 2014


Negative Wicksellian natural rate of interest – savings exceed investment at all non-negative interest rates
Inequality and growth

- Idea that excessively unequal distribution of income can hold back demand and cause stagnation
- Thomas Piketty and rising inequality as a structural feature of capitalism
Looking back into history

- Stagnation theories have a long history going back at least 200 years
- Inequality and aggregate demand - developed by J. A. Hobson around 1900
- “Secular stagnation” - Rediscovery of idea proposed in Alvin Hansen’s “Economic progress and declining population growth” AEA Presidential Address, 1938
Mentions of secular stagnation in JSTOR
1873-96 “Great Depression” in Britain
1889 Hobson and Mummery *The Physiology of Industry*
- underconsumption due to over-investment in capital
- uses idea of the accelerator (not the name)
1909 Hobson *The Industrial System*
- link to unequal distribution of income and “unproductive surplus”
- explanation of capital exports
Hobsonian ideas widespread in USA in the Great Depression
Failure of capitalism due to the growth of monopoly power
Concentration of economic power disrupting commodity markets and the “financial machine”
Institutionalist (price structures)

Business cycle theory drawing on Spiethoff, Aftalion, JM Clark and Wicksell

In 1937, Keynes’s article on population made Hansen realise that Keynes’s multiplier could be fitted into his own dynamic theory of the cycle
1937-8 Recession -- Why has recovery in the late 1930s stalled?

Secular stagnation: “Sick recoveries which die in their infancy and depressions which feed on themselves and leave a hard and seemingly immovable core of unemployment”

NOT a Hobsonian argument

Historical thesis about US economy
  - Closing of the frontier
  - Declining population growth
  - Absence of major capital intensive innovations
Hansen’s stagnation thesis was largely an oral tradition among those associated with Hansen at Harvard:
- Evsey Domar
- Benjamin Higgins
- Alan Sweezy
- Paul Samuelson

... and Samuelson’s student, Lawrence Klein
Secular stagnation and debt – Evsey Domar

- 1944 paper about public debt problem
- Growth of income caused by investment can prevent stagnation if income and capital grow together
- Criticism of Keynes and others on the “desert of the stationary state”
- The “problem of capital accumulation” only exists because capital-deepening is limited and the capital-output ratio is stable
Higgins formalized the argument (1950) - Growing (deflationary) gap between the trends of potential income and of actual income

Noted Harrod (1939, 1948) “very close” to Hansen

Sweezy (1943, 1972) and Higgins were critical of the term “secular stagnation” – consistent with rising incomes and tech progress

Klein (1947) on the negative natural rate of interest
1948 – detailed discussion of Secular stagnation and its opponents

Secular stagnation a feature of a wealthy, mature economy

1958 – one paragraph summary of Hansen

Secular stagnation versus secular exhilaration
Popularizing secular stagnation – Paul Samuelson

1961 – if easy money raised investment, there might be a need for fiscal policy to restrain consumption

1964 - A decade of sluggish growth and rising unemployment

Justification for the “New Economics”

1970 - illustrated with diagram

“whether surpluses must balance deficits depends on circumstances”

Retained till Nordhaus took over in 1985 edition
Macroeconomics and stagnation (1960s-1980s)

- Secular stagnation thesis “has been quietly forgotten” (H. Johnson 1971)
- Nonsensical idea to Robert Lucas (1972) et al
- Disequilibrium macroeconomics: Patinkin (1965) and Leijonhufvud (1968) dismissed secular stagnation

- But "everyone" knew about the idea through Samuelson’s textbook
Modernization theory and the idea of a mature economy

- Modernization theory in the social sciences
  - A mature economy was more advanced with high mass consumption – Rostow’s stages of economic growth
  - Stagnation associated with “under-developed” countries
- The demise of modernization theory connected to rise of rational-agent modeling
- Rostow on Japanese stagnation – after the Cold War
Secular stagnation, then

- Origins in failure of recovery to be sustained
- Origins in New Deal skepticism about concentration and failure of competition with links to Hobson even though Hansen discounted the importance of distribution
- Hostility linked to opposition to government debt
  - Conservatives could accept temporary government deficits not permanent ones
- Fate of secular stagnation linked to events, economic theory and politics
Secular stagnation, then

Historical thesis rendered problematic by postwar growth
But claim that long-term stagnation if government should fail to spend enough was never refuted - WW2 followed by Korean War and reconstruction
Decisive blow was displacement, in the 1970s, of “institutionalist” view of the world with the rational-agent, competitive-general-equilibrium model
Why was the idea dropped from the leading textbook?
Events made secular stagnation seem implausible?
A younger co-author had a different theoretical perspective?
Secular stagnation, now

- Permanent liquidity trap?
- Long-term or cyclical?
- How to model it?
  - Koopmans-Ramsey versus Samuelson OLG - implications for Pareto-efficiency
  - Gordon versus Summers - falling capacity versus shortage of demand
- Policy responses
  - Fiscal policy
  - Inflation targets
  - Unconventional monetary measures