



The re-discovery of secular stagnation

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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**

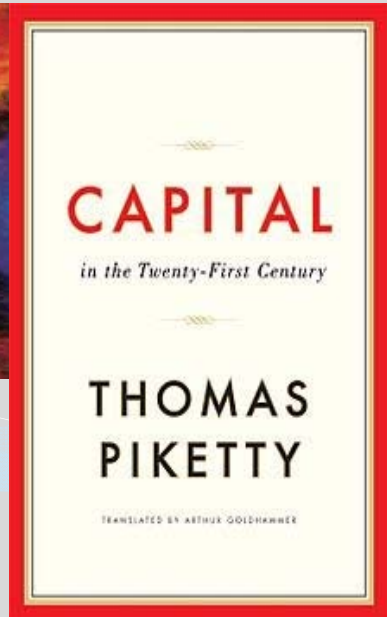
"**Secular Stagnation? The Future Challenge for Economic Policy,**" Institute for New Economic Thinking, Toronto April 12, 2014

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



Lawrence H. Summers is the Charles W. Eliot University Professor and President Emeritus at Harvard University.

Inequality and growth



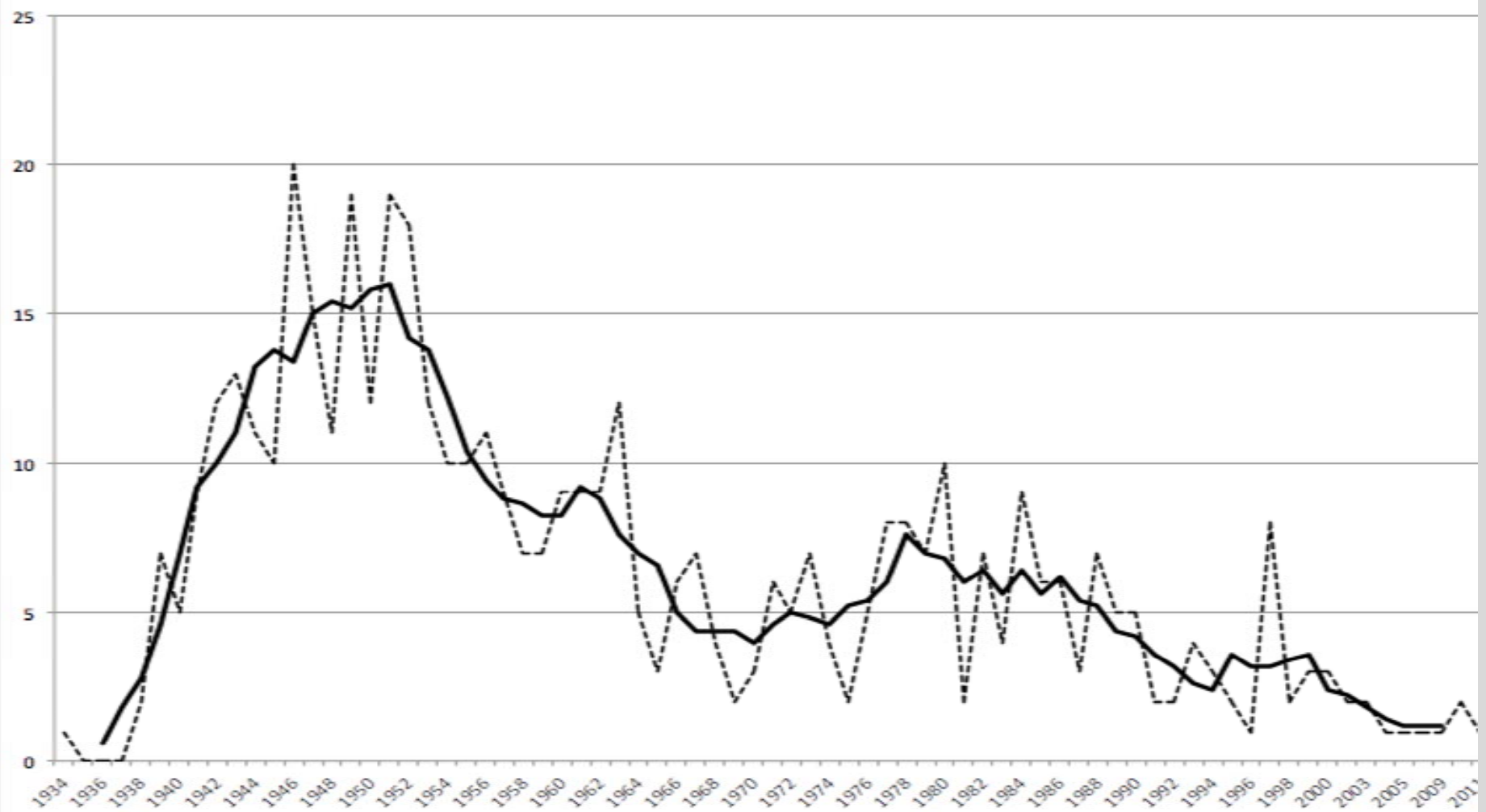
- ✧ Idea that excessively unequal distribution of income can hold back demand and cause stagnation
- ✧ Thomas Piketty and rising inequality as a structural feature of capitalism

A horizontal banner at the top of the slide features a vibrant, abstract image of a cosmic nebula or galaxy, with swirling patterns of purple, blue, orange, and red. The title text is centered over this image.

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





J. A. Hobson

- ✧ 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



J. A. Hobson

- ✧ 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”



Alvin Hansen

- ✧ Institutionalism (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



Alvin Hansen

- ↪ 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



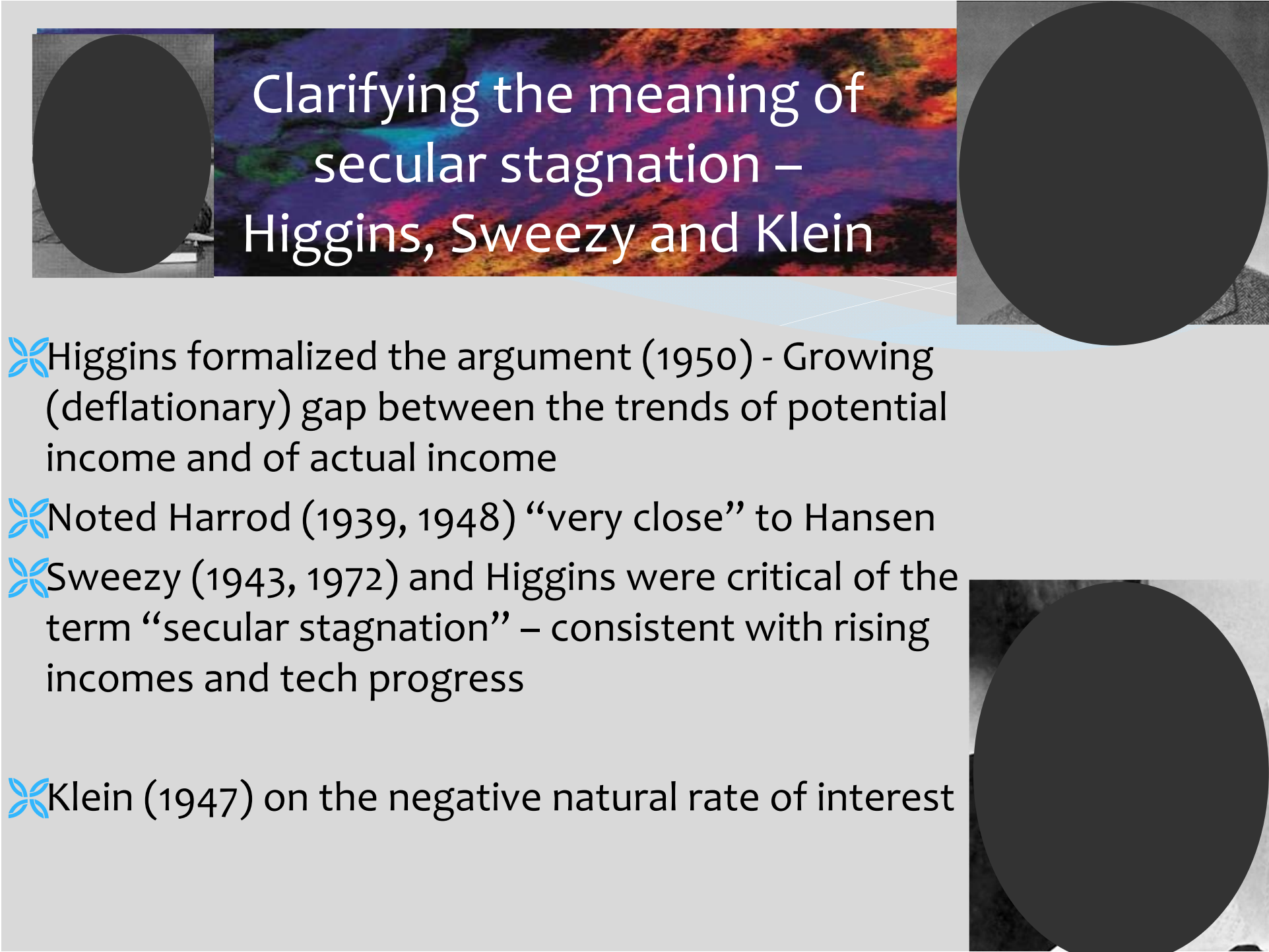
Alvin Hansen

- ✧ 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





Clarifying the meaning of secular stagnation – Higgins, Sweezy and Klein

- ✧ 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




Popularizing secular stagnation – Paul Samuelson

- 
- ✧ 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

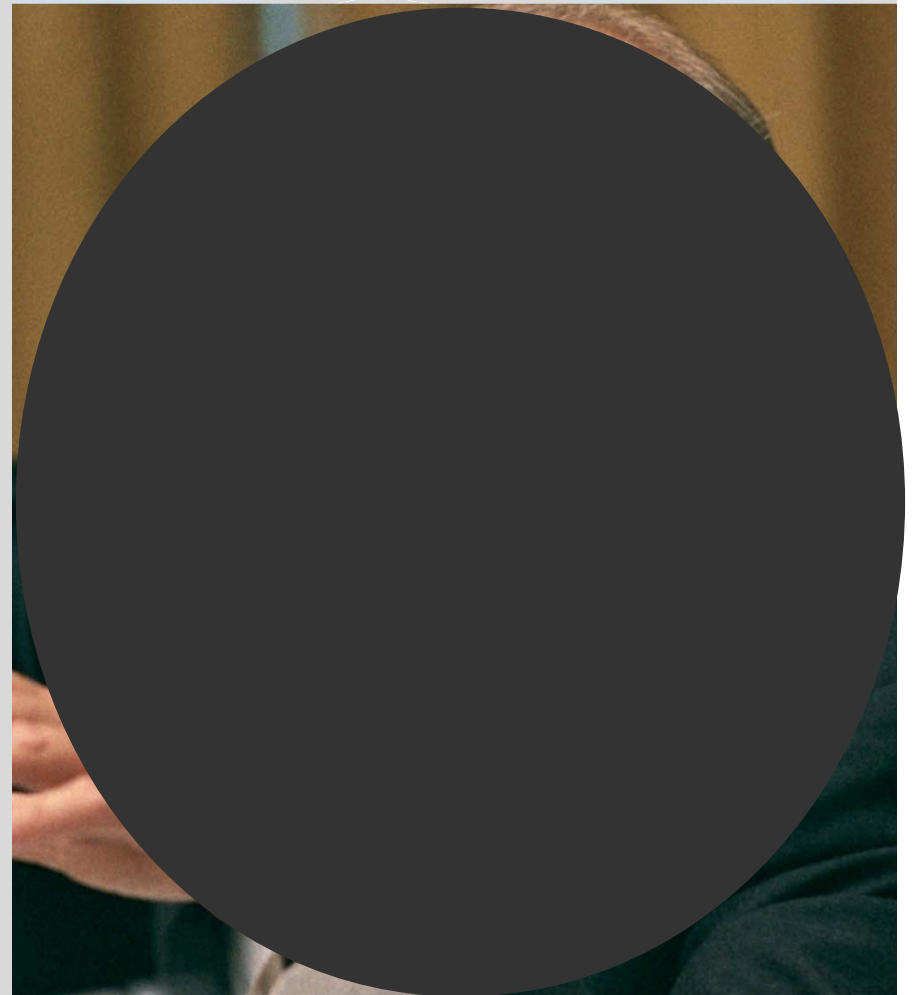
✧ Modernization theory in the social sciences

✧ 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

