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Secular stagnation or stagnation policy? Steindl after Summers

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- 1. Introduction**
- 2. The current debate on secular stagnation and its shortcomings**
- 3. Steindl's 'maturity and stagnation' approach**
- 4. A Steindlian model of distribution, growth and stagnation**
- 5. The role of institutions and policies – or why stagnation did not materialise in the 1950s and 1960s but has become more likely since the 1980s – and after the Great Recession in particular**
- 6. Economic policy implications**
- 7. Conclusions**

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Start of current debate: Summers at IMF Economic Forum

“... the trend in growth can be adversely affected over the longer term by what happens in the business cycle” (Summers 2014a, p. 66)

“ ... a fairly strong consensus has emerged on three points.

- First, a workable definition of secular stagnation is that negative real interest rates are needed to equate saving and investment with full employment.
- Second, the key worry is that secular stagnation makes it much harder to achieve full employment with low inflation and a zero lower bound (ZLB) on policy interest rates. ...
- Third, it is too early to know if secular stagnation is more than just old-fashioned slow growth, but economists and policymakers should start thinking hard about what should be done if secular stagnation materialises – the old macroeconomic toolkit is inadequate.” (Teulings/Baldwin 2014b, p. 2)

1. Factors affecting long-run potential growth (Gordon, ...)

- Lower labour supply growth due to demographic change
- Lower rate of technological progress???

2. Long-run deviation of demand determined growth from potential (Summers, Krugman, Koo, ...)

- Equilibrium real interest is too low, maybe even negative, and cannot be reached by monetary policy due zero lower bound,
- Causes: Fall in demand for loanable (low investment, deleveraging, low minimum capital requirements, demographic change) but rise in supply (higher inequality, shift of funds to safe havens, ..),
- risks of financial instability and 'bubble growth'

3. One-off changes in the level of GDP

- Hysteresis shifts growth path down but should not affect growth rate

Problems

1. Equilibrium real interest rate adjusting real saving and real investment, in principle, in the market for loanable funds?
 - ➔ Cambridge controversies in the theory of capital
 - ➔ Principle of effective demand
2. Potential growth independent of aggregate demand dynamics?
3. What about institutions, power relationships, financialisation, ?

4. No reference to history of economic thought except for Hansen (1939)

but what about:

Hobson (1902), Luxemburg (1913), Sweezy (1942), Keynes (1943), Steindl (1952), Kalecki (1954, Chapter 15, 1971, Chapter 13) and Baran/Sweezy (1966), and modern followers?

Here: Review of Steindl – after Summers

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Steindl (1952, Chapter XIII): integrated model of trend and cycle

Reformulations: Dutt (1995, 2005), Flaschel/Skott (2006)

Here: Simplification based on Dutt (2005)

Assumptions:

- Closed private one-good economy
- Fixed coefficients production technology
- No overhead labour, no depreciation
- Harrod-neutral technological change
- Three classes: rentiers, managers/capitalists, workers
- No labour supply constraint
- Mark-up pricing in oligopolistic markets

Pricing and distribution

$$(1) \quad p = [1 + m(\rho, \gamma)]wa, \quad m > 0, \frac{\partial m}{\partial \rho} \geq 0, \frac{\partial m}{\partial \gamma} \geq 0,$$

$$(2) \quad h = \frac{\Pi}{pY} = 1 - \frac{1}{1 + m(\rho, \gamma)}, \quad \frac{\partial h}{\partial \rho} \geq 0, \frac{\partial h}{\partial \gamma} \geq 0,$$

$$(3) \quad r = \frac{\Pi}{pK} \frac{Y}{Y^p} \frac{Y^p}{K} = hu \frac{1}{v}.$$

P: price, m: mark-up, ρ : rentiers' rate of return, γ : outside finance-capital ratio, w: nominal wage rate, a: labour-output ratio, h: profit share, Π : profits, Y: real output, r: profit rate, K: real capital stock, Y^p : potential output, u: rate of capacity utilisation, v: capital-potential output ratio

Financing of the capital stock and rentiers income

$$(4) \quad pK = B + E_R + E_F,$$

$$(5) \quad \gamma = \frac{B + E_R}{pK},$$

$$(6) \quad \phi = \frac{E_F}{pK},$$

$$(7) \quad \Pi = \Pi_F + R,$$

$$(8) \quad R = \rho(E_R + B).$$

B: debt, E_R : equity held by rentiers, E_F : accumulated retained earnings, γ : outside finance-capital ratio,

ϕ : inside finance-capital ratio, Π_F : retained earnings,

R: rentiers' income, ρ : rentiers' rate of return

Saving, investment and equilibrium

$$(9) \quad \sigma = \frac{S}{pK} = \frac{\Pi - R + s_R R}{pK} = h \frac{u}{v} - (1 - s_R) \rho \gamma, \quad 0 < s_R \leq 1.$$

$$(10) \quad g = \frac{pI}{pK} = \alpha + \omega \hat{y} + \beta(u - u_0) + \theta \left(h \frac{u}{v} - \rho \gamma \right), \quad \beta, \theta, \omega > 0, \theta < 1,$$

$$(11) \quad g = \sigma,$$

$$(12) \quad \frac{\partial \sigma}{\partial u} - \frac{\partial g}{\partial u} > 0 \quad \Rightarrow \quad (1 - \theta) \frac{h}{v} - \beta > 0.$$

σ : saving rate, S : saving, s_R : propensity to save out of rentiers' income,
 g : accumulation rate, α : autonomous investment, animal spirits,
 I : investment, \hat{y} : productivity growth, u_0 : target rate of utilisation.

Table 2: Responses of equilibrium rates of capacity utilisation (u), capital accumulation (g), profit (r) towards changes in exogenous variables and parameters

	u^*	g^*	r^*
α	+	+	+
$\omega\hat{y}$	+	+	+
u_0	-	-	-
s_R	-	-	-
h	-	-	-
ρ	?	?	?
γ	?	?	?

Table 1: Effects of a change in the rentiers' rate of return or the outside finance-capital ratio with interest- and dividend payments-inelastic mark-up and profit share

	'normal case' 'debt-burdened' economy	'intermediate case'	'puzzling case' 'debt-led' economy
	$1 - s_R < \theta$	$\theta < 1 - s_R < \theta \frac{\frac{h}{v}}{\beta + \theta \frac{h}{v}}$	$\theta \frac{\frac{h}{v}}{\beta + \theta \frac{h}{v}} < 1 - s_R$
$\frac{\partial u}{\partial \rho}, \frac{\partial u}{\partial \gamma}$	-	+	+
$\frac{\partial g}{\partial \rho}, \frac{\partial g}{\partial \gamma}$	-	-	+
$\frac{\partial r}{\partial \rho}, \frac{\partial r}{\partial \gamma}$	-	+	+

Note: Assuming the stability condition (12) for the goods market equilibrium to hold implies $(h/v)/[\beta + \theta(h/v)] > 1$, because from $(1-\theta)(h/v) - \beta > 0$, we get $(h/v) - \theta(h/v) > \beta$, and hence $(h/v) > \beta + \theta(h/v)$.

Endogenous technological progress

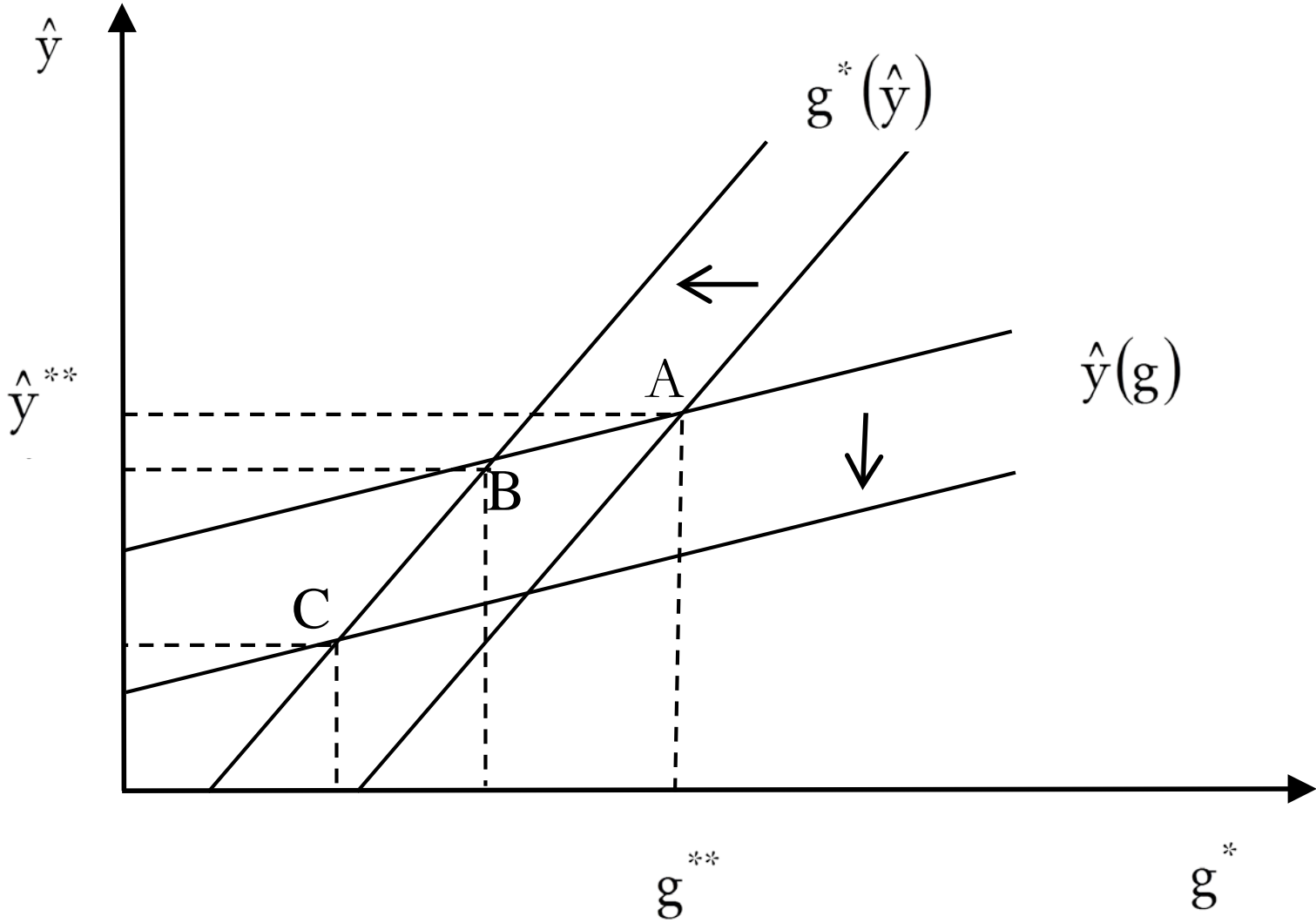
Rowthorn (1981), Dutt (1990, Chapter 5), Taylor (1991, Chapter 10), Lavoie (1992, Chapter 6)

- Kaldor's (1957, 1961): technical progress function
- Kaldor's (1966): Verdoorn's Law
- Marx (1867), Hicks (1932): wage push

$$(16) \quad \hat{y} = \eta + \varepsilon g - \psi h, \quad \eta, \varepsilon, \psi > 0.$$

η : basic innovations, learning by doing

Figure 1: Stagnation with endogenous productivity growth



Stagnation in a Steindlian model

- a fall in autonomous investment growth (or autonomous consumption, government expenditures, or exports) and/or a fall in ‘animal spirits’ of firms,
- a fall in the rate of productivity enhancing basic innovations driving investment,
- a rise in the target rate of capacity utilisation of firms,
- a rise in the rentiers’ propensity to save (or in the workers’ propensity to save set equal to zero in the current model version),
- a rise in the profit share,
- a rise in the rentiers’ rate of return, hence the interest rate and/or the dividend rate, and/or the outside finance-capital ratio, hence the debt-and/or the rentiers’ equity-capital ratio, if the economy is in the *‘normal case’* and in a *‘debt-burdened’ regime*,
- or a fall in the rentiers’ rate of return and/or the outside finance-capital ratio if the economy is in the *‘puzzling case’* and in a *‘debt-led regime’*.

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Steindl (1979): causes of golden age

- Public spending increased tremendously after World War II, financed to a great extent by taxes on profits.
- Technological competition between east and west, spilling over from the public to the private sector
- The post-war tensions triggered close cooperation by the western countries under the leadership of the USA (Bretton Woods, Marshall Plan, ...), increase in international trade and competition keeping profit margins down
- European countries benefited from technological backwardness with respect to the USA ('catching-up' factor in economic growth).

➔ *factors causing a rise in α and ωy^{\wedge} or a fall in h*

Steindl (1976, 1989):

- Improved internal finance conditions for firms (low indebtedness after war, multi-sector oligopolies, ...)
- Lower average propensity to save (re-distribution, consumer credit)

Re-emergence of stagnation in the 1970s (Steindl 1979)

- Reduction of tensions between super powers
- Fading out of catching up
- Increasing environmental and energy problems causing inflation + uncertainty
- Increased rivalry among capitalist economies, collapse of Bretton Woods

→ *factors determining α and ωy^{\wedge}*

- Supposed tendencies towards higher capital productivity
- Rising marginal propensities to save in mature economies

→ *dampened demand and the demand effects on investment*

Most important: „Stagnation policy“ (Steindl 1979):

‘[...] thus we witness stagnation not as an incomprehensible fate, as in the 1930s, but stagnation as policy’ (Steindl 1976, p. xvii)

Kalecki: *Political Aspects of Full Employment*

‘The reasons for the opposition of the ‘industrial leaders’ to full employment achieved by Government spending may be subdivided into three categories: (i) the dislike of Government interference in the problem of employment as such; (ii) the dislike of the direction of Government spending (public investment and subsidising consumption); (iii) dislike of the social and political changes resulting from the *maintenance* of full employment.’ (Kalecki 1971, p. 139)

Steindl (1979):

Stagnation policy or stagnation as a political trend

- decreasing α (decrease in autonomous expenditure growth, falling animal spirits),
- falling ωy^{\wedge} (lower growth enhancing public investment, lower investment in R&D),
- rising the profit share h (weakening workers' and trade union bargaining power, higher interest and hence overhead costs),
- rise in the households' propensity to save (rising inequality in the distribution of household incomes, higher uncertainty triggering precautionary saving).

Bhaduri/Steindl (1985)

Rise of monetarism as a social doctrine

➔ Shift of powers from non-financial to financial sector (collapse of the Bretton Woods international financial system, rise of the Eurodollar market, emergence of oil exporting countries as a class or 'international rentiers', emergence of international commercial banks)

Steindl (1989):

From stagnation in the 30s to slow growth in the 70s

➔ tendency towards 'financialisation' of the non-financial firms: financial instead of real investment

Financialisation in Steindlian/Kaleckian distribution and growth models (Hein 2012a, 2014, Chapter 10)

- re-distribution of income at the expense of the labour income share and the low-income households depressed income-financed consumption demand
- increasing dominance of finance and rising shareholder value orientation of management depressed investment in the capital stock

But

- financialisation has generated an increasing potential for wealth-based and debt-financed consumption
- liberalisation of international capital markets and capital accounts has allowed for persistent and rising current account deficits, on the one hand, and surpluses, on the other.

‘Profits without investment’ regimes

‘debt-led consumption boom’ regimes, as in the US, the UK, Spain, ...

→ Rising private household sector debt

‘export-led mercantilist’ regimes, as in Germany, China, Japan, ...

→ Rising foreign sector debt

→ *Instability and crisis + lower potential growth*

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Implications of the Steindlian view

- Main constraint a capitalist economy is facing in the long run is generation of sustainable demand.
- Stagnation is thus mainly caused by those factors slowing down sustainable demand growth – i.e. demand growth which is not driven by ever rising debt-income ratios of any macroeconomic sector.
- Any lack of sustainable demand growth will feedback negatively on potential or ‘natural’ growth.
- Reversing stagnation policies is thus the main objective when it comes to fighting stagnation tendencies in mature, finance-dominated capitalist economies

Steindlian anti-stagnation policies

- stabilising and raising public autonomous expenditure growth, as well as discretionary anti-cyclical fiscal policies,
- raising growth enhancing public investment, focusing on infrastructure, technology, education and R&D expenditures,
- stabilising and raising the wage share by full employment policies, improving workers' bargaining power, by low interest rate policies, reducing overhead costs, and by the re-regulation of the financial sector reducing the power and income claims of rentiers and shareholders,
- lowering the households' propensity to save by means of redistributing income, both pre-tax via higher wage shares and a more compressed wage structure and after-tax by progressive taxation and social transfers, as well as by removing uncertainty triggering precautionary saving,
- improving international economic and monetary policy coordination in order to avoid severe current account imbalances, 'beggar thy neighbour' strategies, on the one hand, and rising indebtedness in foreign currencies, on the other hand.

Steindl after Summers in terms of policy implications

- The **Steindlian** policy stance contradicts those approaches which exclusively focus on promoting potential growth through supply side measures.
- The Steindlian approach does not ignore the supply side; on the contrary, but it carefully takes into account supply and demand side determinants of growth and acknowledges the endogeneity of many of the supply side determinants of potential growth.
- The Steindlian approach encompasses those policy suggestions aimed at lifting actual output growth towards a presumably given potential growth through low interest rate policies, expansionary fiscal policies and the stimulation of private investment and consumption.
- However, the Steindlian view takes into account the required changes in power relationships and institutions, both nationally and internationally, as well as the feedback effects on potential growth.