The US Economy Since the Crisis: Slow Recovery or Secular Stagnation?

Plenary Session on "Varieties of Stagnation? Europe, Japan and the US"
Conference on "The Spectre of Stagnation? Europe in the World Economy"
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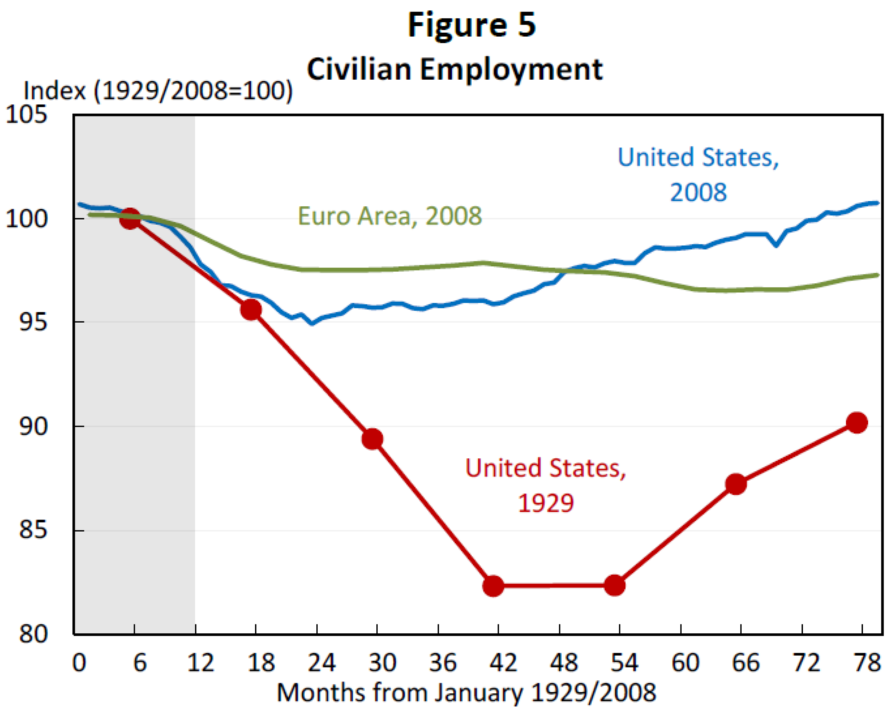
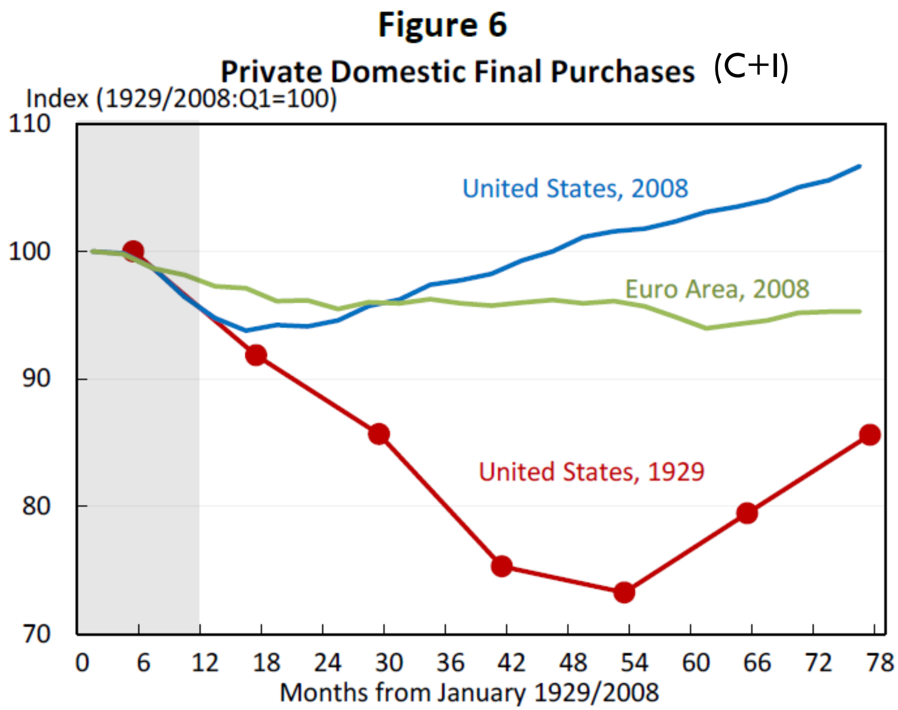
Slow recovery **and** secular stagnation

- The US economy is experiencing **both** the slowest and weakest recovery since World War II **and** a longer-term slowdown
  - Sluggish recoveries from the last two recessions (2001 and 2008-9) are an indication of longer-term stagnation
- Some claim it's not so bad (Ben Bernanke, Jason Furman)
  - The US has done better since 2008 than it did after 1929
    - True, but it's not a high standard
  - The US is doing better than other advanced economies
    - But most of the others (euro area, Japan) are also stagnating
- The US economy is experiencing its slowest growth since World War II and the slowdown pre-dates the 2008-9 crisis and Great Recession
  - Especially in terms of job growth/employment creation

Comparisons with the Great Depression and the Euro Area





Source: Jason Furman, "It Could Have Happened Here: The Policy Response That Helped Prevent a Second Great Depression," Macroeconomic Advisers' 25th Annual Washington Policy Seminar, September 9, 2015 (expanded version of remarks).

The US only looks relatively good in comparison with the other advanced economies, which are doing even worse

	Average annual percentage growth rates		
	Pre-crisis (1992-2007)	Crisis (2008-2009)	Recovery (2010-2015)
Advanced Economies			
United States	**3.2**	**-1.5**	**2.3**
Canada	3.0	-0.8	2.4
Euro area	2.1	-2.0	0.8
France	2.1	-1.4	1.0
Germany	1.5	-2.4	1.9
Italy	1.4	-3.3	-0.3
Spain	3.2	-1.2	0.1
Japan	1.1	-3.3	1.4
United Kingdom	2.8	-2.3	1.9
Emerging Market and Developing Economies			
ASEAN-5	4.9	3.9	5.4
China	10.7	9.4	8.2
India	6.7	6.2	7.3
Russia (data start in 1993)	2.0	-1.3	1.8
Latin America and the Caribbean	3.4	1.3	3.1
Middle East, North Africa, Afghanistan, and Pakistan	4.7	3.7	3.6
Sub-Saharan Africa	4.4	5.0	5.1

Source: International Monetary Fund, World Economic Outlook Database, April 2015 and July 2015 update, and author's calculations. Data for 2015 are IMF staff projections from the July 2015 update.

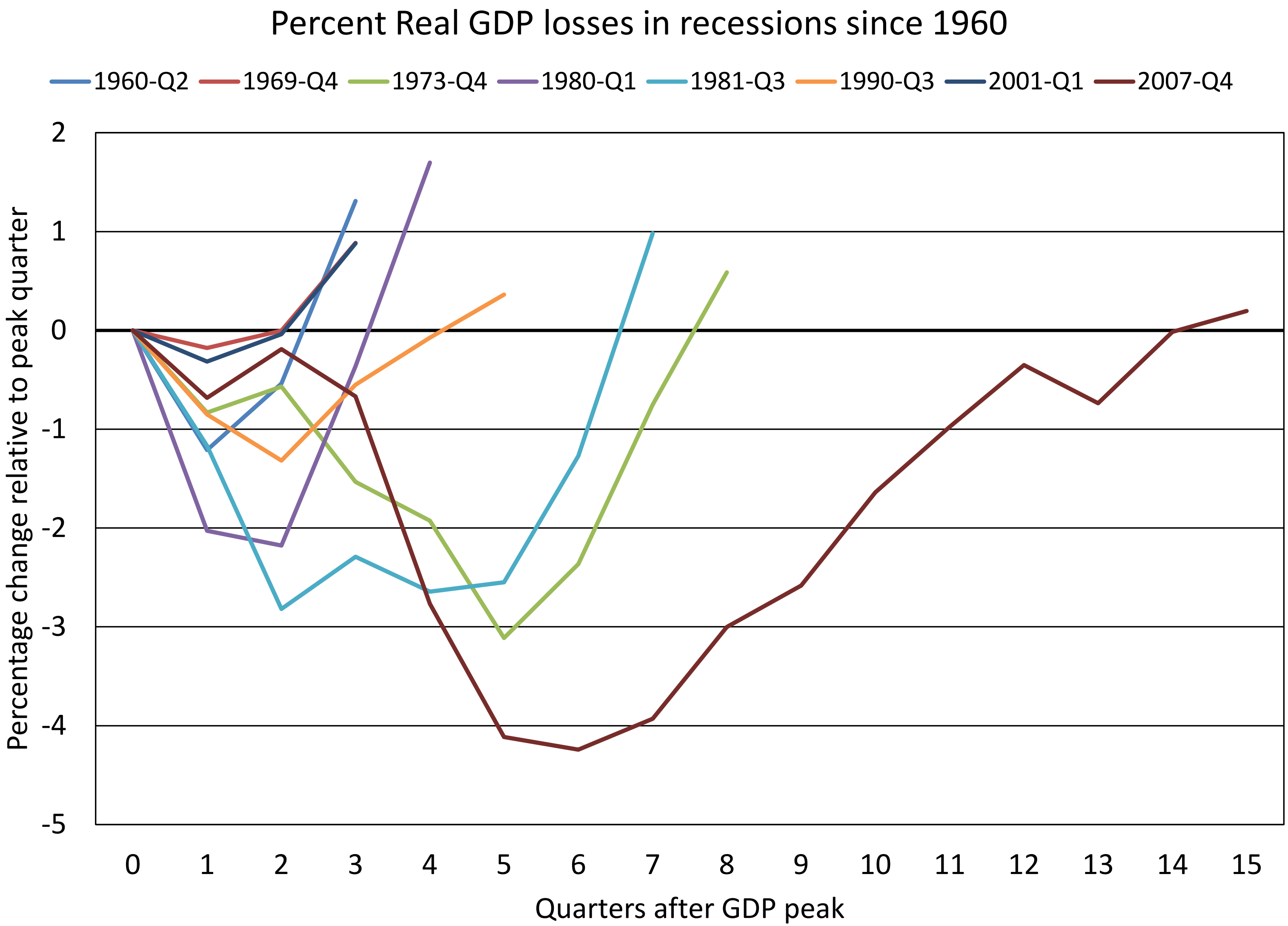
The current US recovery is the weakest in the last 35 years

Each recovery and expansion has been weaker than the one before it since 1981.

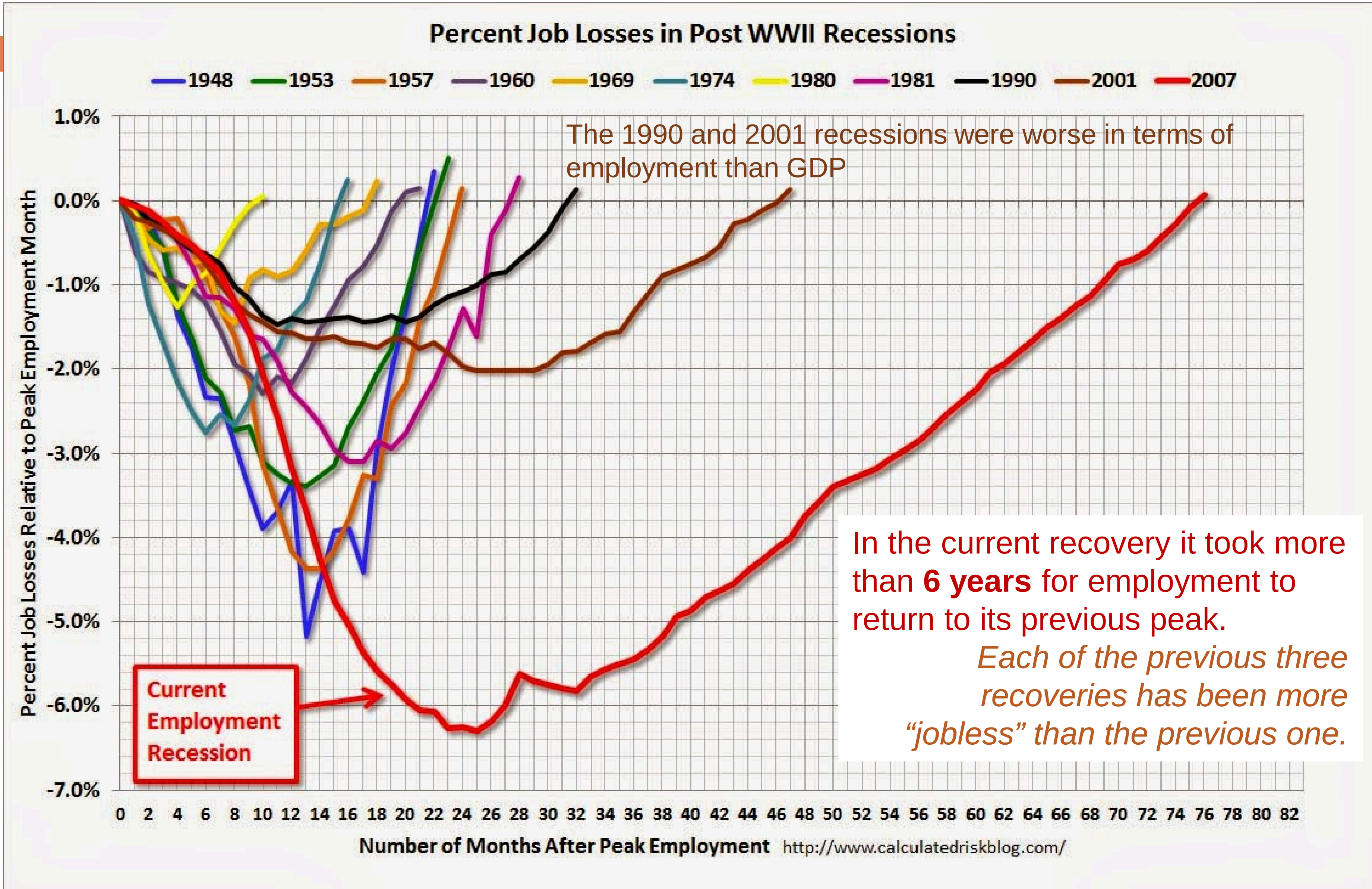
Average annual GDP growth rates, US recoveries/expansions, last four business cycles			
Cycle (Peak-trough-peak)	First 16 quarters of recovery	Expansion (trough to peak)	Entire cycle (peak to peak)
1981Q3-1982Q4-1990Q3	5.2	4.3	3.4
1990Q3-1991Q1-2001Q1	3.4	3.6	3.3
2001Q1-2001Q4-2007Q4	3.2	2.8	2.6
2007Q4-2009Q2-2015Q2*	**1.9**	**2.2**	**1.1**

Source: BEA, National Income and Product Accounts, release of August 27, 2015, www.bea.gov, and author's calculations. Business cycles follow the NBER chronology.
*2015Q2 is not a cycle peak, but is the most recent period available.

Real GDP: Weakest and longest recovery in any business cycle since 1960

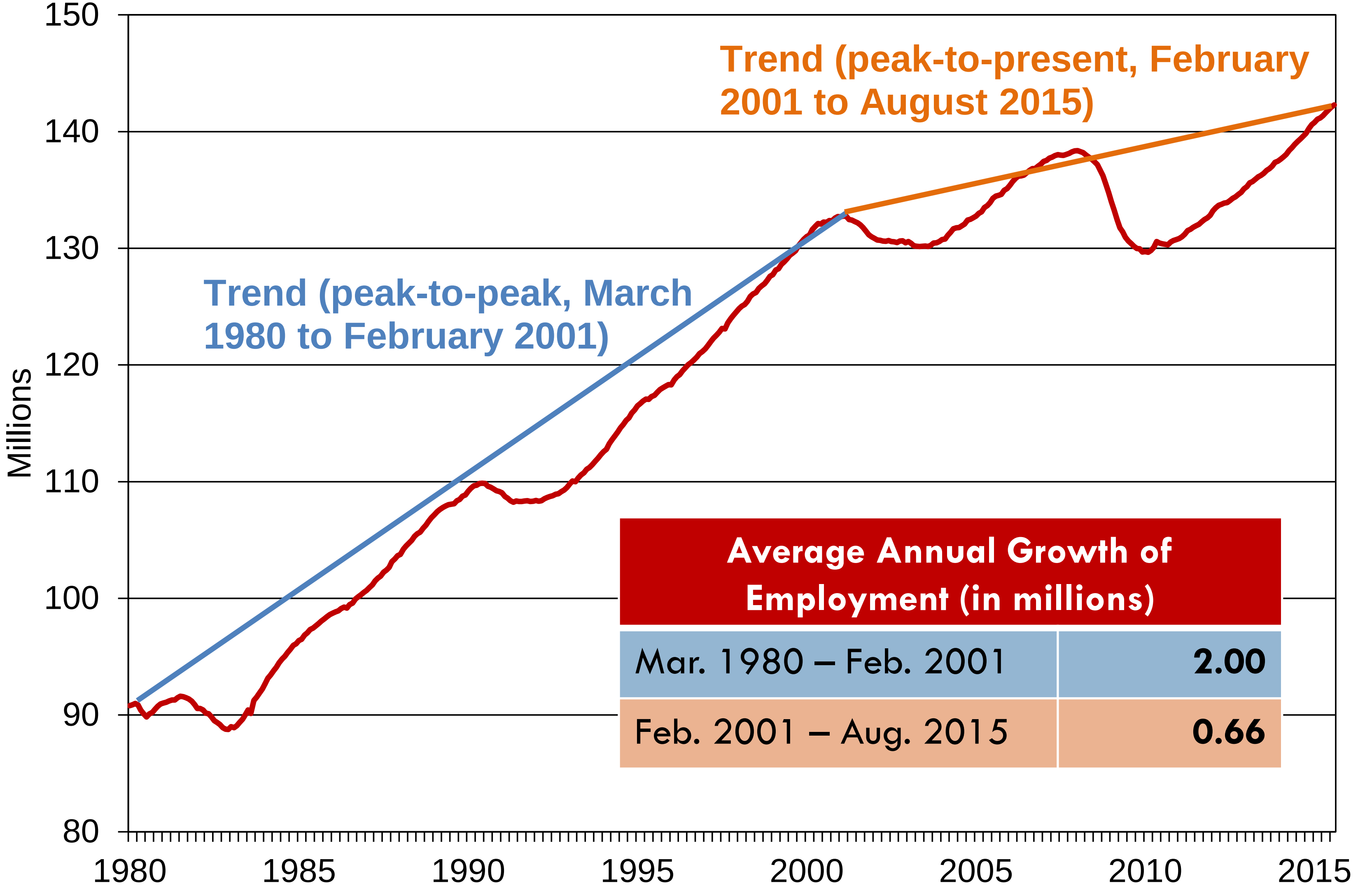


Employment: longer and more "jobless" recoveries since 1990



The long-term slowdown in US employment growth (since 2001)

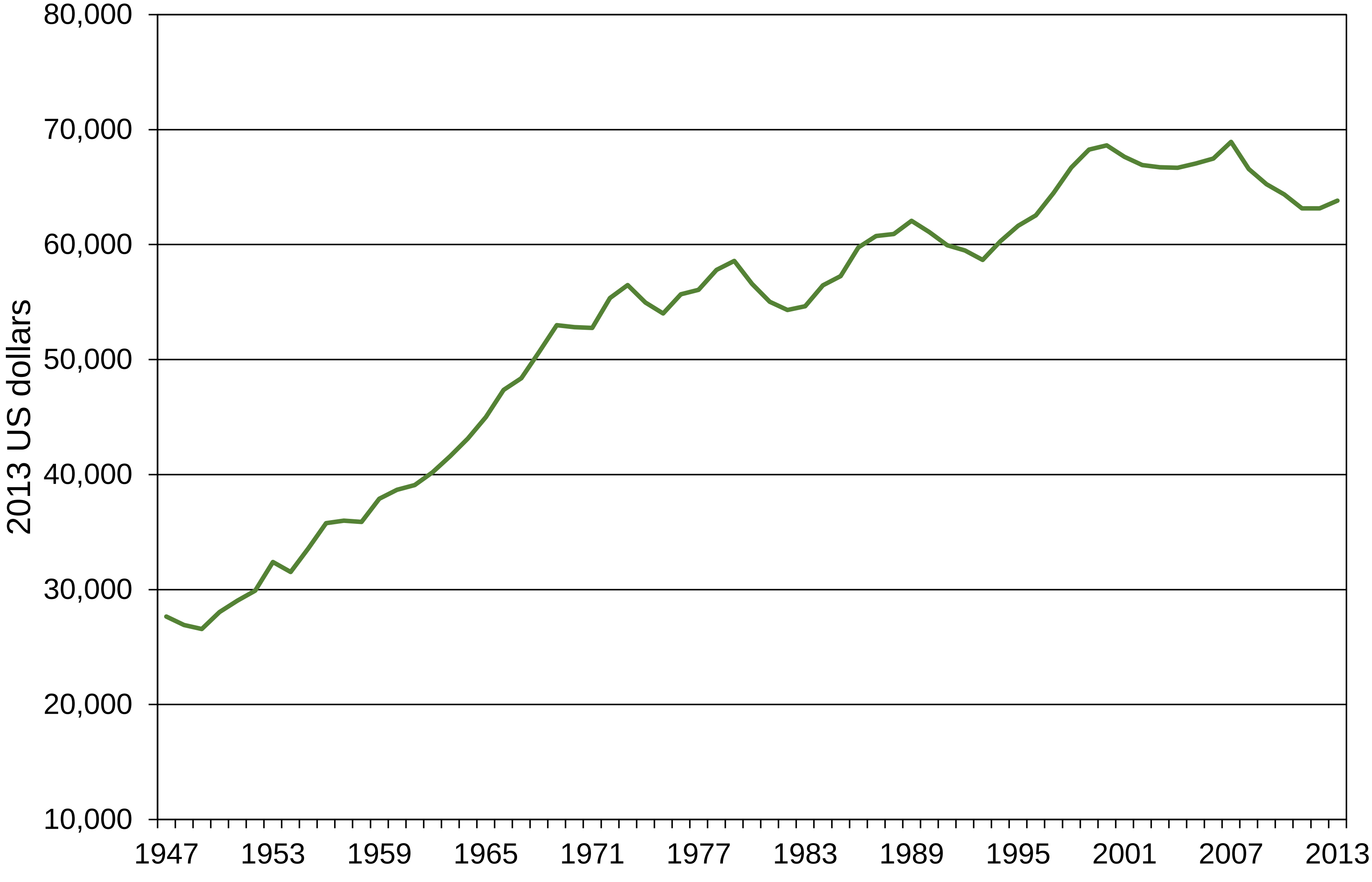
Total US Nonfarm Employment in Millions, Monthly, January 1980 to August 2015



Average Annual Growth of Employment (in millions)	
Mar. 1980 – Feb. 2001	**2.00**
Feb. 2001 – Aug. 2015	**0.66**

Source: US Bureau of Labor Statistics, www.bls.gov, Employment, Hours, and Earnings from the Current Employment Statistics survey (National), downloaded September 26, 2015, and author's calculations.

Real median US family income, annually, 1947-2013

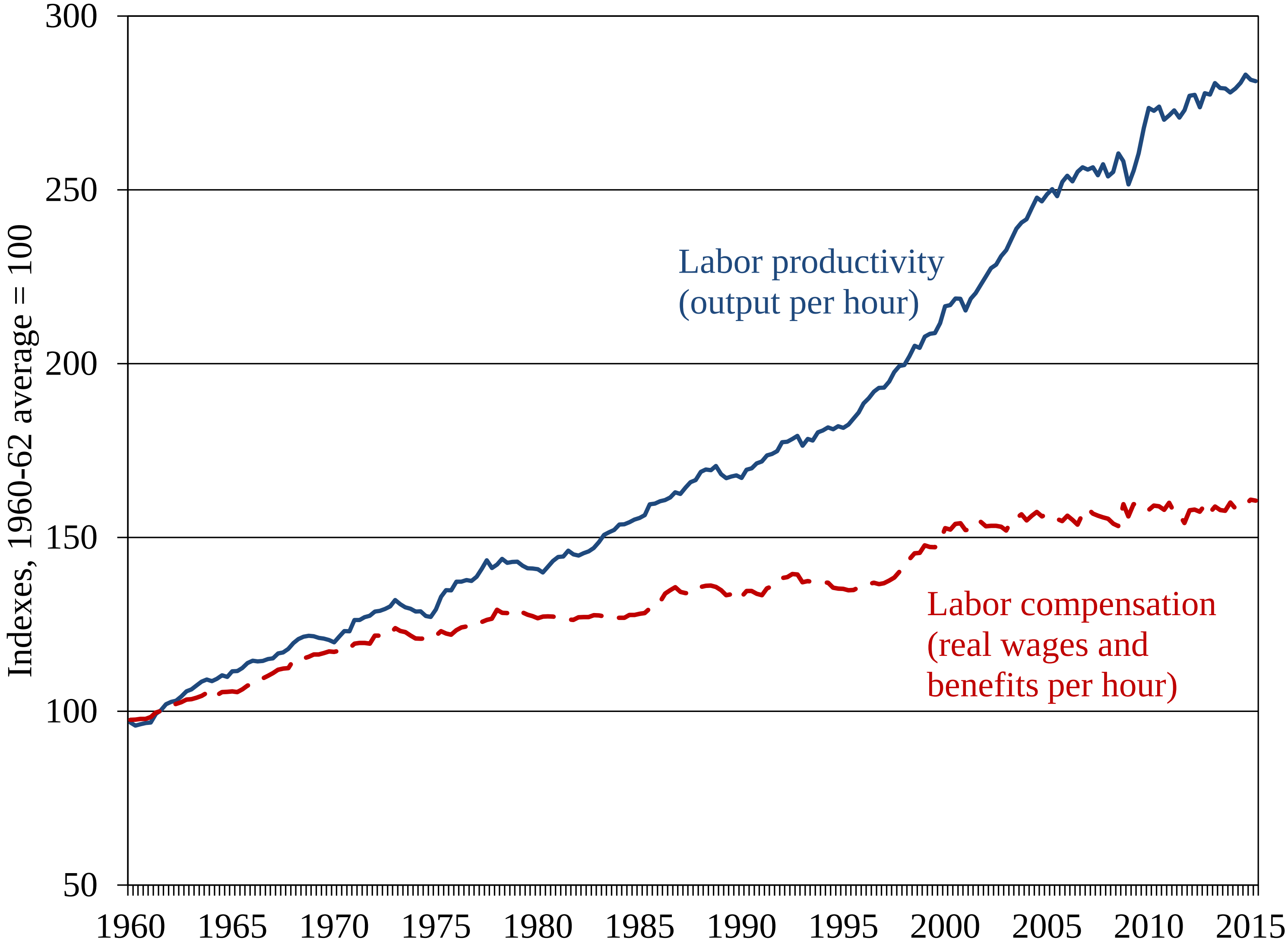


Source: Economic Policy Institute analysis of BLS, Current Population Survey Annual Social and Economic Supplement Historical Income Tables (Table F-5), in *State of Working America*, 2014, www.epi.org.

Demand-side causes of secular stagnation: increasing inequality

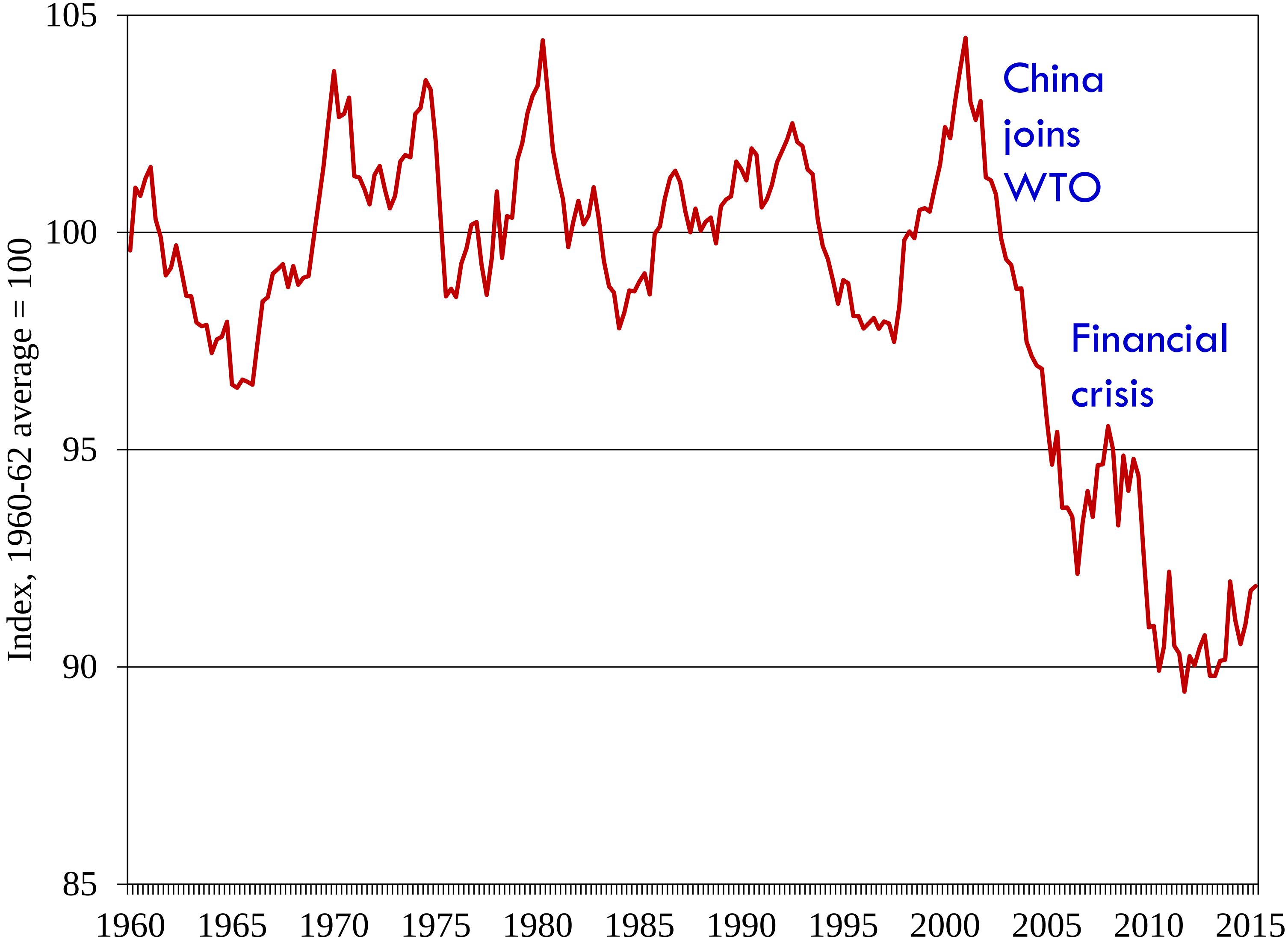
- Inequality has worsened since the 1980s along several dimensions, including:
  - Increased wage gaps between more and less educated workers (so-called “skill premium”)
  - Real wages have lagged behind labor productivity since 1980s
    - Decreasing labor share of national income since 2000
  - Increasing shares of highest quintiles, top 1%, etc. in the distribution of household or family incomes
  - Rising remuneration of CEOs relative to employees
- This weakens most households’ ability to finance consumption expenditures out of current disposable income

Labor productivity and real hourly compensation, all employees, US nonfinancial corporate business sector, 1960Q1 to 2015Q2



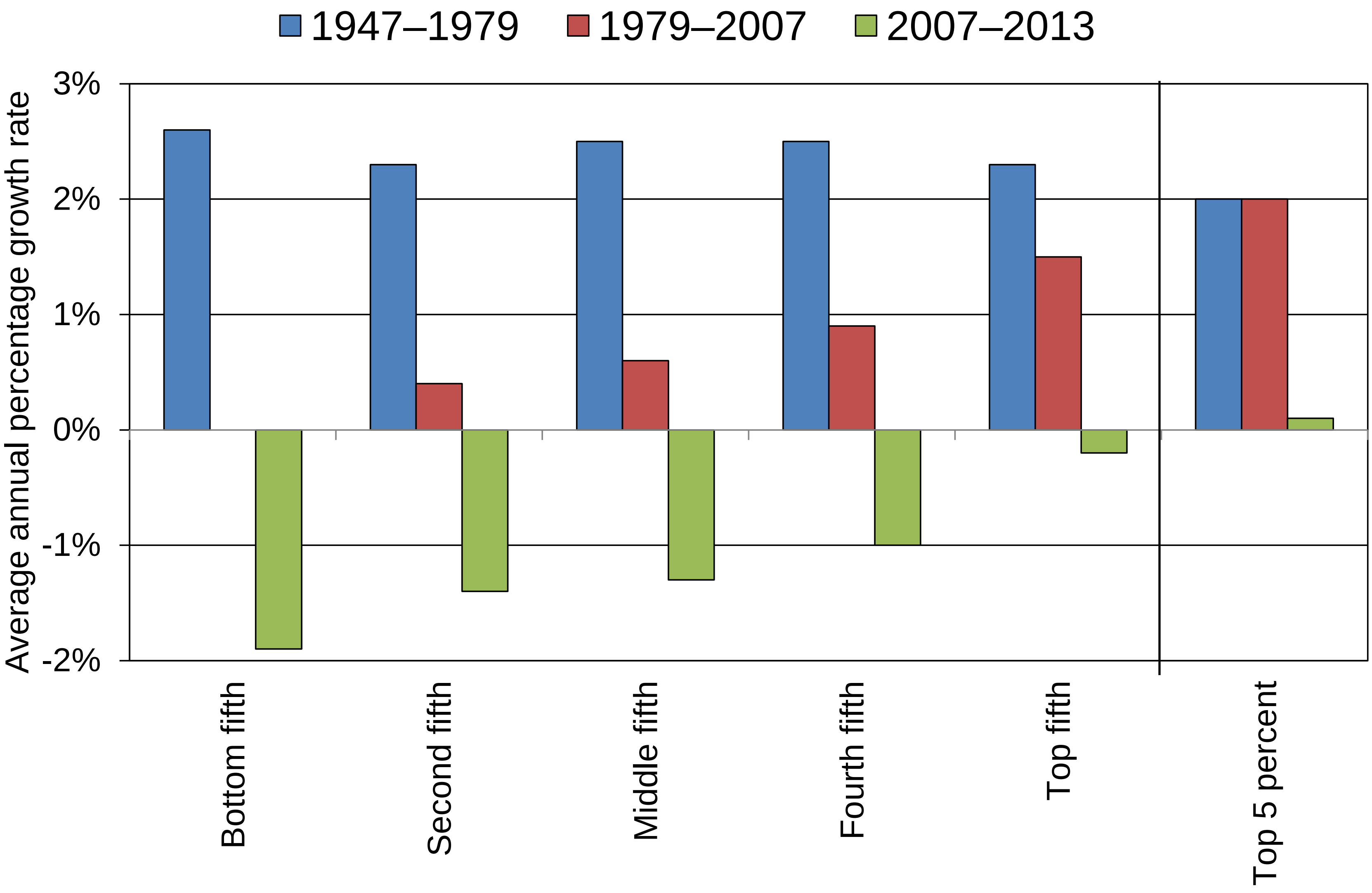
Source: US Bureau of Labor Statistics, www.bls.gov, Major Sector Productivity and Costs, downloaded September 27, 2015, and author's calculations.

Index of the labor share of value added, US nonfinancial corporate business sector, quarterly 1960Q1 to 2015Q2



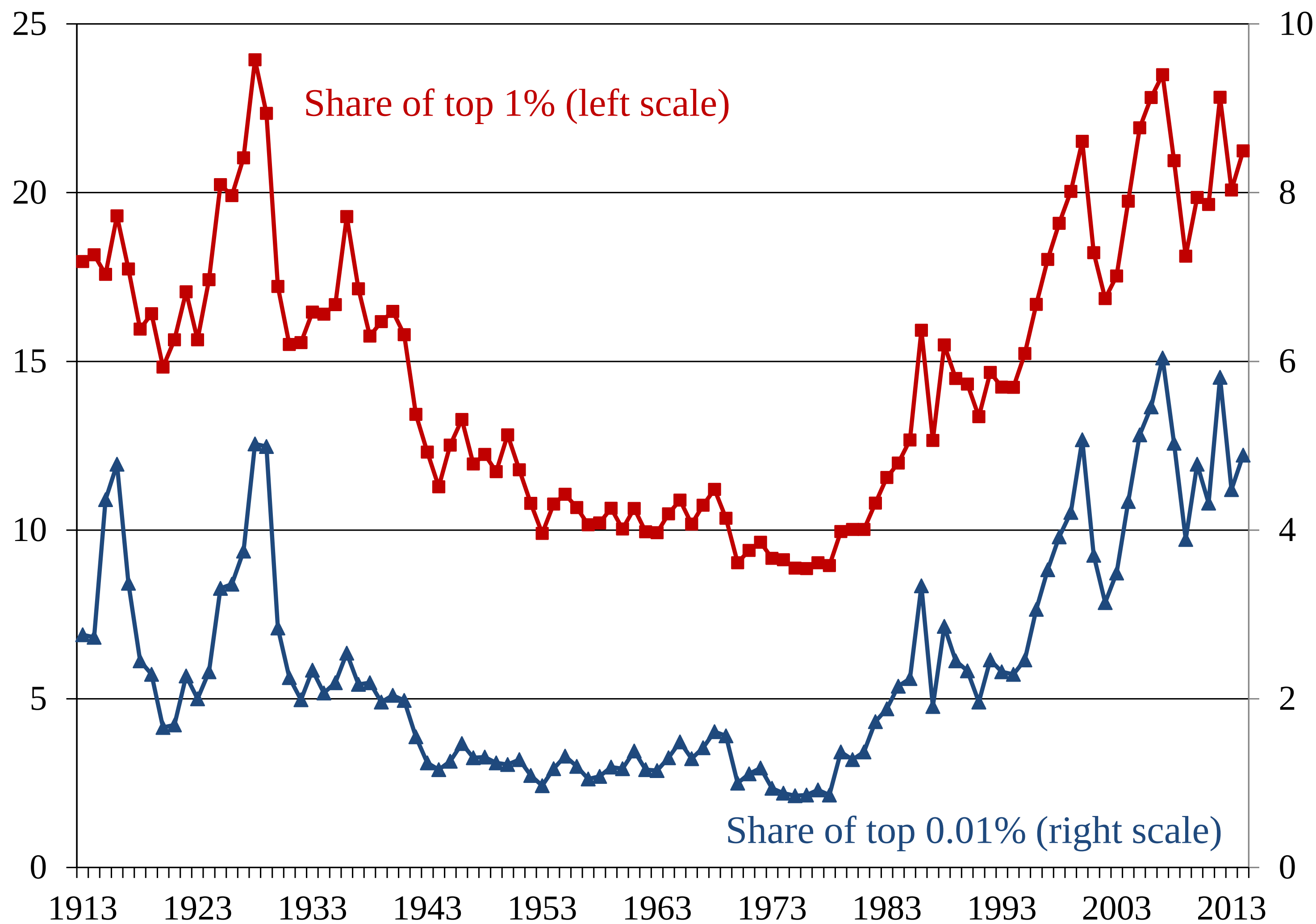
Source: US Bureau of Labor Statistics, www.bls.gov, Major Sector Productivity and Costs, downloaded September 12, 2013, and author's calculations.

Average annual US family income growth by quintile and top 5 percent, various time periods



Source: Economic Policy Institute analysis of BLS, Current Population Survey Annual Social and Economic Supplement Historical Income Tables (Table F-3) , in *State of Working America*, 2014, www.epi.org.

Shares of top 1% and top 0.01% in US income, 1913-2014

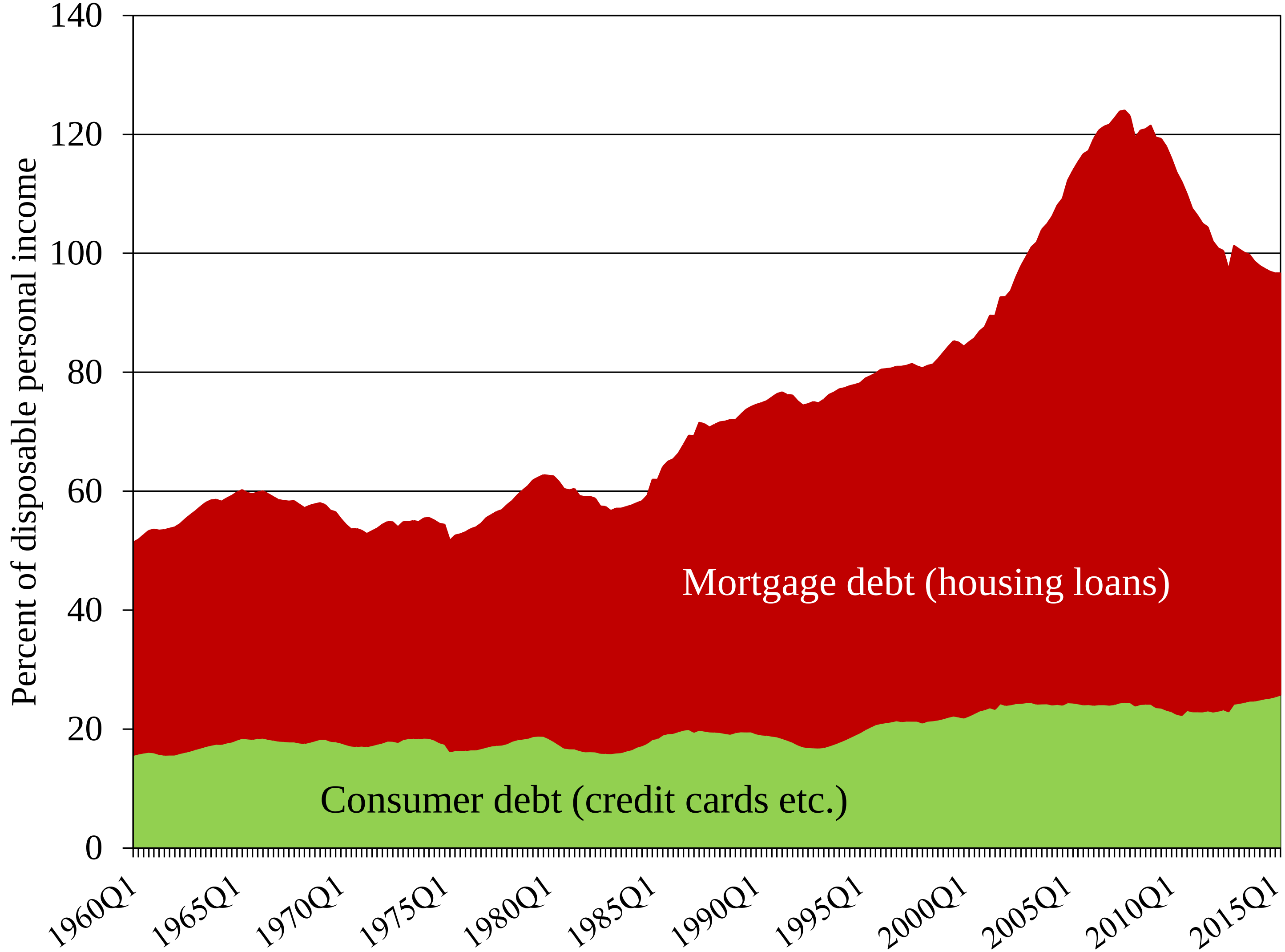


Source: World Top Incomes Database, http://topincomes.parisschoolofeconomics.eu/, last updated July 25,2015, downloaded September 27, 2015.

Household borrowing delayed the stagnation of demand

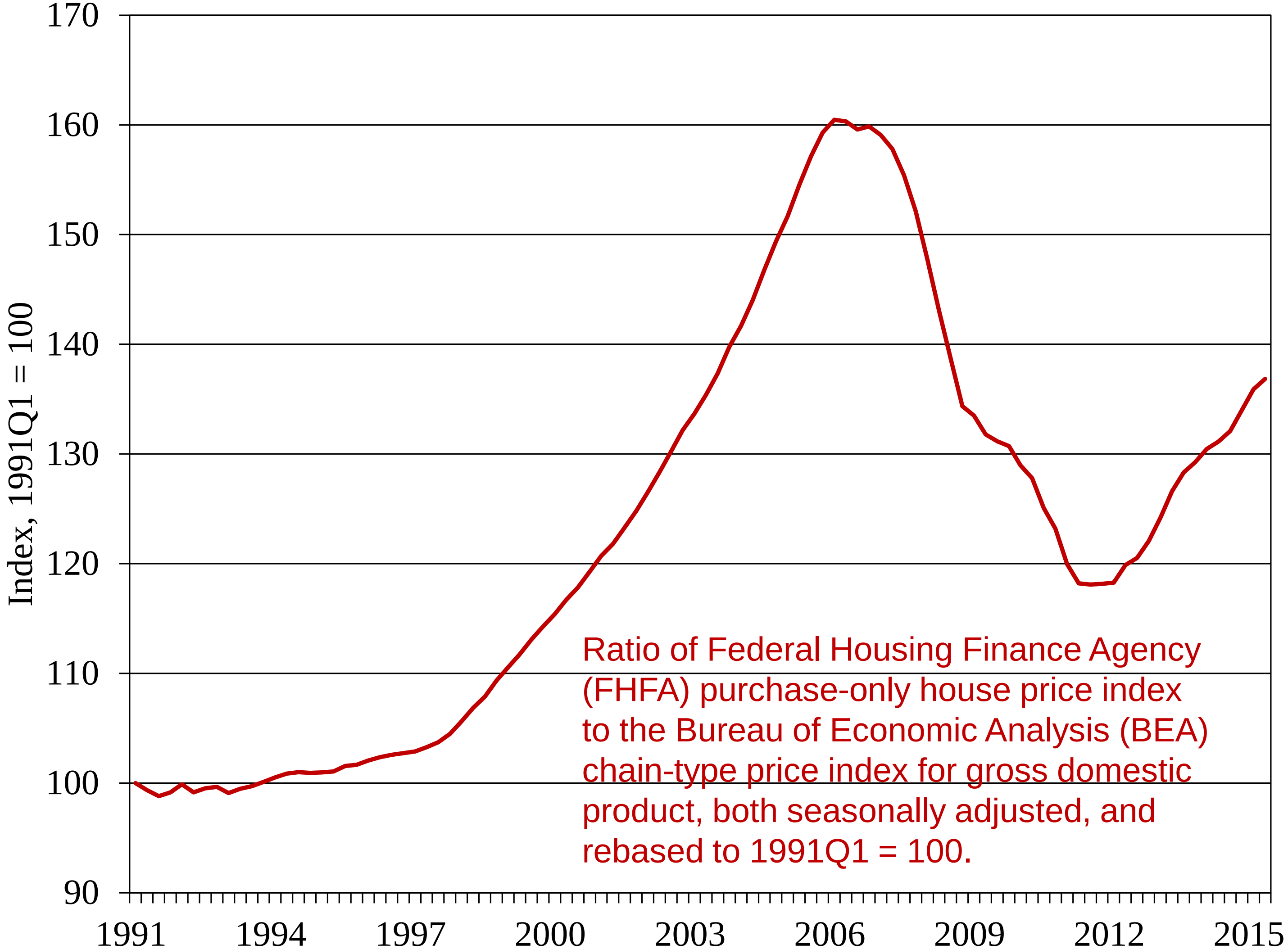
- Rising inequality and stagnant earnings were counteracted by increasing household debt and asset price bubbles during the expansions of the late 1990s and early 2000s
  - This was encouraged by a deregulated financial system that offloaded the risk from the banks that originated the loans into securitized assets
    - Financialization/money manager capitalism
  - But the debts and bubbles were unsustainable
    - Godley (1999); Pollin (2003); Cynamon, Fazzari, and Setterfield, eds. (2013); Lavoie and Stockhammer, eds. (2013); Hein (2012); and many others
- Most of the increased debt was in mortgages, used to pay for housing
  - But some of the borrowed funds can be used directly or indirectly to pay for consumption
- Rising debt service burdens, the collapse of house prices, rising unemployment, and tighter credit conditions after the bubble burst in 2007 put an end to this household debt-led consumption boom

US household debt as a percentage of disposable personal income, quarterly 1960Q1 to 2015Q2



Sources: Federal Reserve, Financial Accounts of the United States (Z.1), http://www.federalreserve.gov/releases/Z1/default.htm; release date 9/18/15; BEA, NIPA Table 2.1, www.bea.gov, release date 9/25/15; all data downloaded 9/27/15; and author's calculations.

US Real Housing Price index, quarterly, 1991Q1 to 2015Q2 (SA)

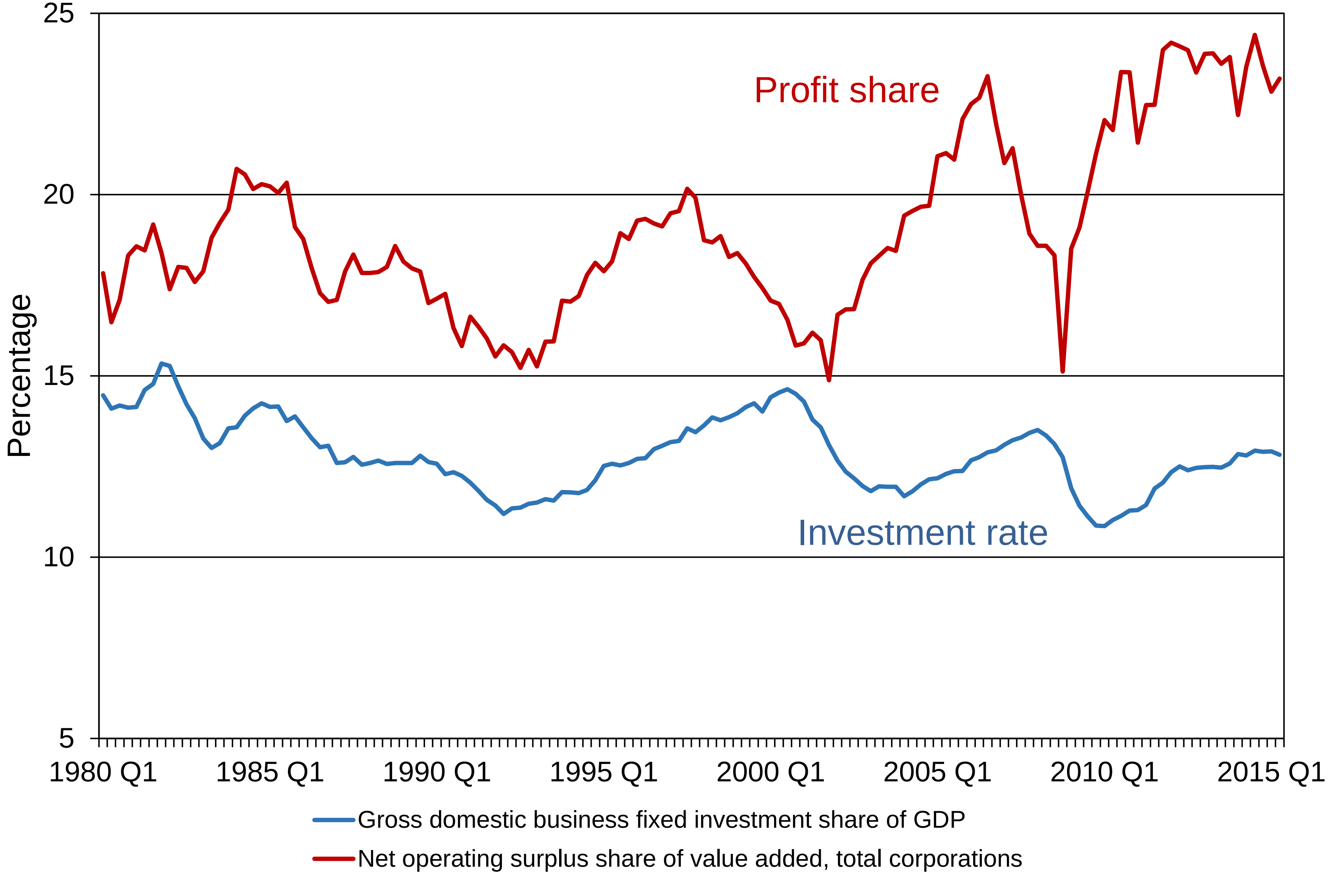


Source: FHFA, www.fhfa.gov, data released 9/22/15; BEA, www.bea.gov, NIPA release of 9/25/15; all downloaded 9/27/15; and author's calculations

Investment has not increased to take up the shortfall in aggregate demand

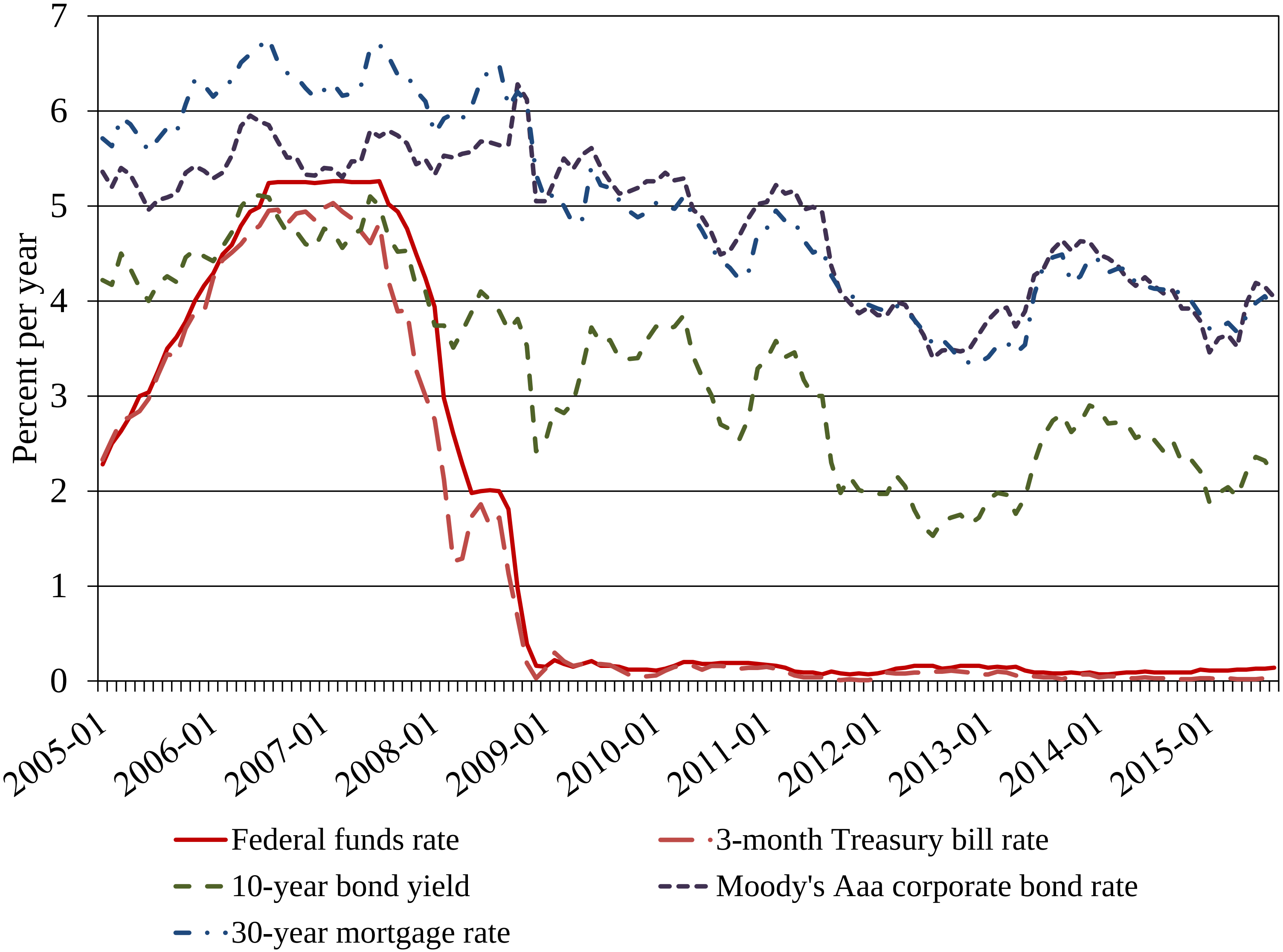
- In spite of record high profits and low interest rates, business fixed investment as a share of GDP has been trending downward since 2000
  - Firms seem to be responding mainly to the lack of demand growth (strong accelerator effect)
  - Contrary to some studies that have found “profit-led growth” in the US
  - This also shows the weak impact of monetary policies (conventional and QE)
- Both housing and business construction are still depressed
  - Business investment in equipment and “intellectual property” has recovered relatively more, but not enough to make up for weaker construction
  - Firms are diverting profits to stock buy-backs, mergers & acquisitions, FDI, and other uses that don’t augment domestic capital stocks

Business fixed investment share of GDP and profit share of corporate value added



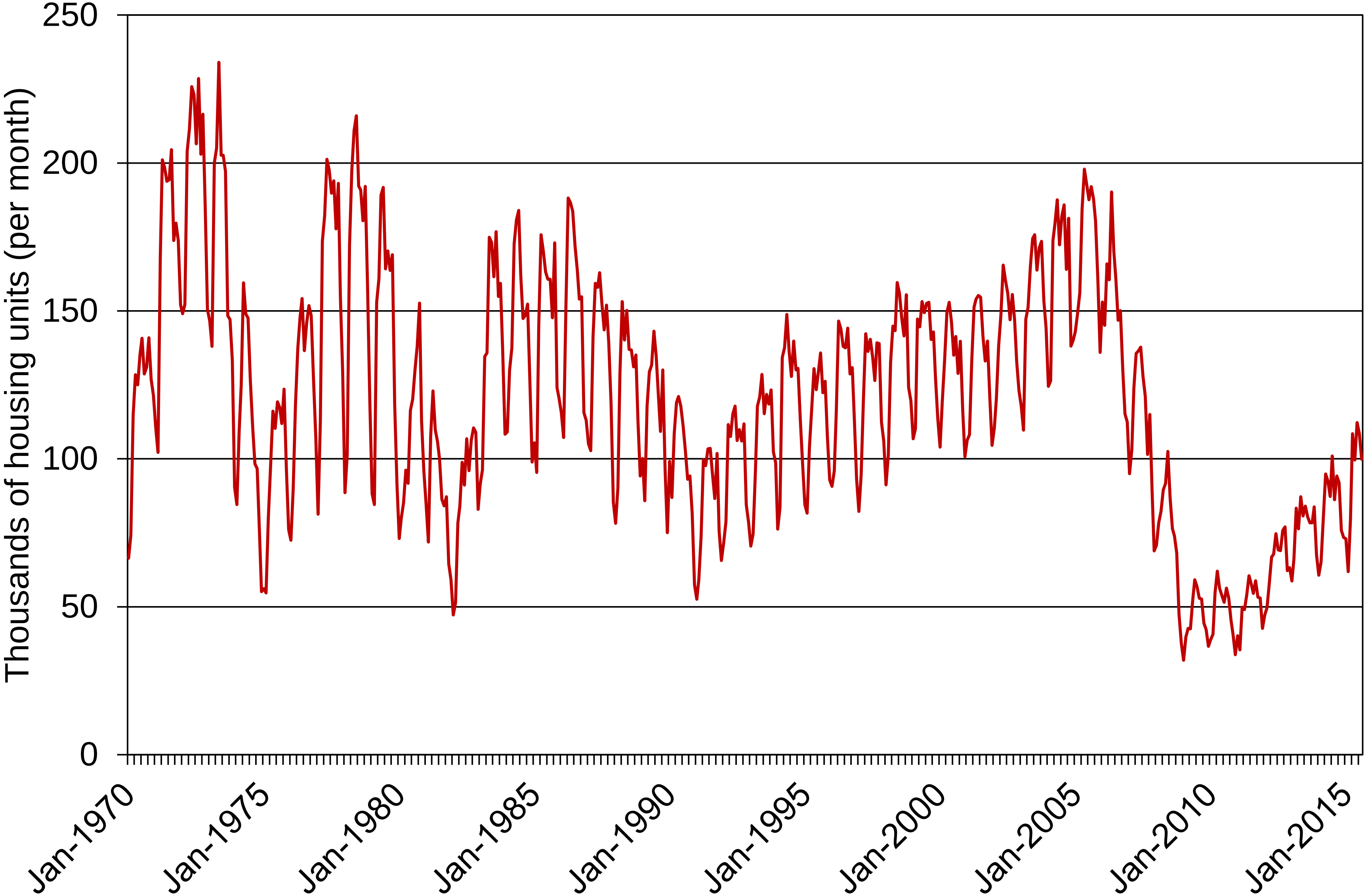
Source: US Bureau of Economic Analysis, www.bea.gov, NIPA Tables 1.1.5 and 1.14, data release of 25 September, 2015; downloaded 2 October, 2015; and author’s calculations.

US interest rates, monthly, January 2005 to August 2015



Source: Board of Governors of the Federal Reserve System, Statistical Release H.15 Selected Interest Rates, http://www.federalreserve.gov/datadownload/, downloaded September 25, 2015.

US Housing Units Started, Monthly,
January 1970 to August 2015 (not seasonally adjusted)



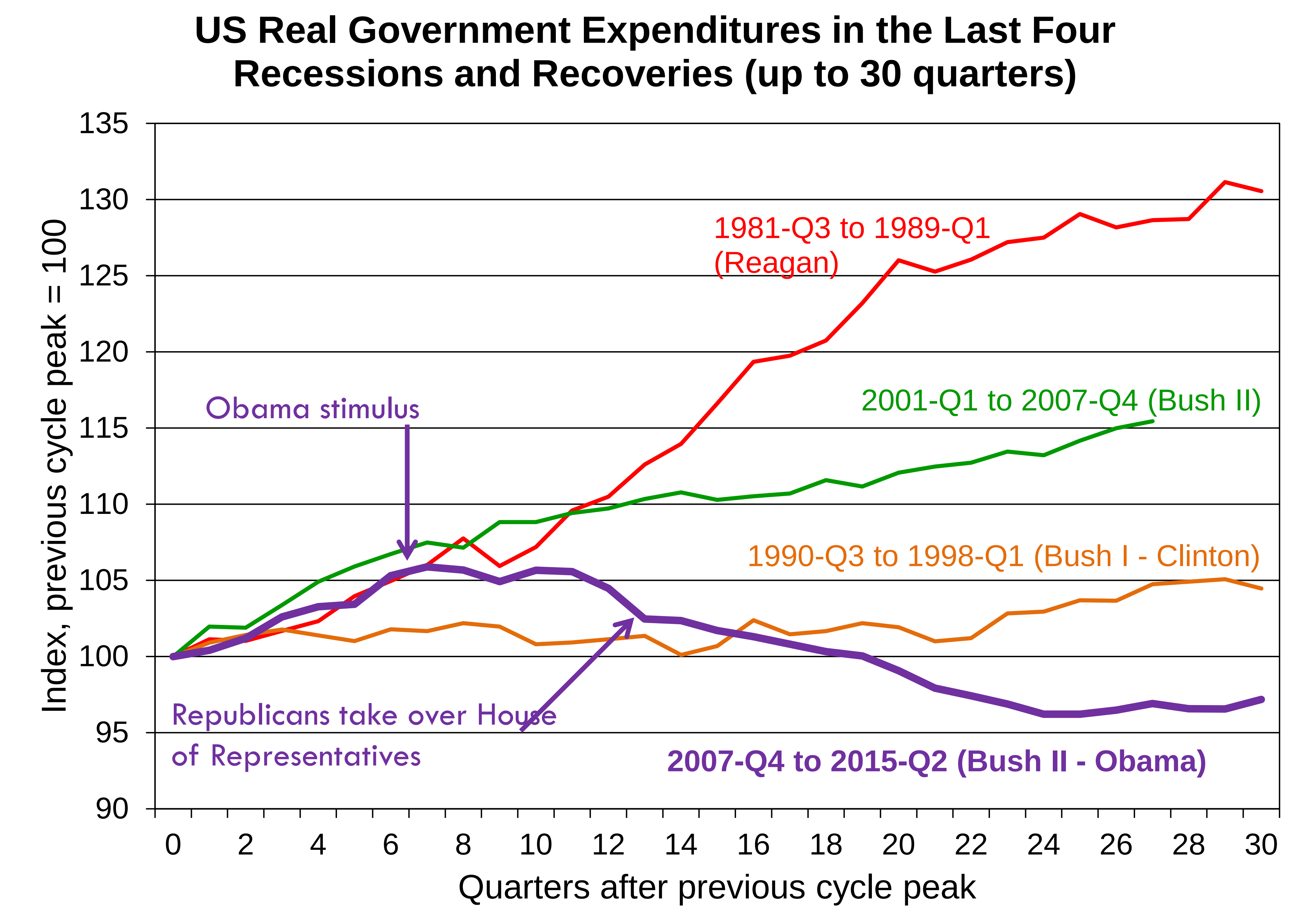
Source: US Census Bureau, www.census.gov, Business and Industry Surveys, New Residential Construction, downloaded September 25, 2015.

Impact on growth of potential output

- The slower accumulation of capital reduces the growth of potential output on the supply side
  - The decrease in growth of potential output is endogenous and results largely from the demand-side slowdown (L. Ball and others)
  - Reduced labor force participation and slower human capital accumulation also contribute
- "A reduction in capital deepening—which we view as mostly an endogenous response to weak demand—caused almost half of the cumulative shortfall in potential output from its pre-crisis trend"
  - Reifschneider, et al. (2013, p. 33)
  - Decreased labor force participation and depreciated human capital of long-term unemployment workers also contribute

Fiscal policy: Austerity US style

- Tax cuts under Reagan (1980s) and George W. Bush (2000s) generated chronic budget deficits, which were later used as an excuse to slash social expenditures and public infrastructure investment
- Stimulus policies during the crisis: too little, too late, too short
  - A small tax cut under Bush, spring 2008
  - Combined tax cuts and spending increases under Obama, 2009-10
- Government expenditures have been cut repeatedly since the Republicans retook control of the House of Representatives in 2011 and Senate in 2013
  - The debt ceiling compromise (2011) led to the fiscal cliff and sequestration (2012-13)
  - The Republicans have demanded spending limits as a condition to avert a government shutdown or raise the (artificially imposed) debt ceiling
- The result has been a serious "fiscal drag" on the recovery



Source: US Bureau of Economic Analysis, www.bea.gov, NIPA Table 1.1.6, data revised August 27, 2015, and author's calculations. Note: Total government expenditures include federal, state, and local.

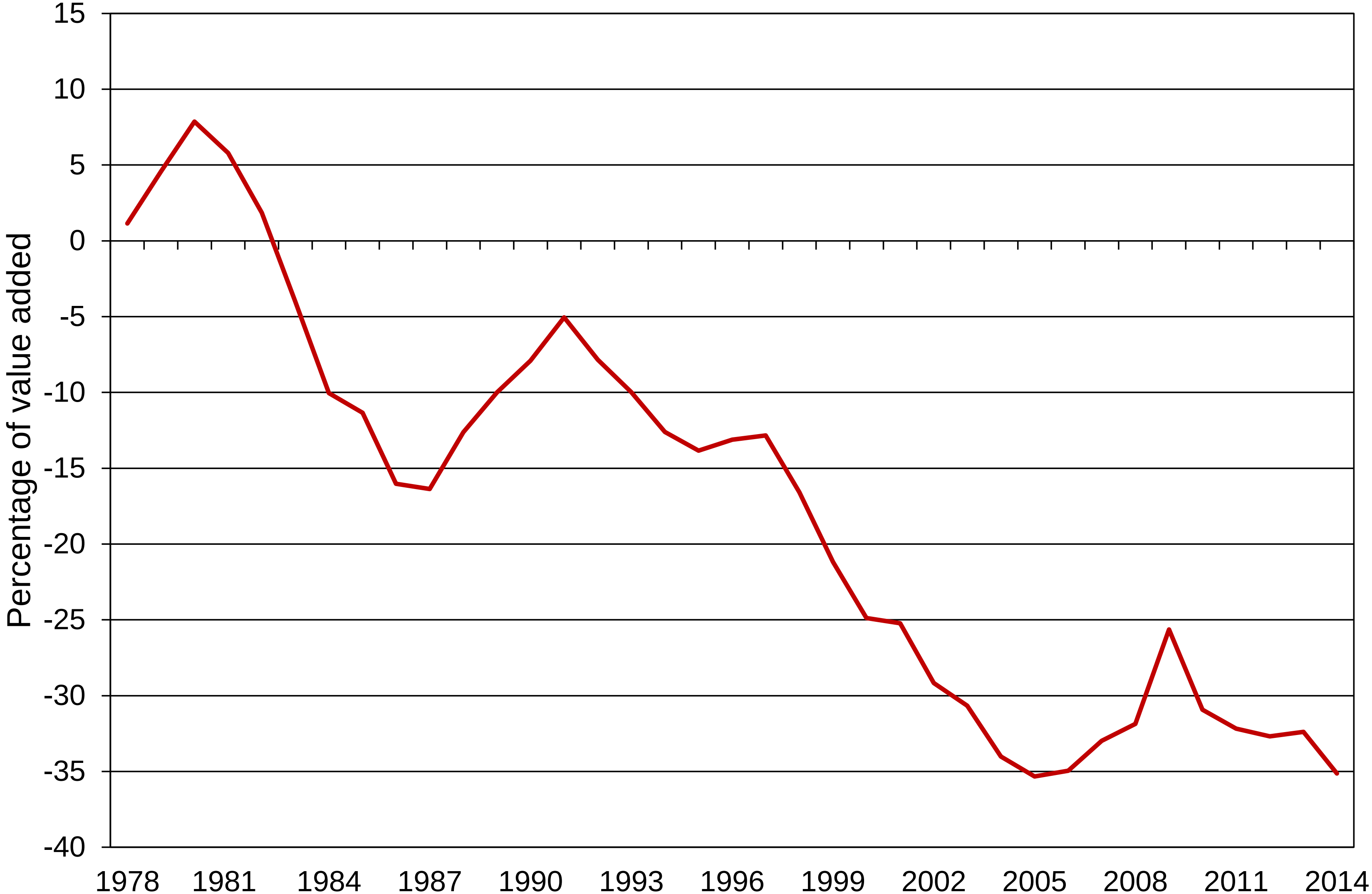
Underlying structural causes

- The story of greater inequality and a reduced wage share creating a tendency toward weaker consumer demand, which was offset by household borrowing and asset price bubbles until 2007, has been told many times
- But what were the ***causes*** of increased inequality and a lower wage share in the US?
  - There are many causes; I will focus on the ones most directly related to secular stagnation of income and employment
- The causes are structural *and* related to the deteriorating performance of the US labor market and the changing position of the US in the global economy

Changes in the composition of output and structure of industries

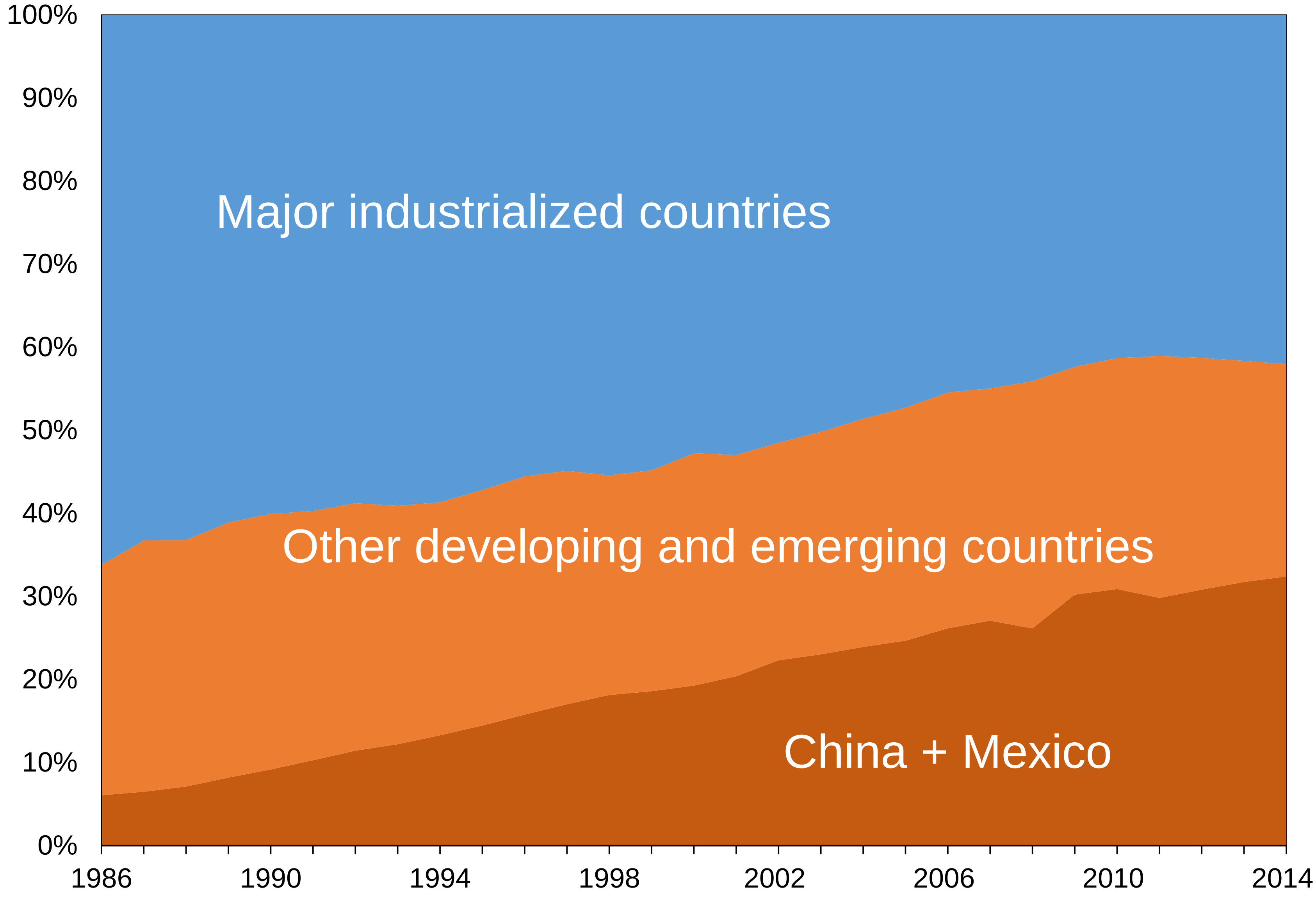
- The share of manufactures and other goods in GDP is falling; the share of services is rising
  - Driven by a rising trade deficit in manufactures and the vertical disintegration of industries (offshoring of intermediate goods and assembly operations) as well as profound technological changes
  - What remains of US manufacturing needs relatively little labor as a result of technological innovation and vertical specialization
    - The most labor-intensive operations are outsourced
- This has a two-sided effect on labor markets and inequality:
  - Downward pressure on wages
    - Most of the growth in manufactured imports comes from low-wage countries (Mexico, China, other developing and emerging economies)
  - Decline in high-wage employment
    - As manufacturing shrinks and low-wage services expand

US manufacturing trade balance as a percentage of value added in manufacturing, annually, 1978-2014



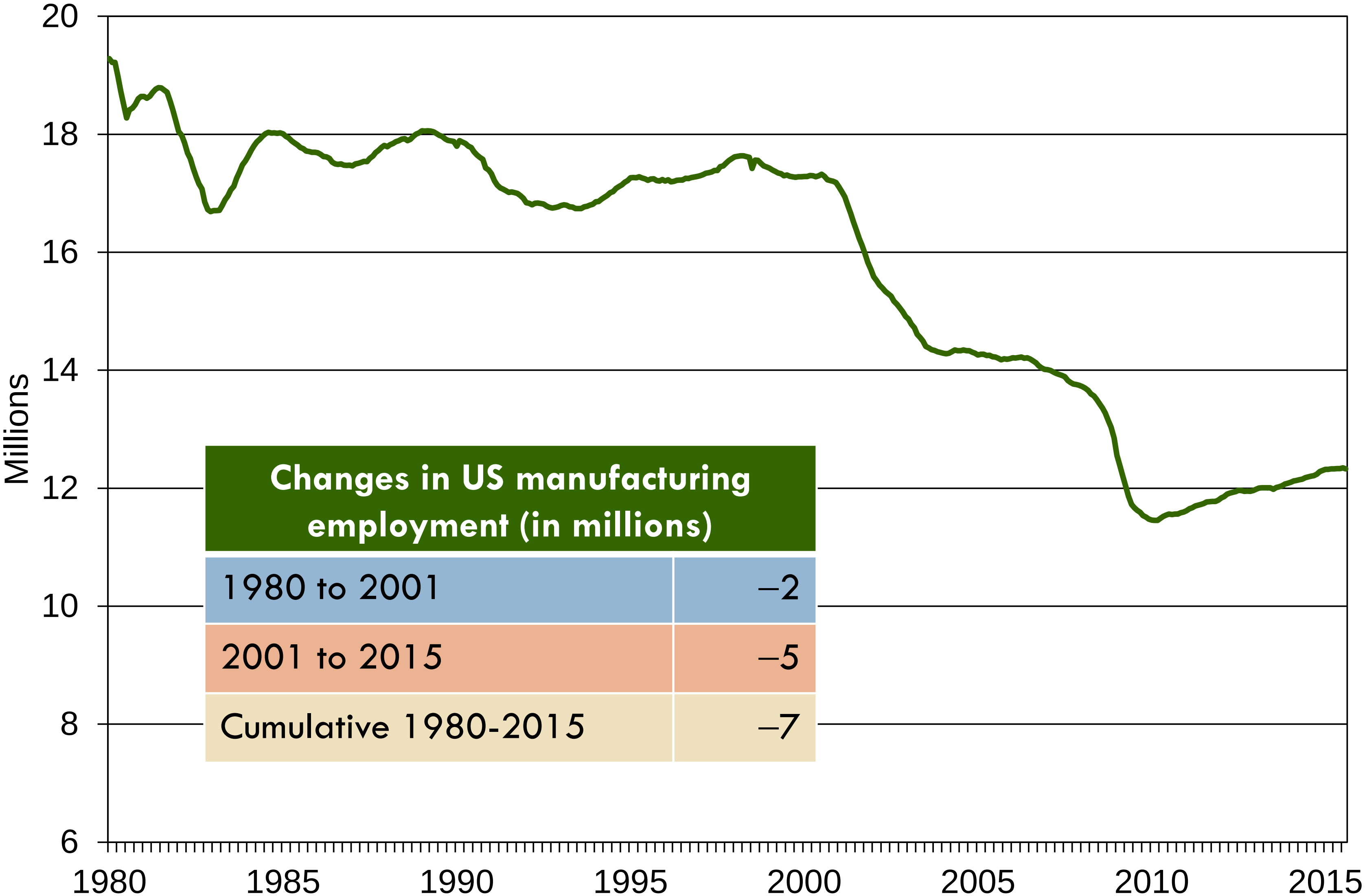
Source: Census, FT900, various years, www.census.gov; BEA, International transactions accounts (release of September 17, 2015) and GDP by industry (release of April 23, 2015), www.bea.gov, all downloaded October 3, 2015, and author’s calculations. Note: trade balance data for manufacturing in 1978-1991 are author’s extrapolations (backward forecasts). Details available on request.

Shares of US imports of goods, annually, 1986-2014



Source: BEA, International Transactions Accounts (balance of payments basis), Table 2.1 and historical Table 2b, release of September 17, 2015, downloaded October 3, 2015, and author's calculations.

US Manufacturing Employment in Millions, Monthly, January 1980 to August 2015



Changes in US manufacturing employment (in millions)	
1980 to 2001	–2
2001 to 2015	–5
Cumulative 1980-2015	–7

Source: US Bureau of Labor Statistics, www.bls.gov, Employment, Hours, and Earnings from the Current Employment Statistics survey (National), downloaded September 26, 2015, and author's calculations.

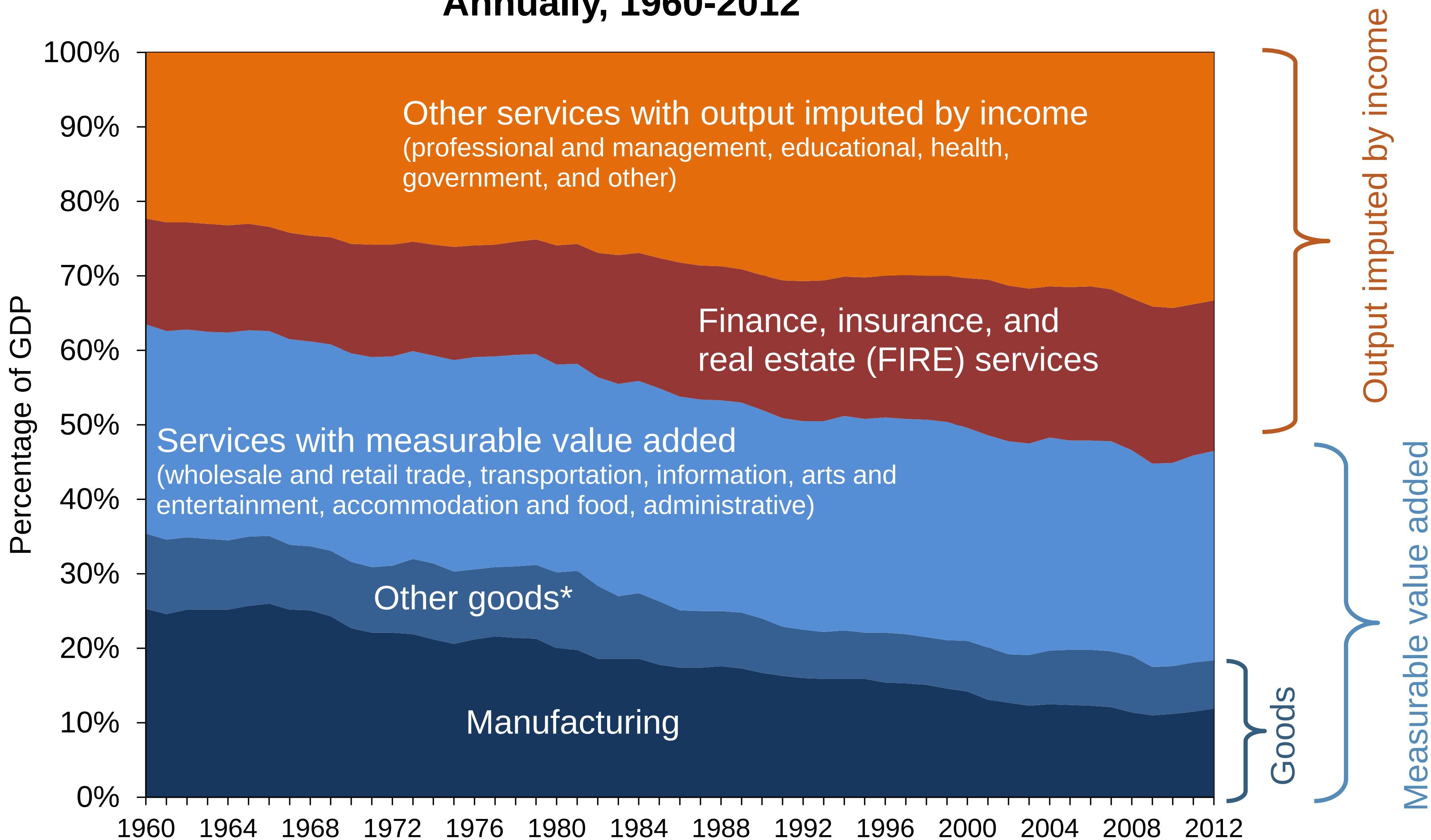
The impact of a rising share of services in GDP on employment in cyclical recoveries

- A growing proportion of services industries implies a slower recovery of employment after recessions (Olney & Pacitti, 2015)
  - Service producers don’t need to restock inventories in anticipation of increased demand
    - Also few services are exported so exports don’t provide a boost in the recovery
    - Much of the recovery in manufactures is transmitted to the exporting nations that supply US imports
  - These factors leader to longer recoveries for employment after a cycle trough, as we have seen following the past three recessions (1991, 2001, 2008-9)

The impact of a rising share of services in GDP on long-term employment trends

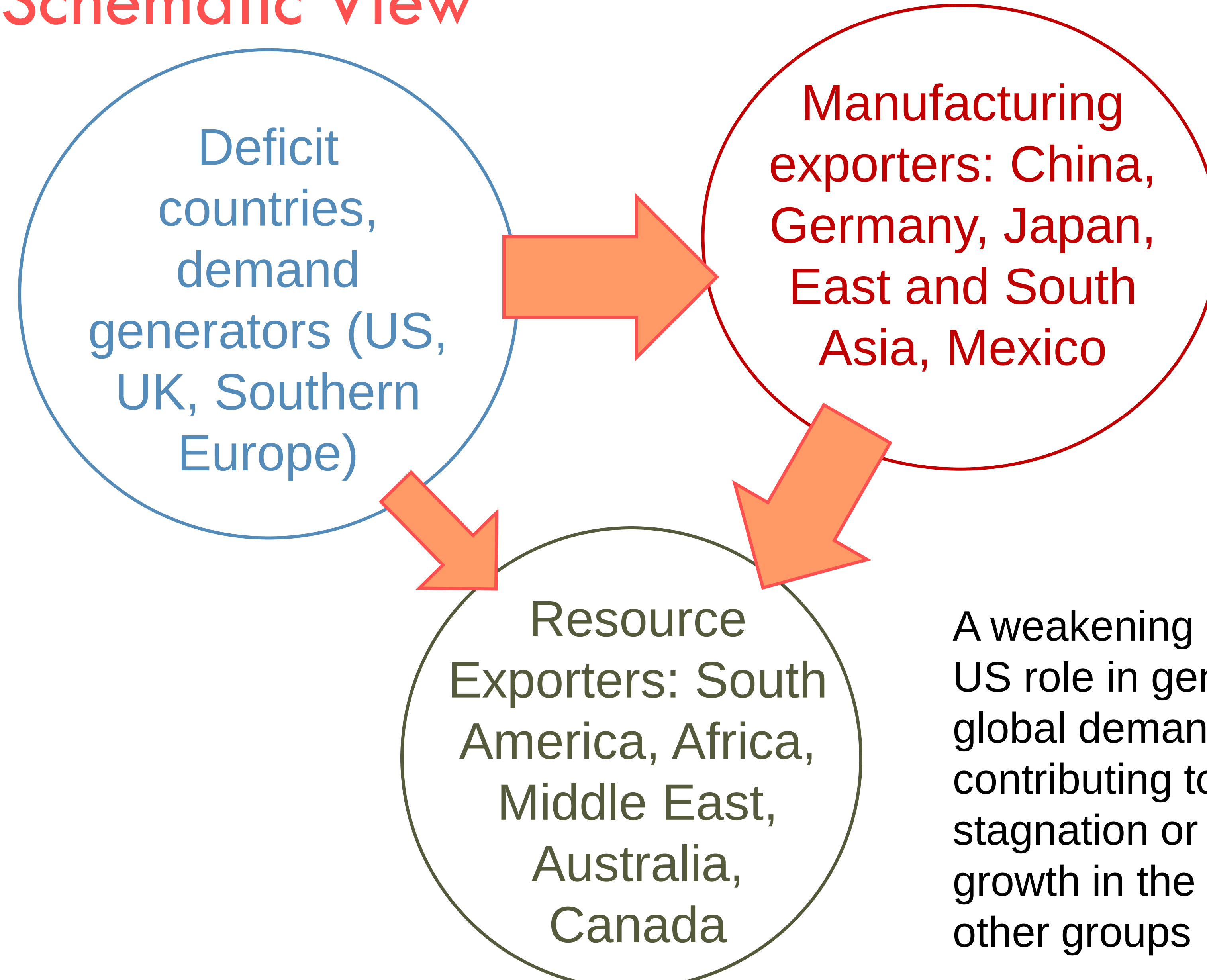
- Services are not all equivalent (Basu & Foley, 2013)
  - Some services have “measureable value added” (MVA)
    - These sectors create jobs in proportion to value added
  - Other services don’t have measurable value added
    - Their “output” is imputed based on income received, and not closely related to job creation
      - Especially “FIRE” (finance, insurance, real estate)
- The growing proportion of non-MVA services in total GDP makes employment growth become delinked from (measured) output growth
  - Thus employment growth has become weaker *relative* to GDP growth in the last several business cycles and secularly since 2001

Composition of US Output (Value Added by Industry), Annually, 1960-2012



Source: BEA, www.bea.gov, GDP by industry tables, release of April 25, 2013, and author's calculations. Categories suggested by Basu and Foley (2013).
*Other goods consist of agriculture, forestry, fishing, mining, and construction.

Principal Net Global Demand Flows: A Schematic View

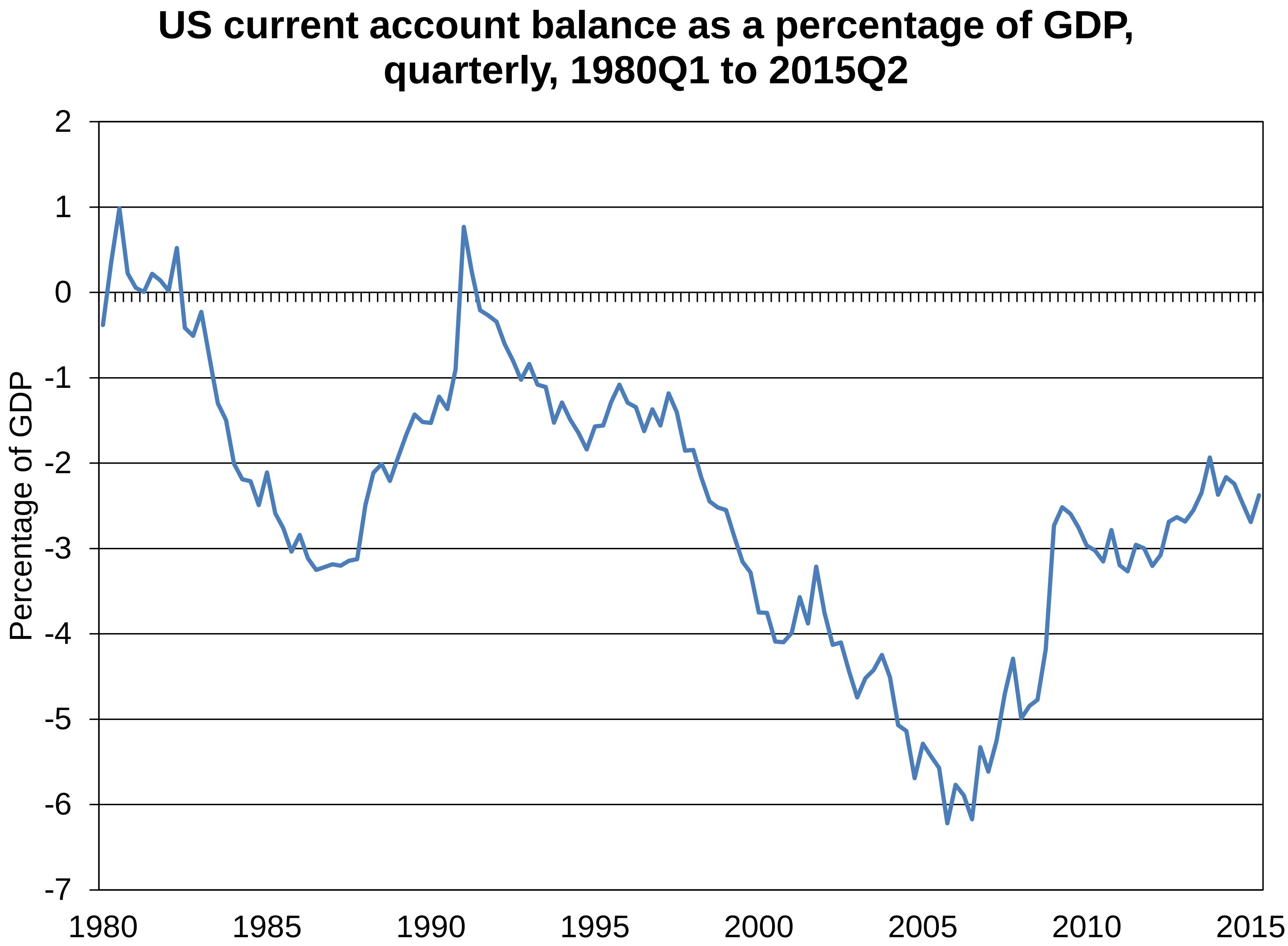


A weakening of the US role in generating global demand is contributing to stagnation or slower growth in the two other groups

Global impact of US stagnation

- In the 1990s and early 2000s, global growth was sustained by a triangular pattern of trade imbalances, financial flows, and demand transmission
  - The US current account deficit and corresponding East Asian surpluses
  - Intraregional imbalances and demand flows *within* the Euro Area, North America, and East Asia
- This pattern of imbalanced growth led to rising commodity prices for resource exporters in the early 2000s
  - The commodity price boom has now ended, causing growth slowdowns in primary commodity exporting nations
  - During the boom, Dutch disease caused deindustrialization in mixed primary-manufactures economies, e.g. Brazil and Canada
- Manufacturing exporters (Germany, China, Mexico, etc.) ultimately relied on debt-driven household demand in the deficit countries (chiefly the US, also the European periphery) for their export-led growth
  - The fallacy in this strategy is that it ultimately weakens the very source of its dynamic by undermining employment and incomes in the deficit nations that generate the demand

A smaller US current account deficit implies a weaker demand impulse to the rest of the world since 2008



Source: BEA, National Income and Product Accounts, Tables 1.1.5 and 4.1, revised September 25, 2015, www.bea.gov, and author's calculations.

Global economic prospects

- The US is not likely to be as strong a generator of global demand in the foreseeable future as it was before 2008
  - The continued US large trade deficit in manufactures is only partly offset by improved trade balances in services, and investment income
  - *Smaller US current account deficits imply less transmission of demand stimulus to the rest of the world*
- To avoid sustained global deflationary pressures, the surplus nations and resource exporters need to generate more of their own demand, and not rely so much on the US or other deficit countries to be the locomotives of growth in the coming years
  - Enhanced "South-South" trade (among developing and emerging market countries) can play a pivotal role
  - But the major surplus countries (Germany, China, Japan) also need to do their part to prevent a deflationary adjustment

Summary

- The US economy is currently locked into a trajectory that implies a *tendency* toward secular stagnation as a result of these *interrelated* factors:
  - Underlying weakness of household demand due to stagnant real wages and increasing inequality
    - Once the artificial fillip of excessive borrowing and debt is removed
  - Structural changes leading to reduced employment generation in proportion to output growth and a shrinkage of high-wage manufactures
  - Weak private sector investment in spite of record profits and low interest rates
  - Political gridlock and the imposition of austerity in fiscal policy
  - Reverberations from foreign slowdowns especially in the euro area and resource exporters, which are key markets for US exports

Tendencies vs. predictions

- The last time I predicted US stagnation was in a 1994 book chapter
  - Very bad timing; I learned a lesson
  - Any prediction must be conditional on the absence of counteracting forces
- Possible offsets include:
  - A new financial bubble and debt-led spending boom
    - We should not underestimate the ingenuity of Wall Street or the short memories of policy makers and private agents
    - Of course it would not be sustainable
  - An enhanced role for the public sector
    - For example, though public investment in infrastructure, clean energy (solar, wind), and other social needs – ***or*** a new military build-up?
    - Restoring Hyman Minsky's "big government" and possibly creating an "employer of last resort" for countercyclical purposes
  - None of this will make a dent in inequality unless it creates sustained high employment leading to a recovery of wages relative to productivity, and unless the underlying structural problems are also addressed