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

Daniele Tavani
@danieletavani

Colorado State University, Fort Collins, CO, United States

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1The presentation draws from joint work with Luke Petach, Belmont University
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).

Secular Stagnation and Inequality

What did we learn about these trends?

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

Balanced Growth condition:

\[
s^c u(1 - \omega) = \gamma(\omega) + n \tag{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, $\omega$ the labor share, $\gamma$ 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 $k/y$. 
What about wealth concentration?

Pasinetti's Theorem!

Workers' saving rate $s_w$ is irrelevant for long-run growth. A two-class wealth distribution arises provided that $s_c (1 - \omega) \geq s_w$ (empirically true for the US).

Long-run, inverse relation between $u$ and the capitalist wealth share $\phi$.

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 $\phi$ (see also Ederer and Rehm 2020).
Secular Stagnation and Inequality (3)

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The “Before Times” – Great Recession & Hysteresis

Real GDP vs. CBO projection of potential GDP in 2007 vs. CBO potential GDP in 2017 (dashed).
Great Recession and Hysteresis  Classical-PK Explanations

Classical-Post-Keynesian “Irenics”

- Demand matters even in supply-driven models because it affects firm beliefs about the state of the economy.
- The output/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:
    - $↑ u$ i.e. higher “utilization”
    - $↑ ω$ i.e. higher labor share
    - $↓ φ$ i.e. lower capitalist wealth share
  - Temporary growth effects with Kaldor-Verdoorn technical change;
  - Permanent growth effects under conflict-driven technical change.
Assessment

The “before times” were not that great.
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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

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 Protection Program: loans to small businesses (< 500 employees, with exceptions, about $500B)

Impact of Paycheck Protection Program on Low-Wage Employment
Change in Employment Rates by PPP Eligibility, Reweighted to Match Industries, Excl. Food Services

(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).
- Pandemic Unemployment Assistance for gig workers who didn’t qualify for UI or PUEC.
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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).
Assessment: 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.
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- Hugely important: deeply concerning trends in women’s LFP rates especially because of partial, idiosyncratic school closures.

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And yet, a new round of stimulus is paramount.

Currently (maybe?) being negotiated between House, Senate, and White House.

Direct gov’t spending especially to cover for State fiscal deficits would be very effective.
Taking Stock

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- And yet, a new round of stimulus is paramount.
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Total Costs

- > 220,000 Covid-deaths as of October 21, \( R_t > 1 \) in 41/50 states, and > 8.3 million infections.
- Cutler and Summers’ (2020) dismal arithmetic of the likely total cost of the pandemic:
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<table>
<thead>
<tr>
<th>Table. Estimated Economic Cost of the COVID-19 Crisis</th>
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<tbody>
<tr>
<td><strong>Category</strong></td>
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<tr>
<td>Lost GDP</td>
</tr>
<tr>
<td>Health loss</td>
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<tr>
<td>Premature death</td>
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<tr>
<td>Long-term health impairment</td>
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<td>Mental health impairment</td>
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<tr>
<td>Total</td>
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<tr>
<td>Total for a family of 4</td>
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<tr>
<td>% of annual GDP</td>
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Abbreviation: GDP, gross domestic product.

(1) Source: Cutler and Summers (2020).
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Looking Ahead

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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.

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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.
Conclusion

Thank you!