The Possibilities and Limits of Macro Policy in the U.S.

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An Economic Crisis of Neoliberal Capitalism

• Wall Street Crash and Great Recession
  – Deregulation of financial markets produced hyper-speculation and overleveraging
    • This has been pattern with unregulated financial markets throughout history
    • Kindleberger, *Manias, Panics and Crashes*
From Financial Bubble To Crash

Figure 16.1
Real Quarterly Housing Prices in the U.S., 1990.1 - 2012.3

Source: Case-Shiller Housing Price Index
Note: Case-Shiller Index deflated by CPI-U price index
Figure 16.3

Source: U.S. Flow of Funds Accounts
Evaporation of $17 Trillion in Household Wealth

Figure 16.2. U.S. Household Net Worth, 2001--2011

In Trillions

(inflation-adjusted 2011 dollars)

Source: Balance Sheets of U.S. Economy
Note: Inflation adjustment with CPI-U.
Policy Responses to Crisis

- Bailouts for financial institutions and markets, and auto industry
  - Via both U.S. Treasury and Federal Reserve
- Near-zero interest rate for Fed policy rate—federal funds rate
- $787 billion fiscal stimulus
  - American Recovery and Reinvestment Act (ARRA) of 2009
Figure 17.3
U.S. Federal Funds Rate, 1998.01 - 2013.01

Source: Economagic
Figure 1. U.S. Federal Deficits as Share of GDP

Deficits as pct of GDP

Source: U.S. Office of Management and Budget
"Recovery" from Great Recession versus 8 Previous Recessions/Recoveries

Where is the Economy 3 Years After Recession Ended?

Unemployment remains much higher

9.2%
average unemployment
3 years after Great Recession ended

6.3%
average unemployment
3 years after 8 previous recessions ended
GDP Growth is Much Slower

4.5%
Average GDP growth 3 years after 8 previous recessions ended

2.3%
Average quarterly GDP growth 3 years after Great Recession ended

Source: Economagic
Why Weak Recovery?

• **Wealth evaporation**
  – Wealth effect ~ 3 – 5%
    • $17 trillion in lost wealth = ~ $500 billion in aggregate demand loss

• **Stimulus too dependent on tax cuts**
  – Congressional Budget Office:
    • Multipliers for direct govt. spending 4 times higher than for tax cuts for high-income people
      – Tax cuts 24% of stimulus

• **Collapse of Credit for Small Businesses**
  – Banks hoarding cash instead
Figure 10.1
Borrowing by U.S. Non-Corporate Businesses, 2001 - 2012

Figures are billions of real 2012 dollars

Notes: Inflation adjustment is with producer price index; 2012 figure is through 2012.3
Source: U.S. Flow of Funds Accounts
Figure 17.6
U.S. Depository Institutions Vault Cash and Reserves, 2001 - 2011

Billions of Dollars

Source: U.S. Flow of Funds Accounts
Arguments of Austerity Hawks

• Most fundamental problem with economy is fiscal deficits/debt
  – Not mass unemployment/weak growth recovery

• Increases in fiscal deficits will produce
  – Inflation
  – High interest rates
  – Overwhelming government debt burden

• Arguments for “sequestration”
  – $110 billion/year in automatic cuts relative to previous allocations
U.S. Federal Debt/Income Ratio from 1800 – 2050 Projection

Projection by U.S. Congressional Budget Office, with Annotation by John Taylor
As Cited in Taylor (2012)
Prof. John Taylor on Rising Debt/GDP Ratio

• “Its soaring upward climb resembles the fireworks on America’s Independence Day. But rather than remind us of America’s founding, it portends America’s ending. I carry a version of the chart in my wallet and show it to my students, and to my children and grandchildren, because it’s their future on the line,” (p. 101).
Figure 2. Interest Rate on 5-Year U.S. Treasury Bonds

- **1982.1 peak at 14.4%**
- **2012.4 at historic low, 0.7%**

Source: Economagic
Debt Burden?

**Figure 16.8**
U.S. Federal Government Interest Payments as pct. of Federal Expenditures

Source: U.S. National Income and Product Accounts
Macro Policy Imperatives for Now

• Fiscal Policy: *New Round of Fiscal Stimulus*
  – Focused on direct government spending
    • State & Local Governments
      – Education, Health Care, Public Infrastructure
      – Green Economy

• Monetary Policy: *Carrot and Stick with Bank Cash Hoards*
  – Maximum reserve requirement/excess reserve tax
  – Expand loan guarantees for small businesses
    • Measures will have almost no fiscal impact