Secular Stagnation in the 21st Century US Economy

INET Conference Session: "A Decade of Stagnation, Why?"
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A Decade of U.S. “Secular Stagnation”

- Summary of presentation
  - Headline data: stagnation in aftermath of the Great Recession
  - Theoretical debate: supply-side vs. demand-side
  - Empirical case: it’s not supply, it’s demand
  - Rising inequality and demand-side stagnation
- Acknowledgements
  - Support from INET
  - Co-authored work with Barry Cynamon

Recent Stagnation
(Peak-to-peak growth of real GDP per capita)

Peak Dates	Growth per Year (per capita)
1973:4 to 1979:3	1.8%
1979:3 to 1990:2	2.1%
1990:2 to 2000:2	2.2%
2000:4 to 2007:4	1.4%
2007:4 to 2017:2*	**0.6%**

*Final cycle is incomplete

Stagnation: Supply-Side Theoretical Lens

- Mainstream theory: Keynesian demand problems relevant only in the “short run;” supply side rules the long run
- The neoclassical synthesis
  - Old version: wage and price adjustment
  - New version: wise monetary policy
- Persistent stagnation
  - 10 years since peak; 8 years since trough
  - Beyond the short run, therefore, <u>problems must be with supply</u>

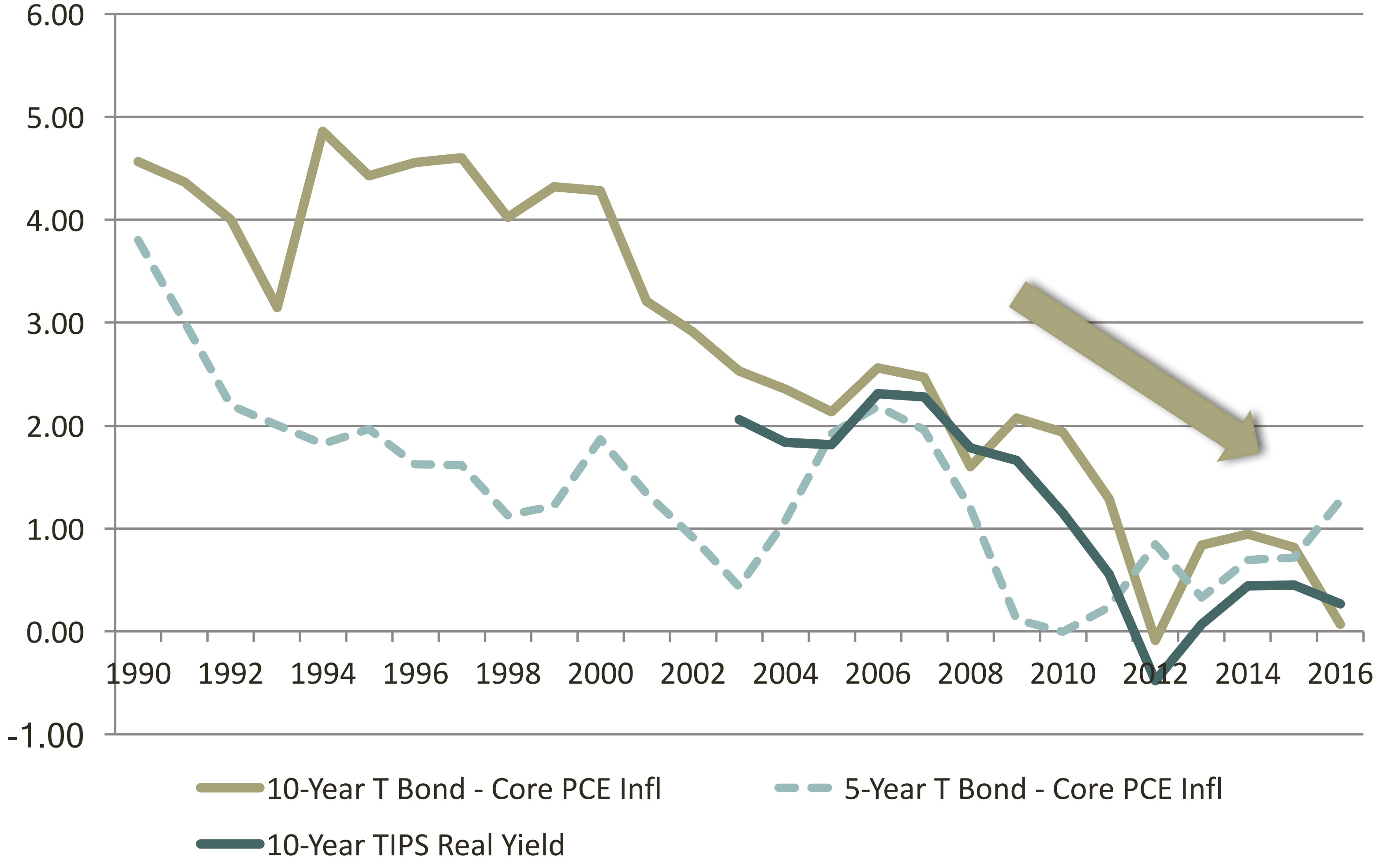
Stagnation: Demand-Side Theoretical Lens

- Critique of the neoclassical synthesis
  - Destabilizing effects of deflation and disinflation
- Can we rely on monetary policy?
  - Low interest elasticities of consumption and investment
  - If monetary policy works, it creates financial instability (Minsky)
  - If a “natural rate” exists, it is likely volatile and often negative
  - Zero lower bound not the main issue
- No endogenous market or policy mechanism to restore demand to potential output “beyond the short run”
- Demand growth dynamics are the engine of economic activity most of the time
- Look at the evidence …

Weak Evidence for Supply-Side Stagnation

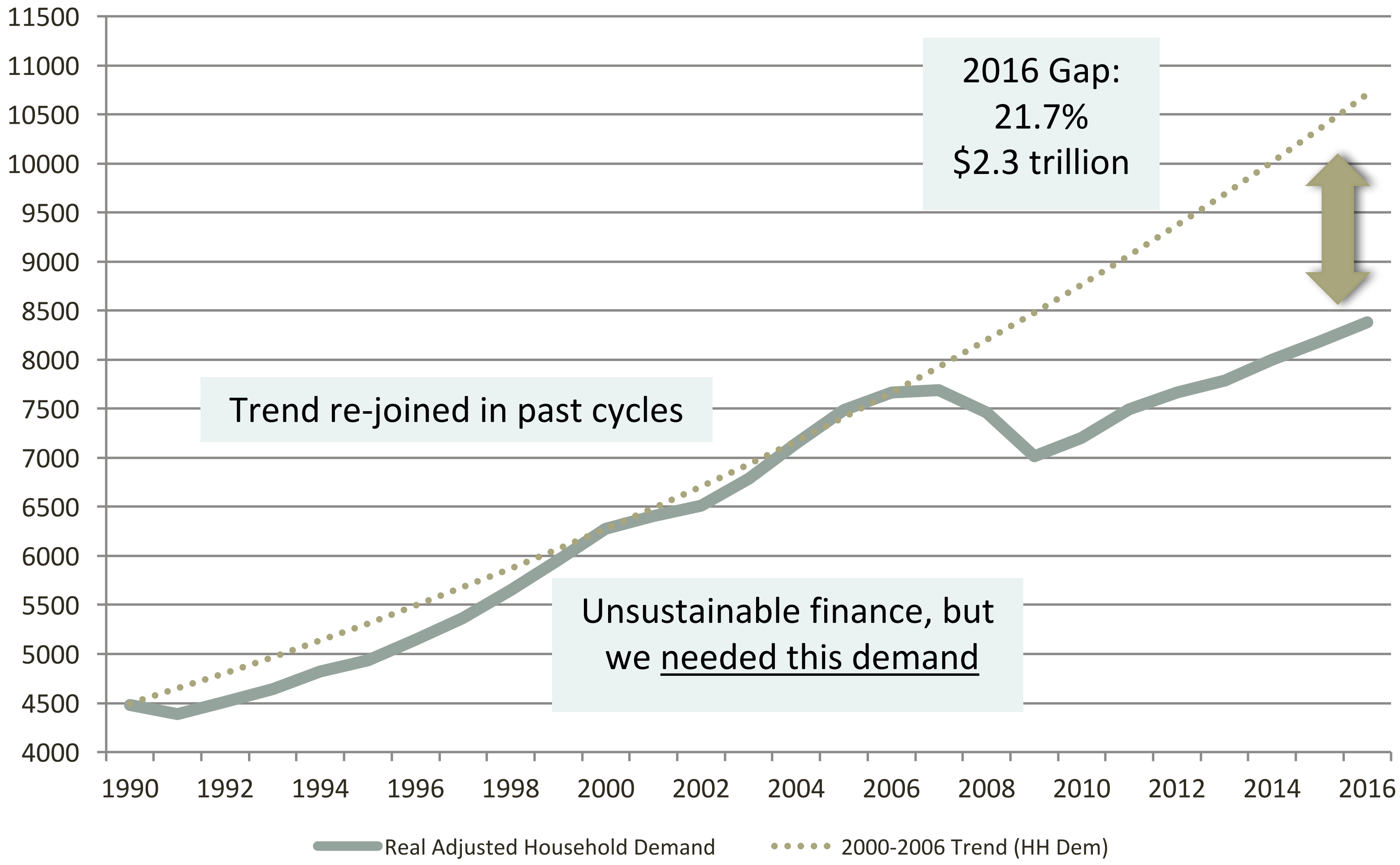
- Paper discusses some detailed evidence
  - More slack in the labor market than suggested by low unemployment rate
  - Business investment not particularly low given slow growth
- Key test: supply-side stagnation should cause high real interest rates

Real Interest Rates: No Evidence of Supply Stagnation



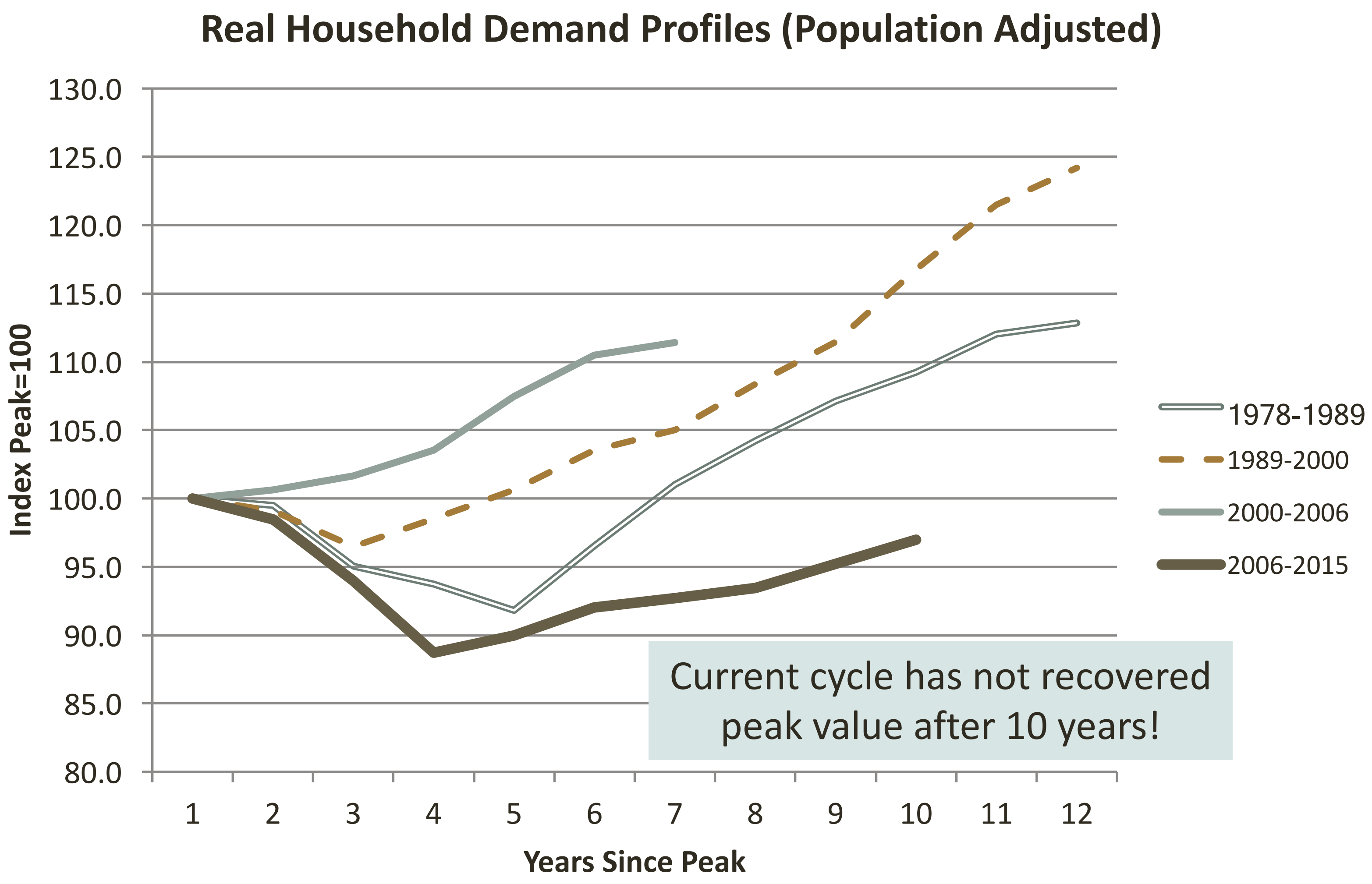
The Demand Side: Household Demand

(Adjusted household demand based on Cynamon & Fazzari, 2017)

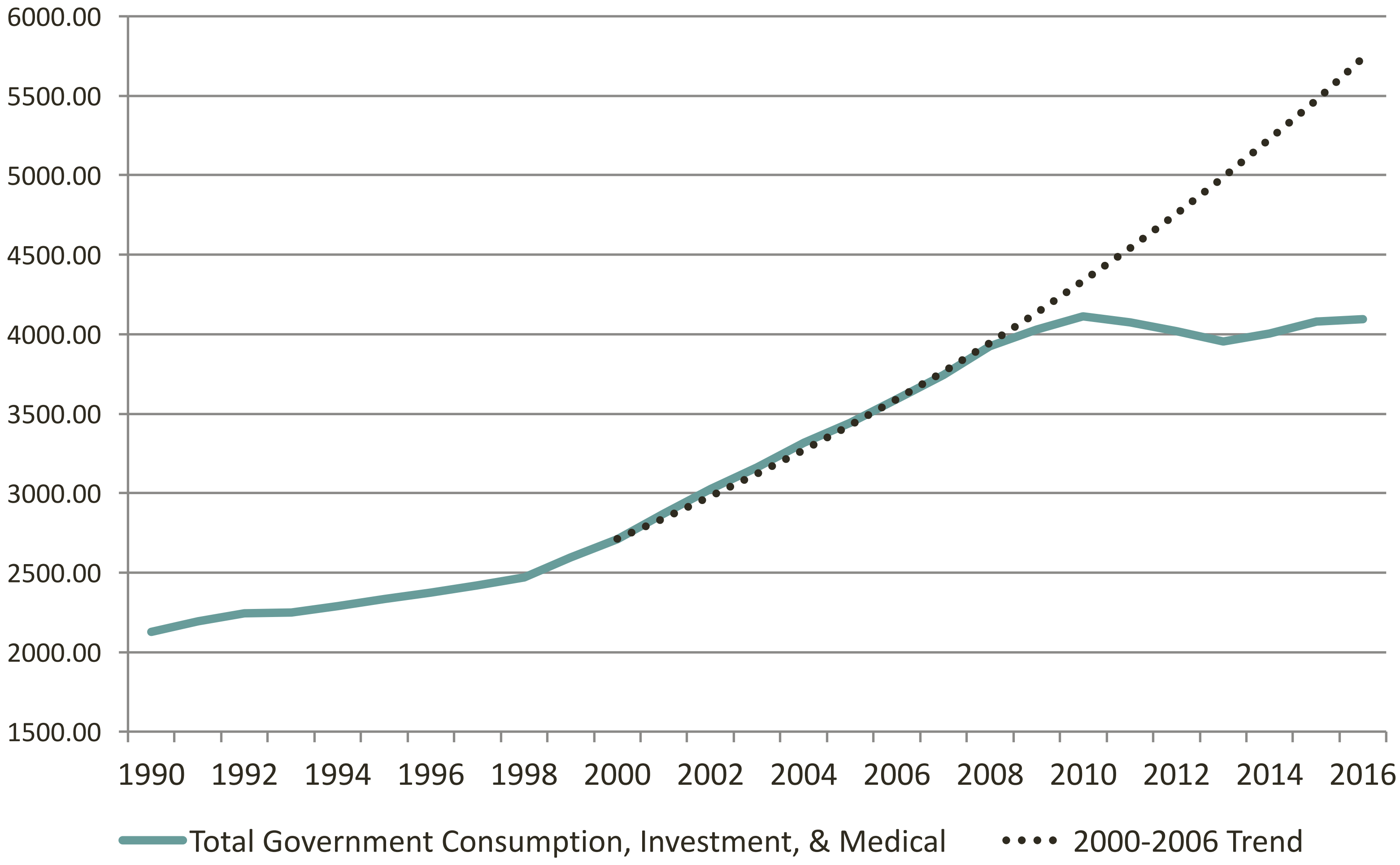


Weak Household Spending and the Stagnant Recovery

(Based on Cynamon-Fazzari Review of Income & Wealth, 2017)



Government Demand Did Not Replace Households



Nuanced Role for Inequality

- Rising inequality as explanation for stagnant demand
  - Rich spend or "recycle" a smaller share of income than others
- But, timing problem
- Borrow-and-spend era <u>postpones</u> demand drag
- Great Recession forces middle-class demand down
  - Now more in line with stagnant incomes
  - But we <u>needed that demand</u>
- Inequality can explain at least 10% slowdown of demand path since mid 1980s (Cynamon & Fazzari, <u>EJEEP</u>, 2015)

Consequences

- Disappointing “recovery” and secular stagnation “beyond the short run”
- Demand leads supply: reverse Say’s Law
- Deleveraging not enough to restore robust demand growth
  - Does not address root cause of rising income inequality
- Inconsistent calls for smaller government without addressing demand gap
- What engine of demand growth?
  - New research on household sustainability not optimistic
  - Recovery relies in large part on spending of the affluent

The Affluent as Growth Engine?