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What we need to do to Revive our Economy[1]

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Introduction

This brief paper addresses: A) Current economic conditions and how recent policy actions will make these conditions worse, B) Long-term structural "Supply Side" imbalances that are at the root of our problems , C) Related long-term "Demand Side" imbalances that are also fundamental to our present condition, and D) Suggested policy responses. The premise of this analysis is that we need to restructure and revitalize our economy away from an increasingly unsustainable and debilitating "rentier" structure to a more viable and sustainable advanced "unequal exchange" economy. [2]

A) Our Current Condition and What We Don't Need to Do

Without Fundamental Economic Restructuring Federal Deficit Cutting Will Hurt in the Short-Run *and in the Long Run.* Like most professional economists my eyes have been rolling at the single minded focus on the federal deficit in Washington as though this is the major source of our economic malaise.[3] It is not. In fact, if anything the current $1.3T federal deficit is a major prop that is keeping our economy going. As much we (and especially bond holders) may not like it, kicking away the prop will not restore our economy. It will cause it to deteriorate further. And unless the economy is fundamentally restructured, this will be the case in the short run *and in the long run.*

Over the last three decades the U.S. economy has gotten fundamentally out of balance and increasingly dependent on private or public sector deficits to maintain demand. Since the start of the Great Recession (that should be more aptly named the New Depression – see below) in 2008 we have replaced (by bailing out - mostly financial) private deficits with public deficits. Cutting the public deficit (without fundamental restructuring) without restoring another unsustainable private deficit (as in the late 90's) will simply cause the economy to further decline.

Deficit reduction is not an economic revitalization strategy - it's more like a "whack a mole" procedure (assuming a new private deficit run-up) or - or more likely under the current circumstances - "cutting off

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[1] I wish to thank my fellow CPEG members for valuable input including new research that I had not been aware of and helpful editorial feedback. However, I take full responsibility for the cogency, or lack thereof, of this short and quick policy outline.
[2] For a more technical and in-depth exposition of these points see: http://www.cpegonline.org/workingpapers/CPEGWP2011-3.pdf
[3] See for example Paul Krugman, March 2011, "The Austerity Delusion," http://economistsview.typepad.com/economistsview/2011/03/paul-krugman-the-austerity-delusion.html

your nose to spite your face". We should be using our ability to print dollars to restructure our economy.[4] Only through a fundamental transformation requiring large increases in public funding and major public policy initiatives will our economy be revived. Continued large scale deficit spending is essential until restructuring has been accomplished. *In the absence of restructuring there is no magic date in the future after which point the economy will be able to grow without public or private deficits*.[5]

The need for fundamental restructuring to revive our economy makes our current downturn more like a "Depression" than a "Recession". This is more than a "financial bubble" work down - as in Japan's "lost decade" which in any case required the support of a decade of large scale deficit spending by the Japanese government - not likely to be forthcoming under current political conditions in the U.S. - to keep it from becoming a full scale depression.[6] The U.S. economy suffers from major macroeconomic imbalances and a three decade loss of productive capacity that cannot be corrected by a decade long spree of public infrastructure spending (though this would certainly help in the short-term and the long-term).

Figures 1 and 2 below show how much worse the 2008-2009 downturn is relative to other post-war “recessions”.

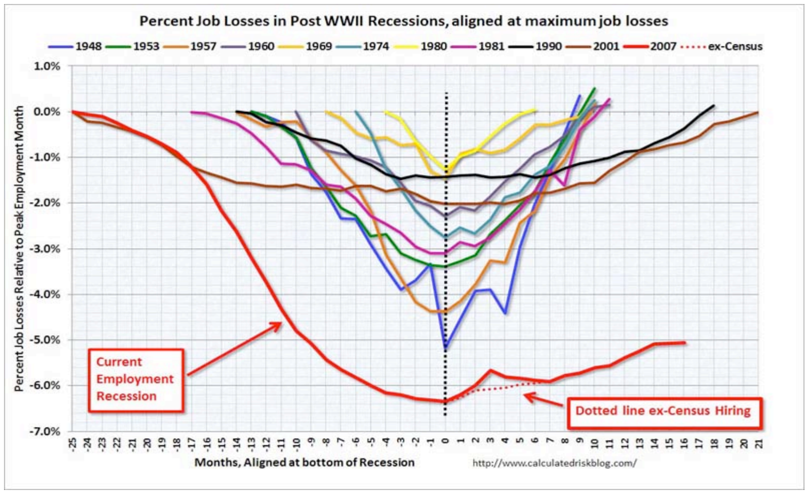
The long-term picture (Figure 1) is that employment has hardly budged at all. The June 2011 employment level (based on non-farm payroll) was 5.04% below pre-recession employment levels, 16 months after the trough job level in February 2010.

Figure 1

[4] A large share of federal debt is "owed" to no one - it's just an accounting artifact that reflects the federal government's ability to print dollars. The real issue is world demand for dollars not U.S. federal deficit. So far this has increased not abated though one can surmise that eventually our ability to produce real claims on world output out of thin air by printing dollars will diminish. This is the point - not now- at which we would need to worry about reducing our public and private deficit.

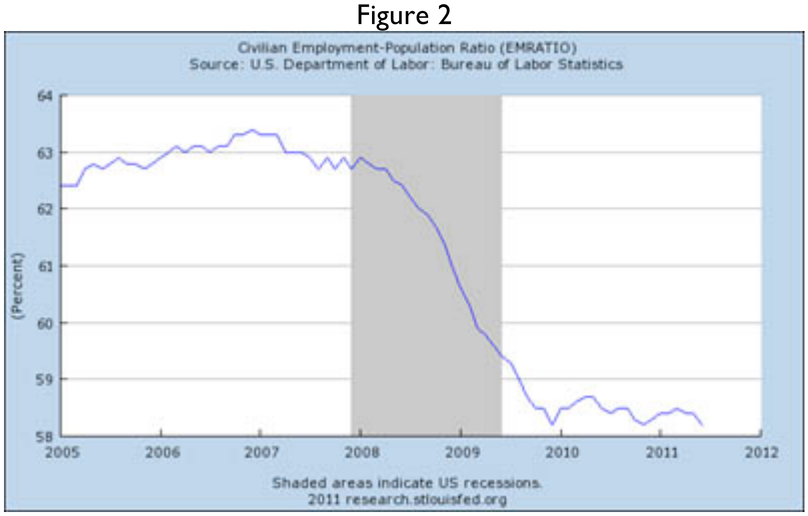
[5] For more explanation see "The Links Between the Three Types of National Deficits," CPEG, R. Baiman, June 2010, at: http://www.cpegonline.org/multimedia/DeficitLinkages.ppt

[6] See for example (Koo, 2008, p. 22): “What sets Japan’s Great Recession apart from the U.S. Great Depression is that Japanese GDP stayed above bubble peak levels in both nominal and real terms despite the loss of corporate demand worth 20 per cent of GDP and national wealth worth ¥1,500 trillion… The financial deficit of the government sector mounted sharply, leaving in its wake the national debt we face today. But it was precisely because of these expenditures that Japan was able to sustain GDP at above peak-bubble losses despite the drastic shifts in corporate behavior and a loss of national wealth equivalent to three years of GDP.”



Similarly, if we look at the Employment to Population Over 16 to 65 ratio (a much better measure of "unemployment" than the UER) in Figure 2 below, it confirms that employment has hardly budged since the official "end" of the 2007 recession.

Figure 2



What are the imbalances?

B) "Supply Side" Imbalances

On the "supply side" the U.S. economy has been experiencing a three decade long financialization and decline of productive capacity through "off-shoring" of production and investment. Financialization, or extraordinary increases in financial activity, has created an increasingly "rentier economy" that generates claims on income (mostly for the very highest income earners) without corresponding increases in output or employment. Out -sourcing of investment, production, and employment, has a similar effect of enhancing investor (short-term) profit without a corresponding increase in domestic production or employment.

Numerous studies have shown that financialization and out-sourcing of production have led to an increased inability of the U.S. economy to produce jobs - particularly at middle income wages even when GDP (at least as measured by income - see below) is expanding. Research by Basu and Foley (2011) and Houseman (2007) suggests that a large share of financial and manufacturing U.S. value-added GDP output increases are erroneously "imputed" and do not correspond to real increases in value-added output or employment. Wessel (2011) reports that U.S. Commerce Dept. data show that from 2000 to 2009, U.S. multinationals that collectively employ roughly a fifth of all American workers cut their work force by 2.9 million while increasing employment overseas by 2.4 million, and a recent study by Sum et. al. (2011) shows that during the six quarters after their official end, in the five recessions since 1975, wage and salary share increases have trended down even as profit shares have increased (the 1991-92 recession is the one outlier). After the current recession there was only a 1% growth in wage and salary share of national income but a 92% growth in profit share from June 2009 to Dec 2011- the worst of all five recessions.[7] Similarly, BLS data shows that employment growth relative to GOP growth has been steadily declining in recent expansions (Foley, 2011) and at the same time the U.S. "structural" (full-employment - measured at similar points in the business cycle) trade deficit has been increasing since the 1980s.[8]

The trend decline in U.S. real productive investment in plant and equipment (Beitel,2009) is not due to low profits or more general ability to finance investment. Net of taxes and interest profits have increased or held steady over the last three decades (Taylor, 2010, Figure 2.2, p. 58). Rather investment has been directed toward: a) further financial speculation or bolstering of short-term returns through stock buy-backs and increased dividend pay-outs, b) residential and commercial (especially retail) construction, c) increased outsourcing of production and research (Ivanova, 2011) (Beitel, 2009) (Baiman, 2010) (Ezell and Atkinson, 2011).

C) "Demand Side" Imbalances

These deteriorating "supply side" trends have been reinforced by a linked "demand-side" massive shift of income from the bottom 90% of families to the top 10% and increasingly to the top 1% and top 0.01% who have more than doubled and more than quintupled their family incomes respectively, even as real family income for the bottom 90% has declined by 6.4%. 120.6% of *all* of the increase in family income from 1973 to 2008 has gone to the top 10% of families meaning that bottom 90% of families *lost* 20.6% of this income increase (Baiman, 2011).

Similarly, government data show that the wage share of value added (that is supposedly produced in the U.S.) has persistently trended downward since1980 falling by over 10% since 1983 to 2008, even as the consumption share of value added rose from about 95% in 1983 to about 105% in 2007, while the household- debt to income ratio rose from about 25% in 1972 (the year of peak U.S. real hourly earnings for non-supervisory workers - $9.27 in 1972 compared to $8.91 in 2010 in 1982-4 dollars[9]) to about 170% by 2007 and profit rates net of interest and taxes) increased or held steady at rates well above 1954 to 1980 rates (Taylor, 2010, Figure 5.14 p. 209, 2.2 p. 58).

[7] See "The 'Jobless and Wageless' Recovery from the Great Recession of 2007-2009," Center for Labor Market Studies, Northeastern University at:
http://www.employmentpolicy.org/sites/www.employmentpolicy.org/files/field-contentfile/pdf/Mike%20Lillich/Revised%20Corporate%20Report%20May%2027th.pdf .
Seven quarter's out shows decline in wage and salary income for 2007 recession.

[8] For 1980 to 2010 data see: http://en.wikipedia.org/wiki/Balance_of_trade . The current widening of the trade deficit shows that the 2007 decline was a temporary result of the recession.

[9] BLS data downloaded July 25, 2011.

These trends show why there has been inadequate demand growth in the U.S. economy over the last three decades. Declining employment growth and redistribution of income to the very top income earners (who spend a very small share of their incomes) has led to an increasingly imbalanced economy dependent on private and public deficit spending and imported goods production.

As employment and wage and salary growth relative to GOP growth has declined, the U.S. has become increasingly dependent on consumer (credit card, and home equity) lending to stimulate domestic demand. U.S. economic "growth" has increasingly been based on financial sector lending to households, home builders, and shopping mall developers - rather than productive investment in plant and equipment that engenders increased capacity to produce rather than to consume. Home equity and consumer credit allowed HH's to maintain living standards through increased consumption of mostly imported consumer goods and increasingly services, causing the trade deficit to trend upward, increasing the "leakage" of income out of the domestic economy that needs to be offset by private or public sector deficit spending.

D) Policy Response

The source of both of these supply side and demand side debilitating trends is the rentier economy and the key policy goal should be to undo this.

What is to be done?[10]

a) For the moment we need to exploit our rentier capacity for public (rather than private rentier) benefit. This means that we need to maintain and increase federal deficit spending to fund existing public services and income support programs both at the federal and state and local levels. We are a sick failed rentier economy. We need federal deficit spending to keep our economy from further short-term collapse. Of course the U.S. cannot continue to run large federal deficits forever - the world would lose faith in the dollar at some point and we will lose the ability to exploit our rentier capacity. *But the time of the world losing faith in the dollar is not now* (and seemed quite far way until our ignorant and fanatic politicians manufactured an artificial U.S. federal debt crises - hopefully not permanently injuring our rentier capability). The point that has to be stressed is that under current conditions we need a large amount of deficit spending to keep the economy going and that maintaining a deficit to support critical public services and transfers is better than blowing up (and then bailing out) another unsustainable private deficit run-up, the benefit of which will mostly accrue to rentiers.

b) We don't need to "shrink the size of the public sector" (what the real underlying "deficit" debate is all about about). Rather, we need to dramatically increase it. We need to vastly expand our taxing and spending in order to reorient our economy away from a rentier and back to a productive and balanced

[10] Progress in pursuing the economic policies below is probably dependent on progress in addressing deeper institutional problems of our "rentier society" (not just economy) including: a) ending "corporate personhood" (Hartmann, 2010), b) enacting "industrial democracy" laws like Europe's "co-determination" laws (Hill, 2010), c) creating a quasi socialized financial sector that serves the real economy like the German Landesbaken, or Regional Community Banks noted above, d) reforming U.S. political democracy that is now so corrupt that is has become in effect a plutocracy rather than democracy through: campaign finance public finance, media access and robust public media, and one-person one-vote (changing the Senate) and some form of proportional representation (Hill, 2010), e) measures to drastically reduce wealth and income inequality such as much higher minimum wage and maximum wage laws, and steeply progressive income (like the Eisenhower era 92% bracket - that would erase our current deficit if just applied to the upper 10% (Baiman, 2011a)) and wealth taxes.

advanced economy configuration by enacting a massive federal jobs program that will expand public and private sector employment in: a) social services, b) infrastructure, c) new green technologies (CPEG 2009, 2011). We desperately need a new New Deal. Our future economic prosperity is dependent on a large scale revival of public jobs programs, industrial policy, and major changes in trade policy (Baiman, 2010). The most successful economies in the world use their advanced traded goods production capacities to generously fund large public sectors - at up to 50% of GDP, that ensure that the benefits of an increasingly productive tradable goods sector (and of more productive domestic goods and service sectors) are broadly spread to the entire nation (Baiman, 2010a) (Hill, 2010). We have the more difficult task of rebuilding productive traded goods economic capacity *and* vastly expanding and enhancing our public sector.

c) As we exploit our (greatest remaining economic "asset" - rentierism) we need to shrink it and eventually eliminate it. A straightforward way to do both (exploit and gradually eliminate) is to impose a financial transaction tax on all financial trading in the U.S. and with European collaboration (the EU parliament has already recommended this) worldwide.[11] It is indicative of the degree of economic distortion of our rentier economy, that this one tax has the potential to raise up to $ 1 T a year and fund up to 25 M living wage jobs over 5 years (Barclay, 2005) (CPEG, 2009,2011). This should be immensely politically popular, would directly repress rentier activity, and if used for a jobs program, directly redevelop the productive side of our economy. Gradually, as we change our self-destructive and misguided "free trade" policies (designed for financial and multinational outsource rentierism) and are able to again produce competitive exports, we can reduce the federal deficit without causing more unemployment and shrink our financial sector to the point where FTT revenue will not be so large.[12] At this point we will be able to rely on more stable broad-based steeply progressive income and wealth taxes to fund a much larger and more generous public sector that will also provide high value-added (in the real human use value sense) and well paid employment to the ever larger share of the workforce not engaged in high-value added traded goods production (Baiman, 2010a). Similarly, recognizing that world trade cannot be sustainably managed (even under the most idealistic – and unrealistic assumptions) on "autopilot" "free market" principles or exchange rate "price signals," and that a politically constructed world trading system needs to be put in place to replace the highly successful Bretton Woods regime will be the first step in reducing and eventually eliminating "outsourcing rentierism" and implementing a global trading system that benefits public rather than rentier interests.

[11] Recently French President Sarkozy and German Chancellor Merkel have stated that they plan to implement an FTT in Europe by 2013 (NYT, 2011).

[12] Contrary to received Wisdom, when studied carefully, Ricardian comparative advantage is an argument for *managed* trade. "Free trade" in the Ricardian parable is over-determined and unsustainable (Baiman, 2010c). Simlarly, unrelated to specific Ricardian assumptions or other *detailed* international trade modeling assumptions - assuming only exchange-rate based demand effects, global "free trade" is mathematically unstable and thus economic infeasible - see (Baiman, 2011b). For an excellent critique of the theoretical assumptions, and policy arguments behind the "free trade" doctrine, see (Fletcher, 2009).

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