Secular stagnation an excuse for flawed economic policies

By Joseph E. Stiglitz New York

In the aftermath of the 2008 financial crisis, some economists argued that the United States, and perhaps the global economy, was suffering from “secular stagnation,” an idea first conceived in the aftermath of the Great Depression.

Economies had always recovered from downturns. But the Great Depression had lasted an unprecedented length of time. Many believed that the economy recovered only because of government spending on World War II, and many feared that with the end of the war, the economy would return to its doldrums.

Something, it was believed, had happened, such that even with low or zero interest rates, the economy would languish. For reasons now well understood, these dire predictions fortunately turned out to be wrong.

Those responsible for managing the 2008 recovery (the same individuals bearing culpability for the under-regulation of the economy in its pre-crisis days, to whom president Barack Obama inexplicably turned to fix what they had helped break) found the idea of secular stagnation attractive, because it explained their failures to achieve a quick, robust recovery. So, as the economy languished, the idea was revived: Don’t blame us, its promoters implied, we’re doing what we can.

The events of the past year have put the lie to this idea, which never seemed very plausible. The sudden increase in the US deficit, from around 3% to almost 6% of GDP, owing to a poorly designed regressive tax bill and a bipartisan expenditure increase, has boosted growth to around 4% and brought unemployment down to a 18-year low. These measures may be ill-conceived, but they show that with enough fiscal support, full employment can be attained, even as interest rates rise well above zero.

The Obama administration made a crucial mistake in 2009 in not pursuing a larger, longer, better-structured, and more flexible fiscal stimulus. Had it done so, the economy’s rebound would have been stronger, and there would have been no talk of secular stagnation. As it was, only those in the top 1% saw their incomes grow during the first three years of the so-called recovery.

Some of us warned at the time that the downturn was likely to be deep and long, and that what was needed was stronger and different from what Obama proposed. I suspect that the main obstacle was the belief that the economy had just experienced a little “bump,” from which it would quickly recover. Put the banks in the hospital, give them loving care (in other words, hold none of the bankers accountable or even scold them, but rather boost their morale by inviting them to consult on the way forward), and, most important, shower them with money, and soon all would be well.

But the economy’s travails were deeper than this diagnosis suggested. The fallout from the financial crisis was more severe, and massive redistribution of income and wealth toward the top had weakened aggregate demand. The economy was experiencing a transition from manufacturing to services, and market economies don’t manage such transitions well on their own.

What was needed was more than a massive bank bailout. The US needed a fundamental reform of its financial system. The 2010 Dodd-Frank legislation went some way, though not far enough, in preventing banks from doing harm to the rest of us; but it did little to ensure that the banks actually do what they are supposed to do, focusing more, for example, on lending to small and medium-size enterprises.

More government spending was necessary, but so, too, were more active redistribution and pre-distribution programmes – addressing the weakening of workers' bargaining power, the agglomeration of market power by large corporations, and corporate and financial abuses. Likewise, active labour-market and industrial policies might have helped those areas suffering from the consequences of deindustrialisation.

Instead, policymakers failed to do enough even to prevent poor households from losing their homes. The political consequences of these economic failures were predictable and predicted: it was clear that there was a risk that those who were so badly treated would turn to a demagogue.

A fiscal stimulus as large as that of December 2017 and January 2018 (and which the economy didn't really need at the time) would have been all the more powerful a decade earlier when unemployment was so high. The weak recovery was thus not the result of "secular stagnation"; the problem was inadequate government policies.

Here, a central question arises: Will growth rates in coming years be as strong as they were in the past? That, of course, depends on the pace of technological change. Investments in research and development, especially in basic research, are an important determinant, though with long lags; cutbacks proposed by the Trump administration do not bode well.

But even then, there is a lot of uncertainty. Growth rates per capita have varied greatly over the past 50 years, from between 2 and 3% a year in the decade(s) after World War II to 0.7% in the last decade. But perhaps there's been too much growth fetishism – especially when we think of the environmental costs, and even more so if that growth fails to bring much benefit to the vast majority of citizens.

There are many lessons to be learned as we reflect on the 2008 crisis, but the most important is that the challenge was – and remains – political, not economic: there is nothing that inherently prevents our economy from being run in a way that ensures full employment and shared prosperity. Secular stagnation was just an excuse for flawed economic policies. Unless and until the selfishness and myopia that define our politics – especially in the US – is overcome, an economy that serves the many, rather than the few, will remain an impossible dream. Even if GDP increases, the incomes of the majority of citizens will stagnate. – Project Syndicate

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