

Discussant comments of Steven Fazzari, Professor of Economics and Associate Director of the Weidenbaum Center at Washington University on “The Continuing Unemployment Crisis: Causes, Cures, and Questions for Further Study,” by Christina D. Romer

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It is an honor and a pleasure to share a panel with Christy Romer. She is a fine scholar whose prominent research has changed the way economists think about important issues. She also handled a difficult job in the Obama administration at a very challenging time with competence and grace.

I agree with most of what Dr. Romer has said here today. I strongly second her concern about unemployment. I too found the somewhat celebratory tone out of place following the March jobs report. We should not be satisfied with a pace of job creation that will not return us to a reasonable estimate of full employment for 10 years!

But I want to use the few minutes I have today to summarize a somewhat different perspective on the current challenges faced by the U.S. economy.

Even though the U.S. economy has been in a recovery for nearly 2 years, according to the arbiters of such things at the National Bureau for Economic Research, I believe that this recovery is different in fundamental ways from what we have seen after post-WW2 recessions. And, unfortunately, I fear that this difference poses a greater threat to our economic well-being than is suggested by most of today's conventional wisdom.

Business will not hire workers to produce goods and services that firms don't think they can sell. So, I think all economists would agree that growth in sales, or growth in demand, is a necessary condition for recovery. But there are substantial differences in economists' views about how that growth in demand will occur.

Some see demand growth as almost automatic, so that the ability to sell goods and services is never a serious barrier to hiring more workers.

Dr. Romer clearly is not in this camp. Her prepared remarks this afternoon as well as her comments in an informal discussion earlier in the day show that she understands how stagnant demand can be a barrier to employment. This is the deep reason why she and I both argue that government stimulus can be helpful in a recession. Effectively, the government steps in with additional demand when private demand falters.

But my concern is that we are challenged by more than just a temporary shortfall in private demand. I believe that the Great Recession marks the end of a decades-long era during which the engine of private demand growth was aggressive household borrowing.

It is widely reported that wage and salary growth has been relatively stagnant across much of the U.S. income distribution since the late 1970s. But American household spending was far from stagnant. How did Americans spend so much more when most of them did not enjoy much income growth? Everyone in this room knows the answer: we borrowed like crazy. My co-author Barry Cynamon and I labeled the period beginning in the mid 1980s as “the consumer age.”¹ During this period the ratio of our debt to disposable income doubled.

In a narrow sense, this way of generating demand growth was effective. During the consumer age, U.S. macroeconomic performance was pretty good with strong growth relative to most other developed countries and only rather mild recessions. There is, however, consensus that this process has come to an end with the onset of the Great Recession. In my view, the end of this debt-consumption boom and the debt-financed boom in housing construction, were by far the most important sources of the economic crisis and the tragic rise in unemployment we have experienced in the last few years.

This observation takes me to my concern about recovery: what will replace debt-financed consumption as the engine of demand going forward? I believe that without a strong new source of demand growth we cannot do much better than painfully slow job growth. Unfortunately, I’m not optimistic that we will find a replacement for the excessively leveraged American consumer. Let me briefly go through the possibilities:

Business investment. There has been a modest rebound recently, but it’s a small bounce off the lowest investment share of GDP in about a half century. There has been some retreat from the panic of late 2008 and the first half of 2009, but I don’t expect robust business investment until the economy enters a strong recovery.

International trade. Perhaps there is some hope here. There seems to be a recognition in surplus countries like China that they need to do more to stimulate their own domestic demand rather than relying on production for export as their primary source of growth. Over time, this could lead to an important rebalancing of the world economy. But I think it will take a lot of time. China and other emerging countries are going to aggressively pursue export growth for years to come and strongly resist adjustments, like a major decline in the dollar, that might stimulate the U.S. economy.

Government. In principle, as a simple matter of accounting, this could work. Government has the means to create demand, especially in a country that controls its own currency. We could replace rapid consumption growth with rapid growth in the size of government. But recent events in Washington make it abundantly clear that such a solution to our longer term demand problem is way outside of what is politically feasible. And even if continued stagnation, or even worse a double-dip recession, changed the political calculus on government spending, I have deeper concerns about relying on government to provide the magnitude of demand growth that I believe the economy needs.

¹ Reference: Cynamon, B. Z., & Fazzari, S. M. (2008). Household debt in the consumer age: Source of growth—risk of collapse. *Capitalism and Society*, 3(2), Article 3. Available at <http://www.bepress.com/cas/vol3/iss2/art3>

I have no doubt that there are some useful government activities that would pass a cost/benefit test. Dr. Romer mentioned some infrastructure and education programs. But I would also expect that it would be difficult to find enough government activity to generate the number of jobs we need. We are just in too big of a hole.

Government can help, but we need more private demand. If business investment remains largely on the sidelines until things really turn around, if any significant improvement in net exports will take a decade or more, simple arithmetic shows that we need more consumption. What could restore consumption growth? Another debt bubble. Obviously, that is hardly desirable. We could consider a large middle-class tax cut. If designed correctly, I believe such a policy could be effective. (A result supported by some of Dr. Romer's recent research.) But this kind of policy faces barriers from fears about rising U.S. government debt. I personally think that these fears are exaggerated, but nonetheless they constrain what is politically feasible.

Of the various possibilities, my favorite path to prosperity is restore strong middle-class income growth. If there were robust wage growth across a wide swath of the income distribution, consumption could grow faster without requiring higher and higher household borrowing rates. In this respect the immediate post WW2 decades are a model. American business paid its workers rising wages that allowed those workers to grow their purchases of the output produced by American business. Middle-class standards of living grew along with business profits. The saving rate stayed reasonably high. Household debt ratios rose in the 1950s as baby boom parents bought houses with mortgages, but that debt seemed quite manageable in an environment of robust wage growth and the household debt-income ratio stabilized in the 1960s.

This is a win-win scenario. But it is not the kind of structural change that can be easily be brought about by pulling some obvious policy lever. The decline of middle-class income growth is a difficult and complicated problem. We need to understand better why it has occurred and what can be done to reverse it. I believe this issue needs to be at the top of the research agenda in macroeconomics.

Fortunately for me, I'm out of time, so I don't have to solve this difficult problem this afternoon! But I think this issue is of first-order importance going forward. We have already faced some nasty disappointments about the performance of the U.S. economy as it struggles to recover from the Great Recession. I hope that we can think "outside the box" about these issues to improve our prospects for the next few years. Thank you very much.