BROOKINGS

HAS THE GREAT RECESSION BECOME THE GREAT STAGNATION?

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Prepared for the AEA Meetings

Society for Policy Modeling

2:30 pm, January 4, 2014

Penn Convention Center, 204-C

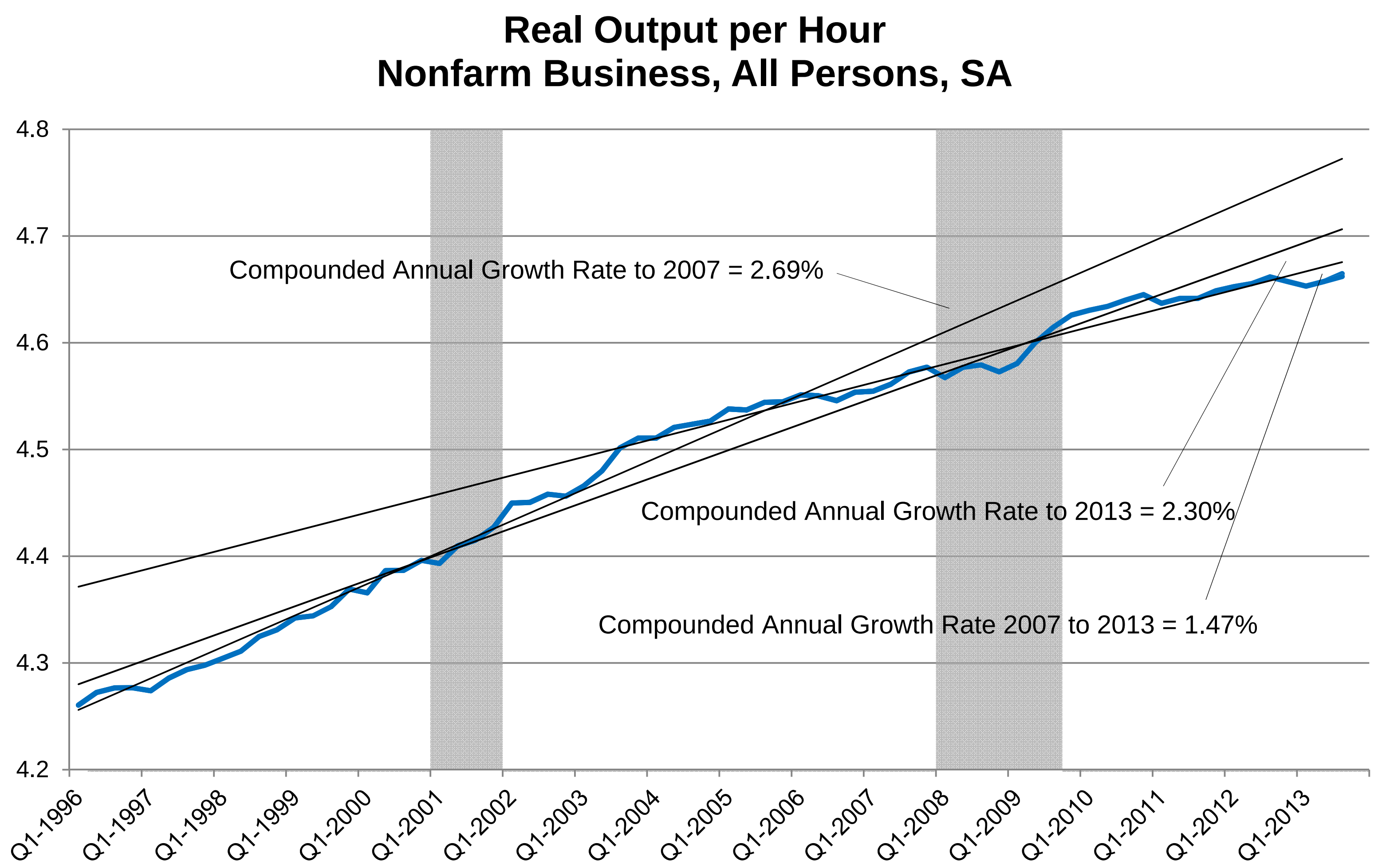
Background

- This presentation is an (early stage) extension of the September 2013 paper by Baily and Bosworth on the slow US recovery, to include supply considerations.
- The United States Economy, Why Such a Slow Recovery? By Martin Neil Baily and Barry P. Bosworth
- http://www.brookings.edu/research/papers/2013/09/united-states-economy-why-weak-recovery-baily-bosworth

Supply: Slow Productivity and Labor Force Growth

- Labor productivity growth (output per hour in the non-farm business sector) has slowed in the past few years, by 1.2 percentage points a year post 2007.
- Byrne Oliner and Sichel (2013) suggest a decline of 1.5 percent per year post 2004, the result of slower capital deepening (0.5 percent), a decline in MFP growth (1.3 percent) and other factors.
- Labor force participation rate declined very sharply in the recession.
- Participation is declining because of demographics, but also because of a decline in job opportunities.

Based on Linear Trends, Output per Hour Slowed by 1.2 Percent Post-2007, from 2.7 percent to 1.5 percent



Contributions to Changing Growth of Labor Productivity in the U.S. Non-Farm Business Sector, Post 2004[a]

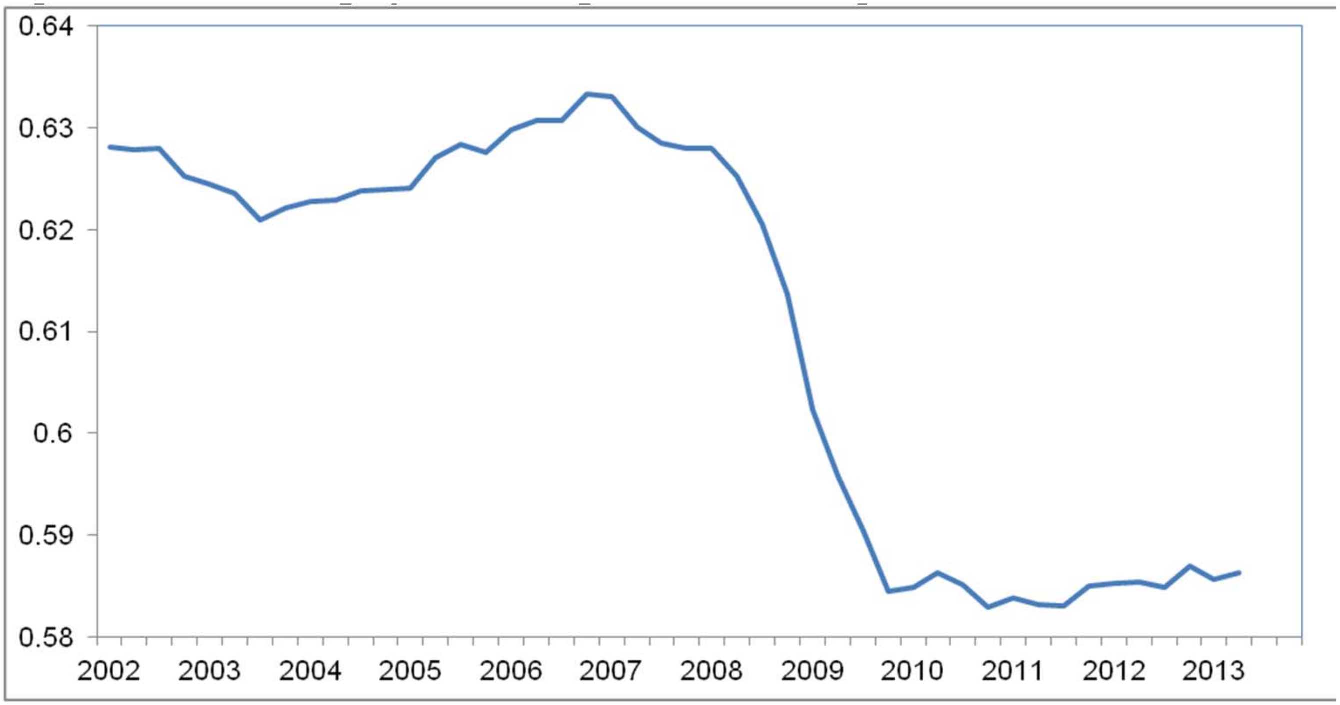
Byrne, Oliner, and Sichel (2013)

	Change between 1974 – 1995 and 1995 – 2004 (2) – (1)	**Change between 1995 – 2004 and 2004 – 2012 (3) – (2)**
1. Growth of labour productivity[b]	1.50	-1.50
2. Capital deepening	0.48	-0.48
8. Labour composition	-0.04	0.12
9. Multifactor productivity (MFP)	1.06	-1.14
12. MFP after adjustments	1.11	-1.27

a. Detail may not sum to totals due to rounding
b. Measured as 100 times average annual log difference for the indicated years.

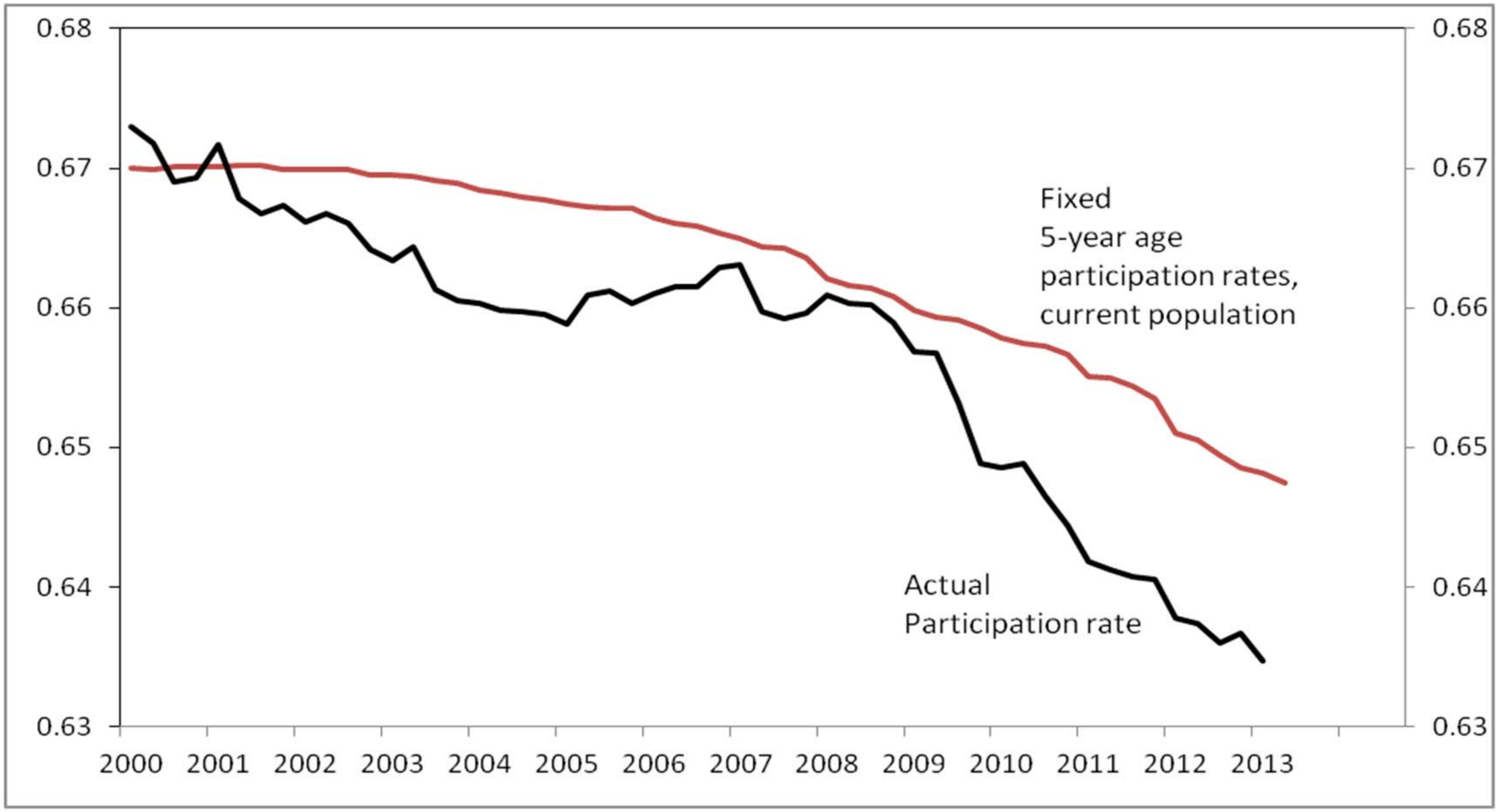
Employment to Population has Slumped; Little Recovery

Civilian Employment to Population Ratio, Age 16 and Over



Source: quarterly seasonally adjusted data from the Bureau of Labor Statistics.

Only About a Half of the Decline in Participation is Demographic

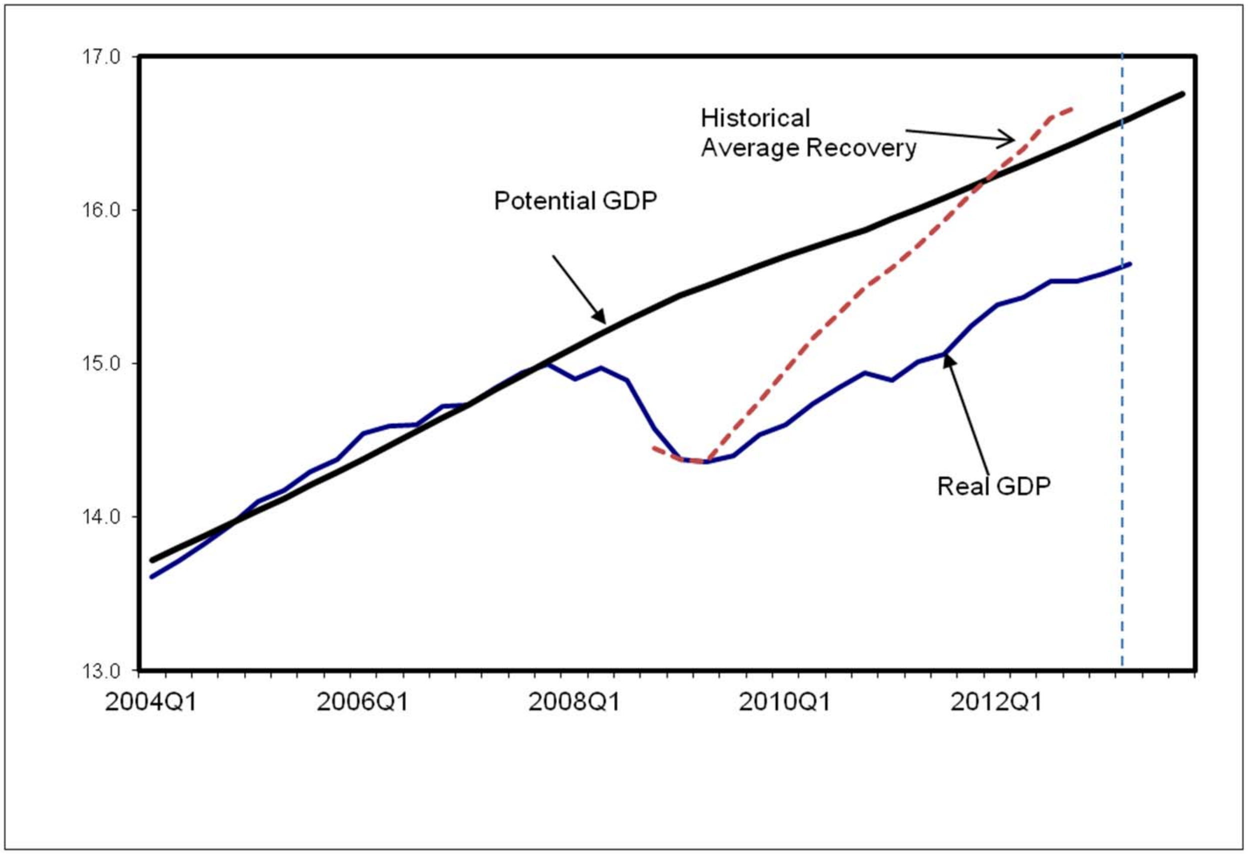


Demand: A Substantial Output Gap Remains

- Economic growth since the trough has matched the growth of potential output but no more. Unemployment rate has fallen largely because of a decline in potential GDP (estimated).
- Consumption growth has kept pace with income growth. The savings rate is a little higher than it was before the crisis, but not much higher.
- Investment has been weak and so far has been heavily driven by the recovery in the auto industry and the energy boom. As auto sales peak, a source of investment demand may weaken.
- Federal and state and local purchases have declined, reducing demand, but government transfers are propping up disposable income (and hence demand).
- The trade deficit has declined from its peak, but is still dragging down US demand.

Actual and Potential GDP, 2004 – 2013

trillions of 2009 dollars



Source: Congressional Budget Office, Bureau of Economic Analysis, and authors' estimates. The estimate of potential GDP has been adjusted to reflect the July 2013 revisions to GDP and the change to a 2009 base year.

Composition of the Gap Between Actual and Potential GDP

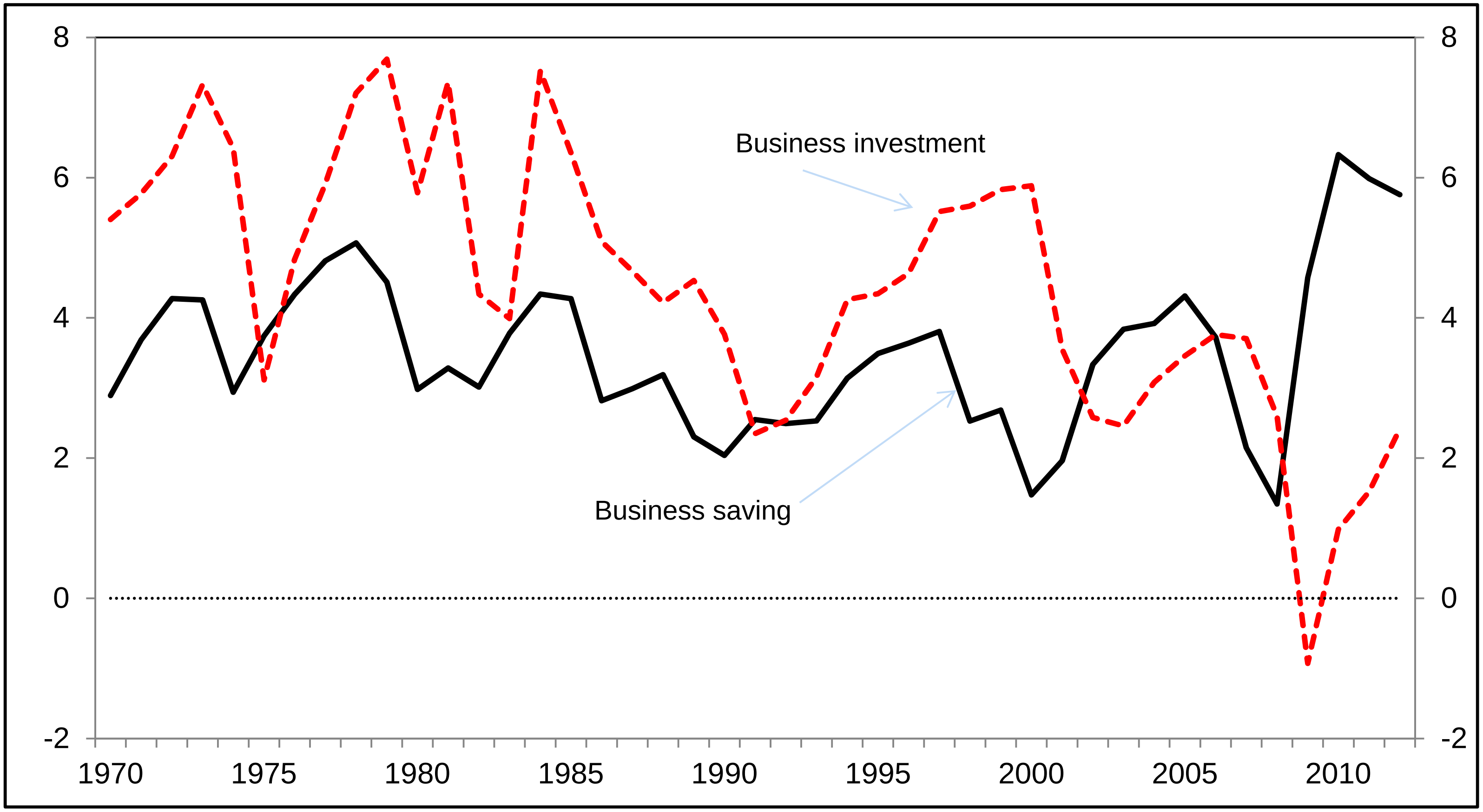
Deviation from full employment shares, percent of potential GDP

Category	Base Period	Difference from Base Period		
	2006-2007	2009:2	2012:2	2013:2
Total GDP	**100.0**	**-7.4**	**-5.3**	**-5.7**
Personal Consumption	**67.3**	**-4.1**	**-2.9**	**-2.9**
Non-residential Investment	**13.2**	**-3.9**	**-1.0**	**-1.0**
Residential Investment	**5.0**	**-2.5**	**-2.4**	**-2.0**
Net Exports	**-5.1**	**2.7**	**2.4**	**2.3**
Federal Gov't	**7.3**	**0.6**	**0.2**	**-0.2**
State and Local Gov't	**12.4**	**-0.3**	**-1.7**	**-1.9**

Source: computed by the authors. The base period values are the average shares of potential GDP in 2006 and 2007. The differences are the change in the share for the indicated period relative to the base period.

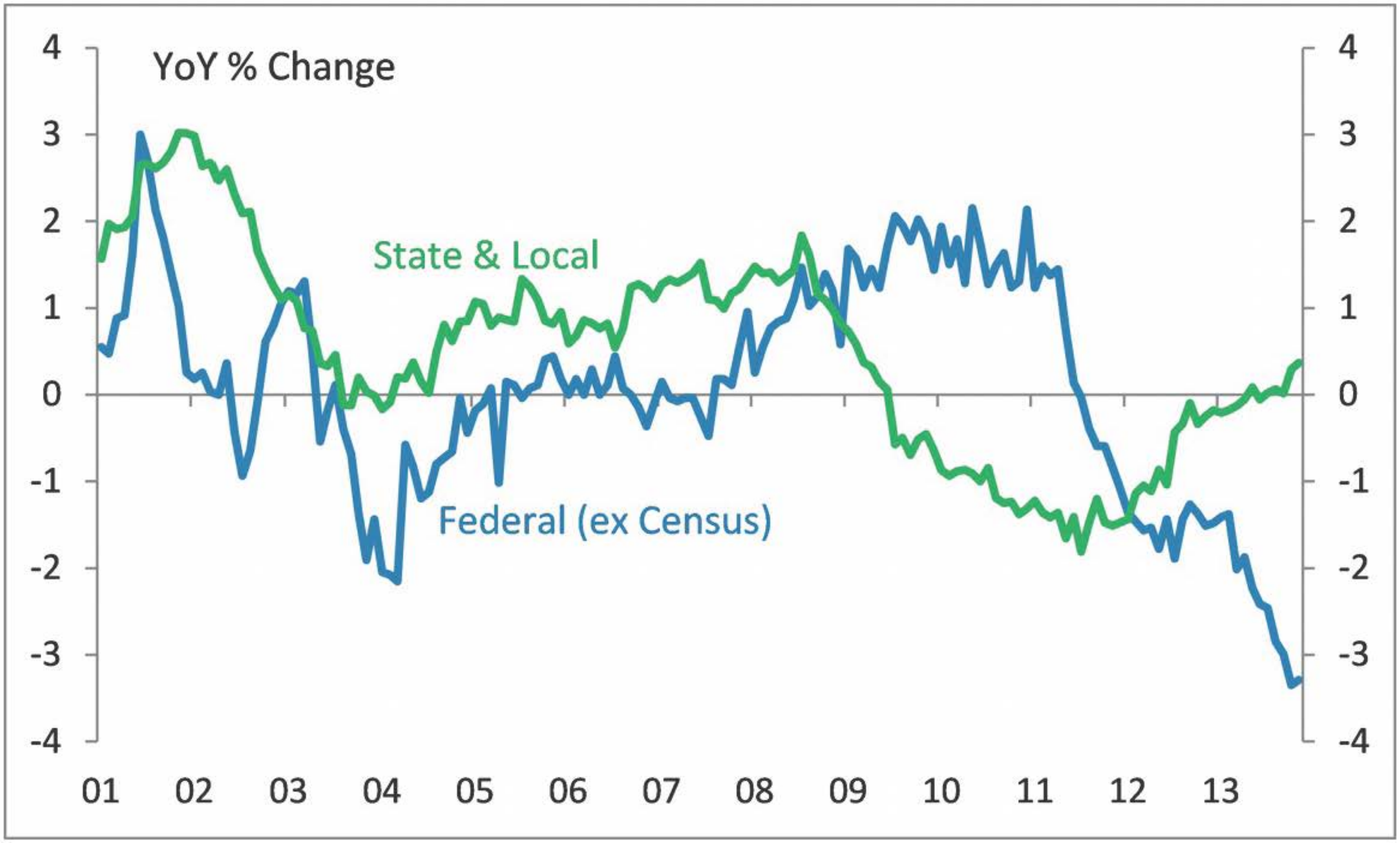
Business Has Become a Net Saver

Business investment and saving, nominal GDP shares.



Federal and State & Local Employment Has Slumped

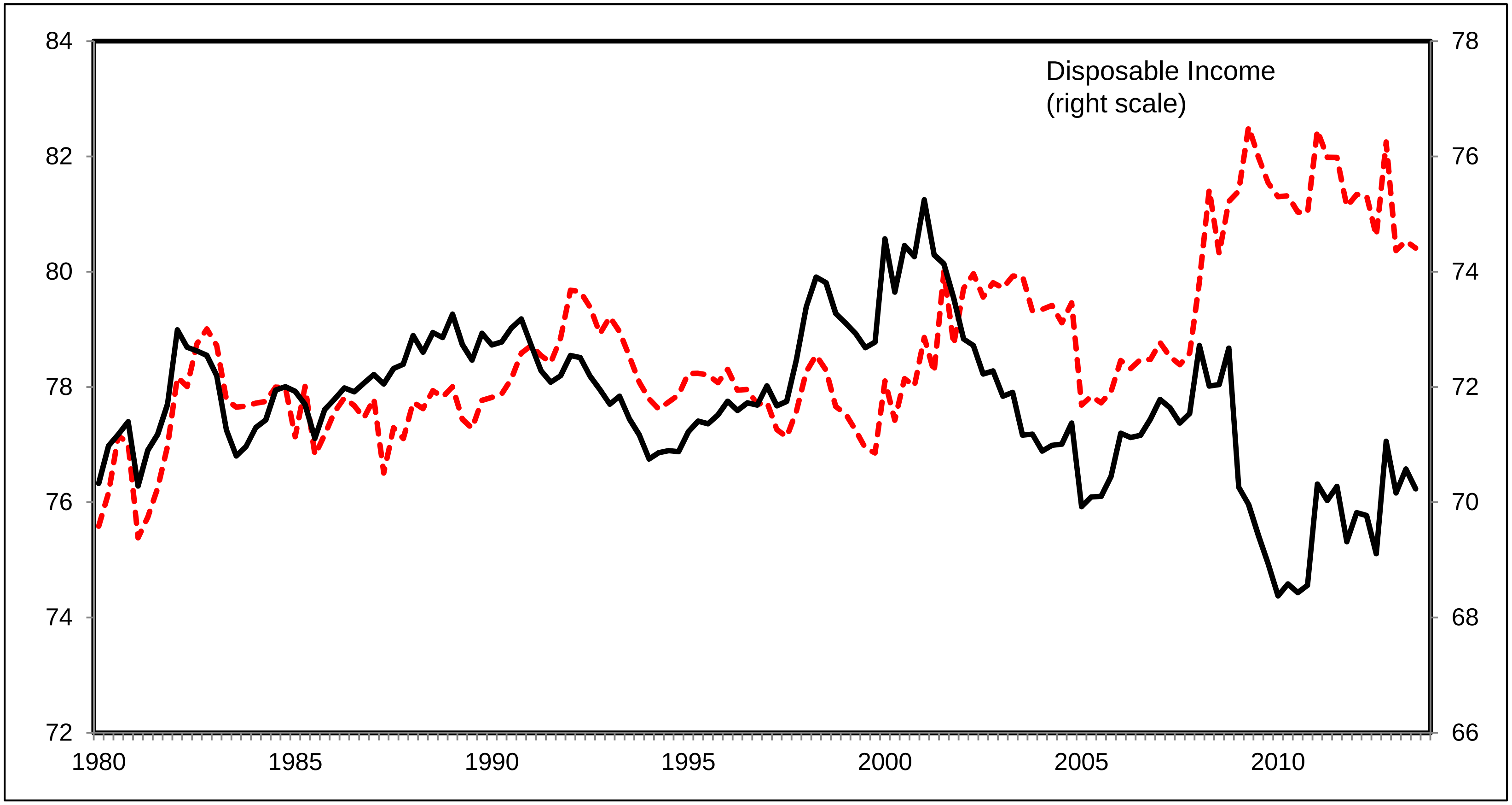
Government Payroll Growth



Source: Bureau of Labor Statistics, Morgan Stanley Research

Market Income has not Recovered but Disposable Income is High

Scaled as percent of GDP. Market income is disposable income plus transfers minus employment taxes.



The Goods Trade Deficit is a Drag on US Demand and Employment

- The current account deficit was 5.6 percent of GDP in 2005 and was still 3.1 percent in 2012. As long as aggregate demand is strong enough to ensure full employment, the trade deficit just changes the composition of output. With a chronically slow recovery, the deficit is a drag on the economy.
- The manufacturing trade deficit has also fallen since 2005, but not by as much—from $542 billion to $460 billion. By 2012, the manufacturing trade deficit was more than 100 percent of the current account deficit. Improvements in the current account are coming largely from increasing net foreign income and reduced energy imports.
- US companies continue to be highly competitive in technology, but have sharply reduced their goods production in the United States.

U.S. Balance in Manufactures Trade by Area, 2000 – 2012

Billions of dollars

Item	2000	2005	2012	Change 2005-2012
Total	-316	-542	-460	83
Asia	-240	-372	-478	-106
China	-84	-206	-342	-137
Hong Kong	3	7	31	23
Other Asia	-160	-173	-166	7
Canada	-15	-16	46	62
Latin America	-3	-28	57	85
Europe	-58	-131	-128	3
Middle East & Africa	1	4	43	39

Source: U.S. Department of Commerce, Bureau of the Census. "International Trade in Goods and Services, Supplementary Tables."

Policy Issues

- Biggest growth constraint is aggregate demand. Monetary policy not effective. Government spending restricted by politics and by deficit.
- Low-growth equilibrium not secular stagnation. Need public sector and private sector demand boosts. Try a well-planned infrastructure program financed by future energy taxes.
- Global exchange rates are not market determined. Surplus countries must adjust their imbalances (including Germany). US cannot afford chronic trade deficits; we no longer have aggregate demand to spare.
- Much of the productivity growth since 2000 occurred in 2002-3 and 2009-10. Restructuring not expansion.
- Lots of innovation, but it is not generating investment demand and hiring as in the past.
- Energy revolution is big and there are other private sector areas ripe for growth. Lower the corporate tax rate. Regulate smarter.
- The big unknown is the extent to which productivity growth and labor force participation will respond positively to a high pressure economy.