

Is it Great Depression-II? Crisis in Theory and Policy

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Outline of the Presentation

Crisis in Theory

Is it Great
Depression-II?
Crisis in Theory
and Policy

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Broad Outline

Crisis in Theory

Crisis of Policy

Political
Response

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Crisis in Theory

- ▶ Vertical Phillips Curve (Mainstream) Vs Horizontal Phillips Curve (Heterodox).

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Crisis of Policy: Political priorities

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Crisis of Policy: Political priorities

- ▶ Monetary policy Vs Fiscal Policy.

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Crisis of Policy: Political priorities

- ▶ Monetary policy Vs Fiscal Policy.
- ▶ Tax cuts Vs Spending Increase.

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- ▶ Vertical Phillips Curve (Mainstream) Vs Horizontal Phillips Curve (Heterodox).

Crisis of Policy: Political priorities

- ▶ Monetary policy Vs Fiscal Policy.
- ▶ Tax cuts Vs Spending Increase.
- ▶ Favouring 1% over the 99%.

Crisis in Theory

Mainstream Theory and Policy

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Mainstream Theory and Policy

PC: $\pi_t = \pi_t^e - \alpha(U_t - U_{NAIRU})$; π = Inflation; U = Unemployment

Heterodox Theory and Policy

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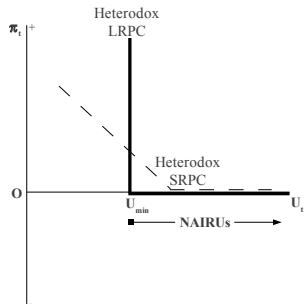
Heterodox Theory and Policy

PC: $\pi_t = Z + \max(0, \pi_{t-1} - \alpha(U_t - U_{min}))$; $Z = \text{cost-push}$

Heterodox Theory and Policy

$$\text{PC: } \pi_t = Z + \max(0, \pi_{t-1} - \alpha(U_t - U_{\min})); \quad Z = \text{cost-push}$$

L-shaped Phillips Curve



- ▶ $U \geq U_{\min}$ (Robinson's Inflationary Barrier). Diametrically opposite to the New Classics.

- ▶ Fluctuates between chronic unemployment and inflation.
 1. Inflation can't be negative.
 2. No RatEx.

Increased Policy Space In Globalisation

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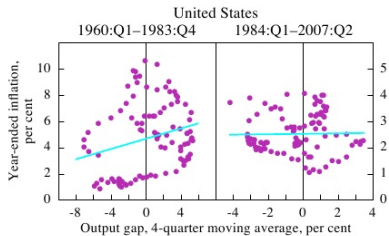
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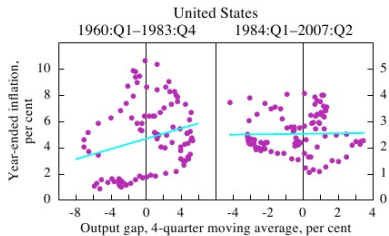
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Political
Response



Source: Kuttner and Robinson (2010)

Increased Policy Space In Globalisation



Source: Kuttner and Robinson (2010)

Table: Estimation Results

Dependent Variable: Growth in Per Unit Nominal Labour Cost (ω_t)		
Coefficients		
Variables:	Pre-Globalization (1960:Q1 - 1983:Q4)	Globalization (1984:Q1 - 2010:Q4)
Constant	-0.000(0.001)	0.001(0.002)
π_{t-1}	1.971***(0.069)	1.325***(0.343)
U_t	-0.044***(0.006)	0.015(0.011)
ω_t^a [Mexico]		0.009***(0.003)
Hansen Test	0.34(P Value: 0.84)	3.19(P Value: 0.36)
No. of Obs	97	107

Notes: 1) *** indicates significance at the 1% level.

2) Standard errors are in the parenthesis.

Source: Rohit and Das (2012) working paper.

Crisis of Policy

Current condition of the US economy

Output Gap as a % of actual GDP

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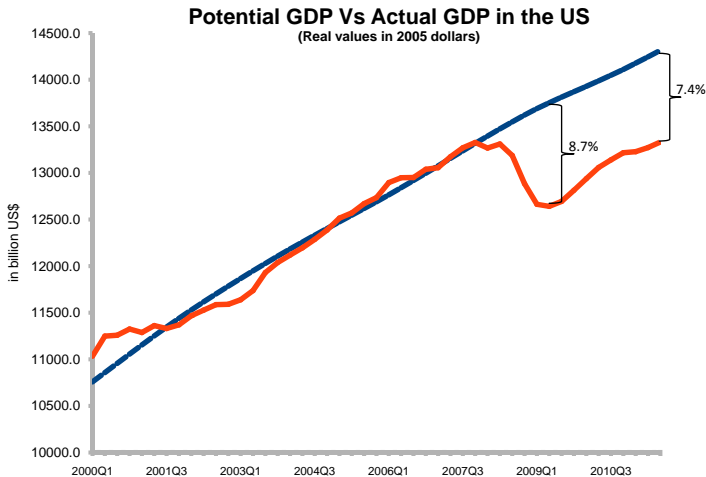
Crisis of Policy

Monetary Policy

Fiscal Policy

Political

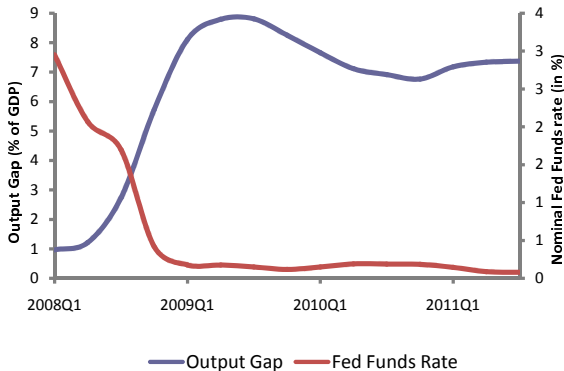
Response



Source: Hersh and Vij (2011) Updated

Limitations to the Monetary Policy

Liquidity Trap in the US



Source: Author's Calculation from BEA and Federal Reserve Statistics

Federal Funds rate has been close to 0 since 2009:Q1 i.e. for 3 years. There is hardly more that can be done on this front.

Is Spending more productive than Tax Cuts?

Type of Activity	Estimated Output Multipliers	
	Low Estimate	High Estimate
Spending		
Federal Govt's purchases of goods and services	1	2.5
Transfer to state govts for Infrastructure	1	2.5
Transfer to state govts for other purposes	0.7	1.8
Transfer Payments to Individuals	0.8	2.1
One-Time Payments to Retirees	0.3	1
Tax Cuts		
For lower and middle-income	0.6	1.5
For higher-income	0.2	0.6
Corporate Tax	0	0.4

Source: CBO (2011)

- ▶ Social sector spending is almost *double* as productive as tax cuts!

Is Spending more productive than Tax Cuts?

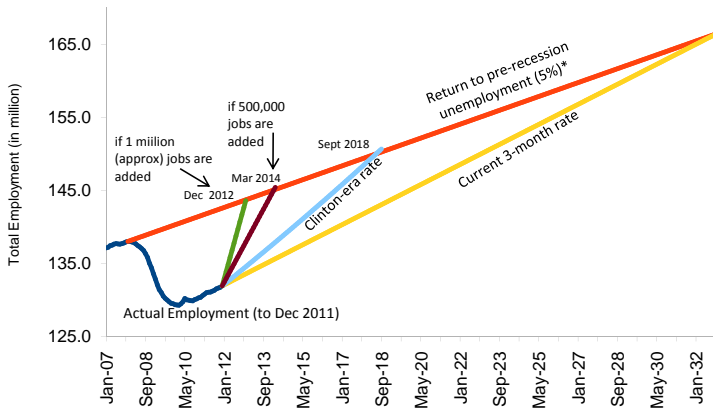
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Source: CBO (2011)

- ▶ Social sector spending is almost *double* as productive as tax cuts!
- ▶ Despite making economic sense, why is it not Obama's priority?

99% are not a priority,

Employment Generation Under 4 scenarios



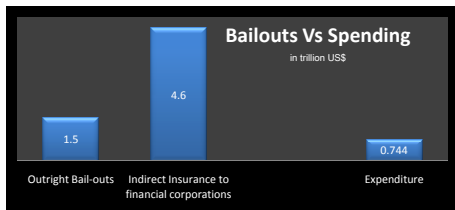
Source: Hersh and Vij (2011). Updated with minor addition

Current 3-month rate: 137,000 jobs p.m.

Clinton Era rate: 200,000 jobs p.m.

Labour Force growth: 100,000 p.m.

but 1% is!



Programs	Amt. Committed	Prominent Bail-outs*	Amt. Committed
Troubled Asset Relief Program (TARP)	\$700 billion	Fannie Mae and Freddie Mac	\$1.6 trillion
Fed Rescue Efforts	\$6400 billion	Citigroup	\$245.4 billion
FDIC total	\$45.4 billion	AIG	\$182 billion
Other financial total	\$1700 billion	Bank of America	\$124.5 billion
Other housing total	\$745 billion	Automobile Industry	\$85.1 billion
Fiscal Stimulus	\$1200 billion	Bear Stearns	\$29 billion
Total	\$11 trillion		
Financial Vs Real Initiatives			
Financial Initiatives	\$9.5 trillion	Real Initiatives	\$1.2 trillion
Outright Bail-outs	\$1.5 trillion	Tax Cuts	\$456 billion
Indirect Insurance	\$4.6 trillion	Unemployment benefits	\$8 billion
Increasing Liquidity	\$3.4 trillion	Students Loan guarantees	\$195 billion
		ARRA Stimulus	\$499 billion
		Cash for clunkers	\$3 billion
		Advanced Tech Vehicles Program	\$25 billion
Political Priority Quotient (Fiscal Expenditure/Financial Initiatives)			7%

* Includes other financial assistance

Source: Author's calculations based on data available at CNNMoney; Note: Figures as of Nov. 16, 2009

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Working People

Capitalist Class

References

- ▶ Adam Hersh and Vij (2011), “Employment Growth Continues, but Too Slowly to Secure Recovery”, *Center for American Progress*, January 7.
- ▶ Congressional Budget Office Report (2011), “Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from April 2011 Through June 2011”, August.
- ▶ K. Kuttner and T. Robinson (2010), “Understanding the flattening phillips curve”, *The North American Journal of Economics and Finance*, 21(2):110-125.
- ▶ Rohit and Anupam Das (2012), “Increased Policy Space Under Globalisation”, *Working Paper*.