Inequality, and the Challenge of Economic Recovery

Steven Fazzari

Professor of Economics, Washington University
Levy Institute Minsky Conference– April 18, 2013
(Joint work with Barry Cynamon)
“Consumer Age” (Middle 1980s to 2007)

- High spending by American households fuels demand generation (20+ years)
- Historic rise in household indebtedness
  - Sows the seeds of the Great Recession
  - Basic Minsky dynamic
- Rising inequality and stagnant growth of middle class incomes
A Paradox

- Intuition and theory suggest that rising inequality => “demand drag” from consumers

- But remarkably **strong** household demand growth in Consumer Age

- Message of this paper:
  - Bottom 95% spent a higher share of their slow-growing income; took on excessive debt
  - Spend–and–borrow process **postponed** demand drag from rising inequality
  - Structural demand generation problem going forward
Inequality Trends

- For data reasons, we focus on top 5%
- Remarkable stability: 1950s to 1980
- Remarkable rise in top 5% share during Consumer Age period
Income Share of U.S. Top 5% (Piketty/Saez -- Pre-Tax)

12.5%
WSJ Editorial: residential construction is really consumption

PCE treatment of housing
  ◦ Owners’ equivalent rent – no financial transaction
  ◦ Tenant rent: demand or transfer?

Residential construction as true source of demand from housing sector
  ◦ Parallel to consumer durables

Consistent aggregation of residential construction and non-housing PCE
  ◦ Redefine consumption, income, even GDP
Household Debt to Disposable Income

Fairly stable prior to Consumer Age
What was happening to spending and debt across income classes?

Survey of consumer finance for debt

Data challenges for spending and saving
  - Mark Zandi (plus a lot of work) for spending rates
Who Was Borrowing? (SCF)

- Middle Class: Up 95%
- Top 5%: Roughly Flat
Disaggregated Demand Rates

Everyone’s spending rises (for different reasons)

Middle class boom continues

Great Recession
Outlays (Demand + Transfers): Precarious Finances of the Middle Class (Share of Adj. Disposable Income)
Macroeconomic Effects

- Magnitude of unsustainable demand
  - Level (about 7.5% by 2006)
  - Growth rate (0.4% to 0.7% per year in Consumer Age)

- Possible linkage between saving shortfall and income shortfall for bottom 95%
  - Robert Frank (consumption “arms race”)
  - Bertrand–Morse
  - Role of access to credit
Demand Loss Estimate to Restore 7.0% Benchmark Saving (Bottom 95%)
Correlation of Bottom 95% Saving Shortfall and Income Inequality Shortfall
Aftermath: Loss of Demand Engine

- Disappointment, quarter after quarter
  - March 2013 jobs report

- Why? Loss of household demand engine
  - Unprecedented consumption stagnation (data)
  - What replaces this source of stimulus?
  - Macroeconomic challenge from rising inequality
  - Can we grow robustly with so much inequality AND sustainable middle class financial conditions?
Real Consumption Profiles Until Initial Employment Restored

- 1/1981 - 9/1983
- 8/1990 - 2/1993
- 2/2001 - 1/2005
- 12/2007 - 12/2012