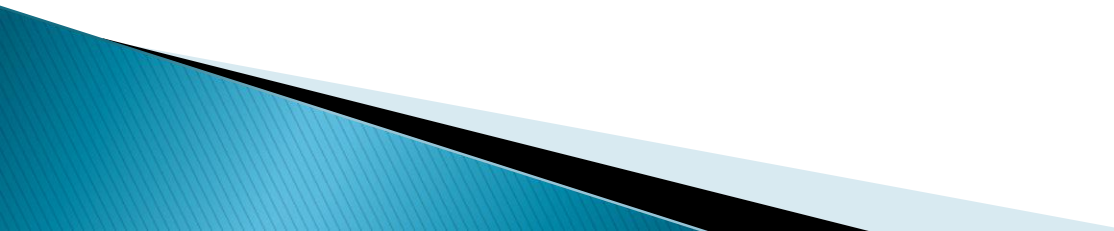


Inequality, and the Challenge of Economic Recovery

Steven Fazzari

Professor of Economics, Washington University
Levy Institute Minsky Conference- April 18, 2013
(Joint work with Barry Cynamon)

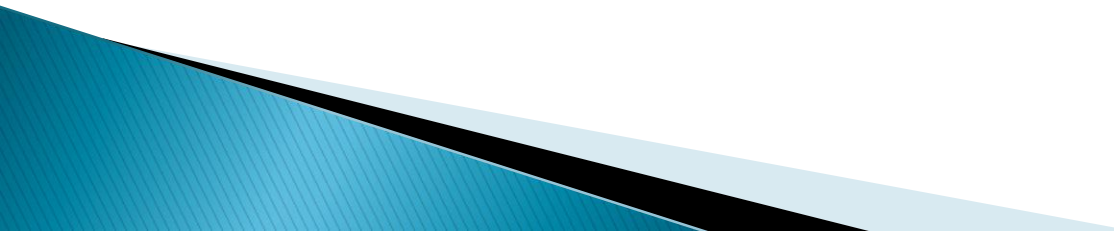
“Consumer Age” (Middle 1980s to 2007)

- ▶ 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
- 

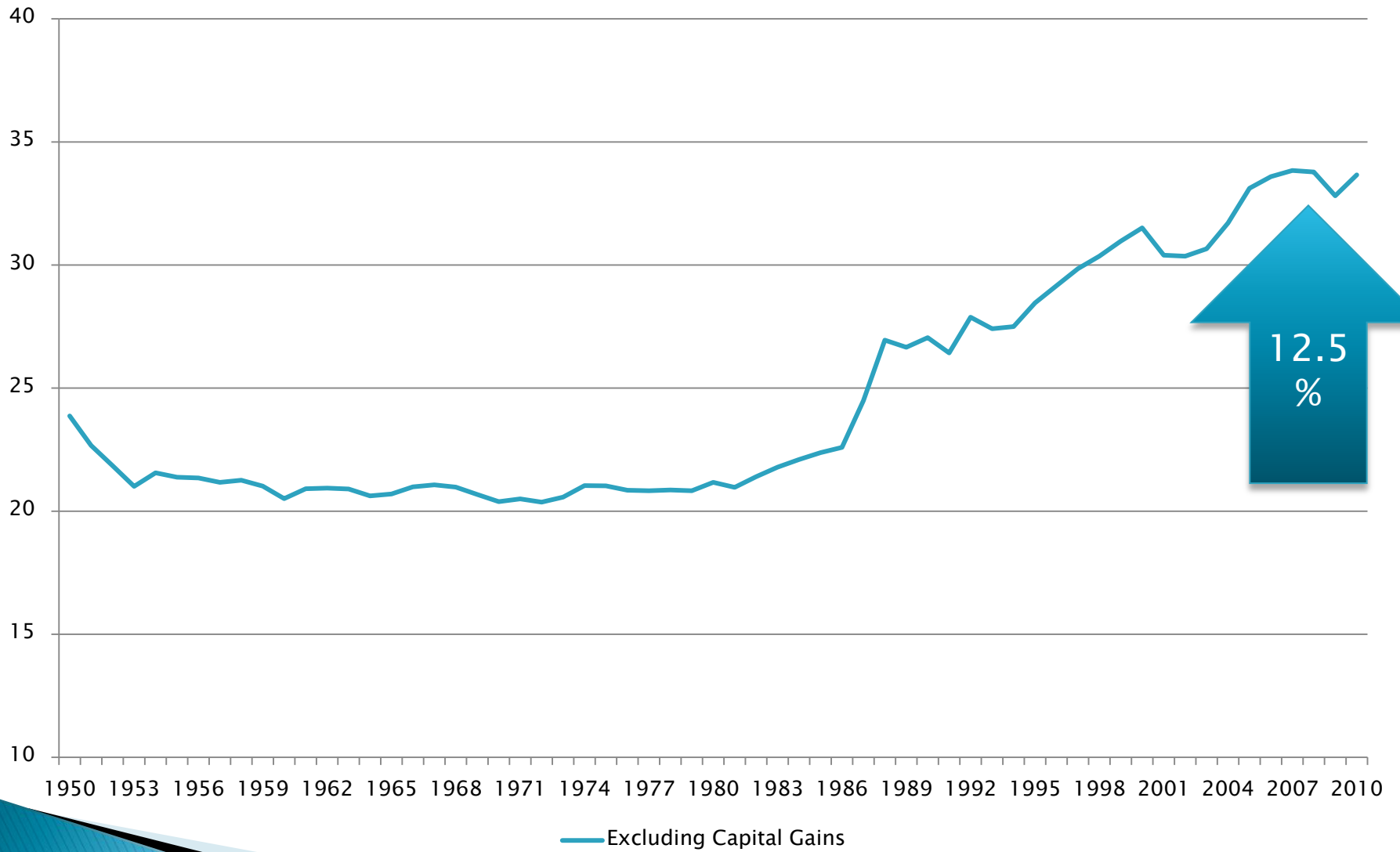
A Paradox

- ▶ 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)

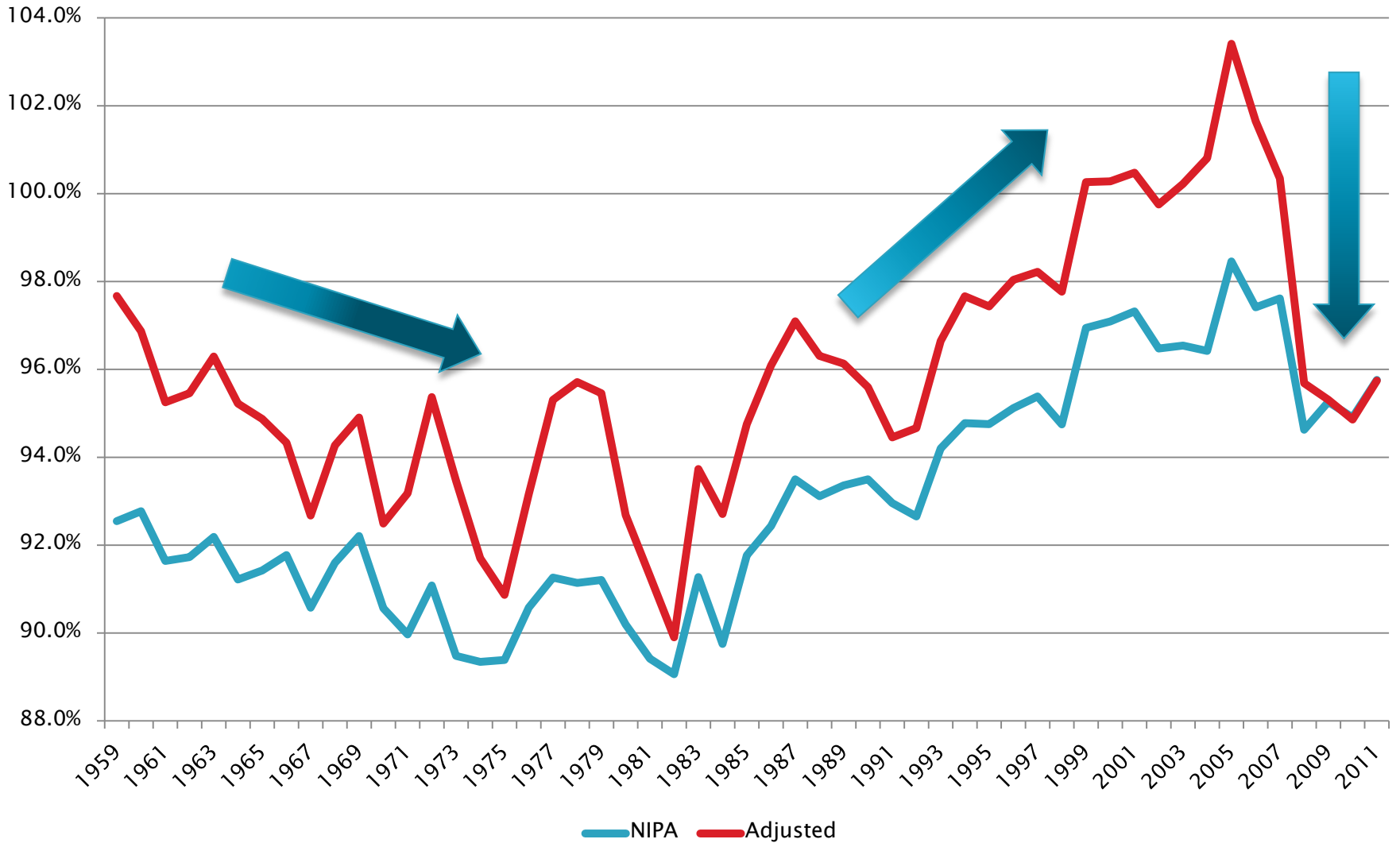


12.5
%

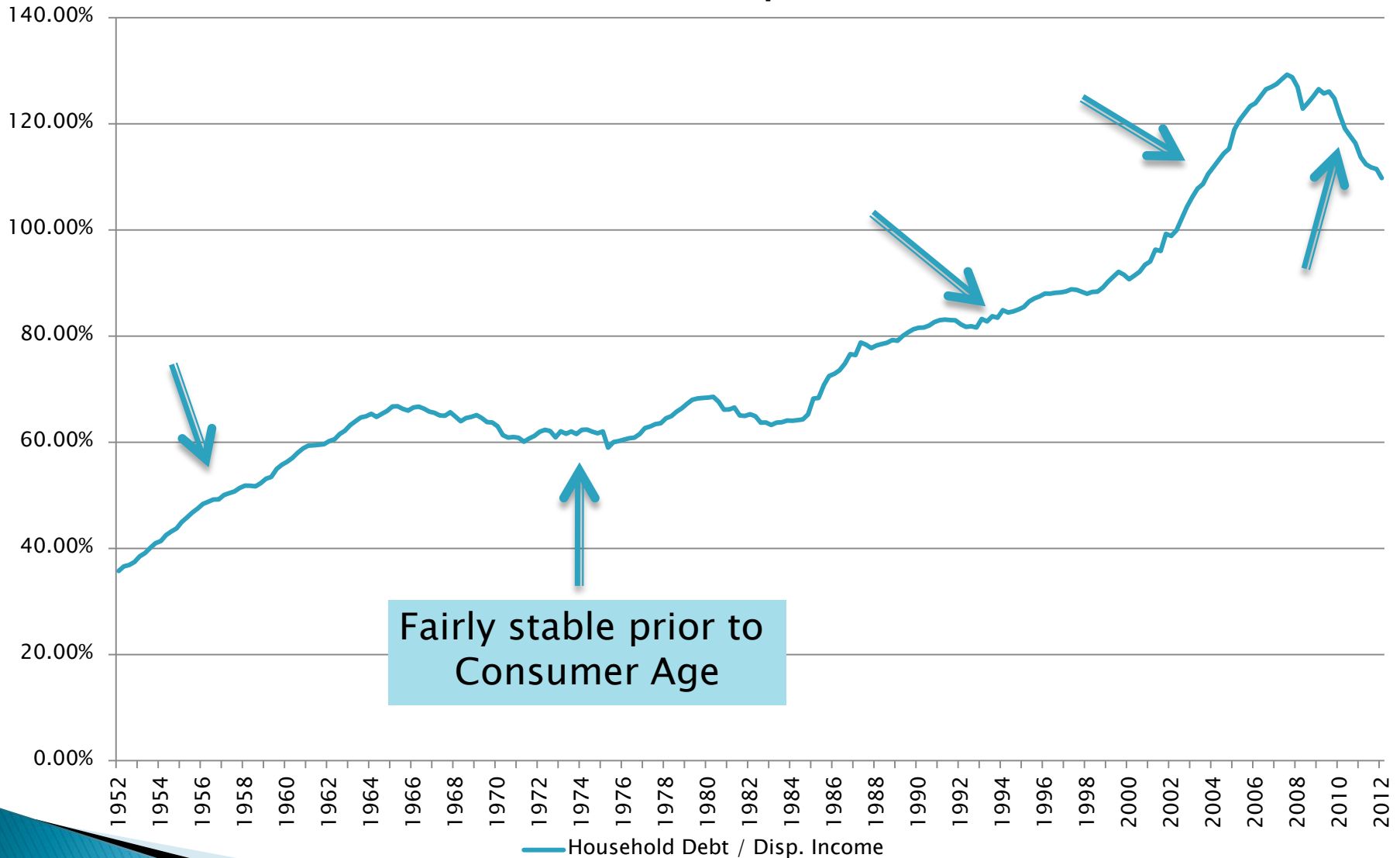
Measuring Household Demand

- ▶ 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 Outlays to Disposable Income: NIPA and Adjusted



Household Debt to Disposable Income



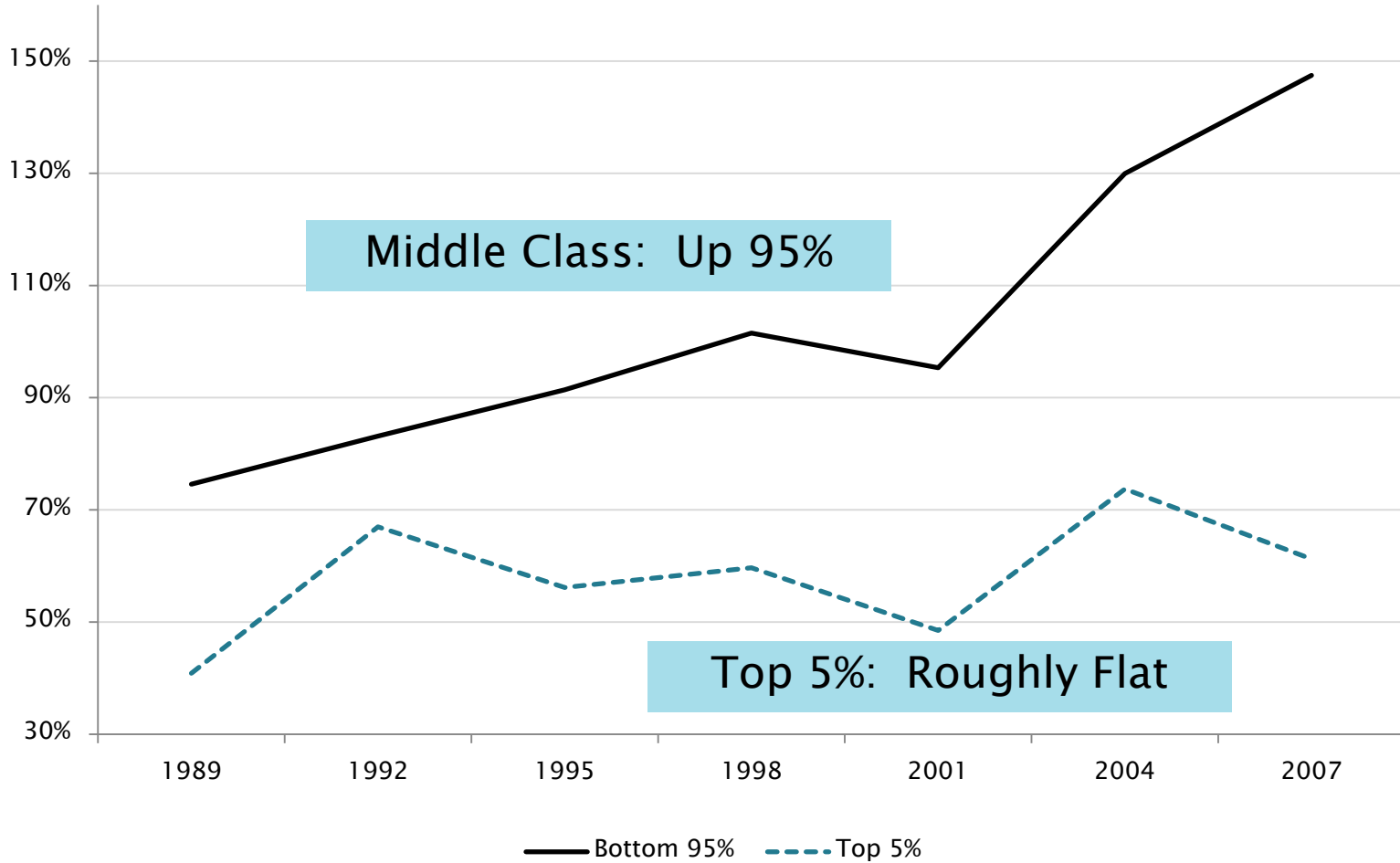
Fairly stable prior to
Consumer Age

Household Debt / Disp. Income

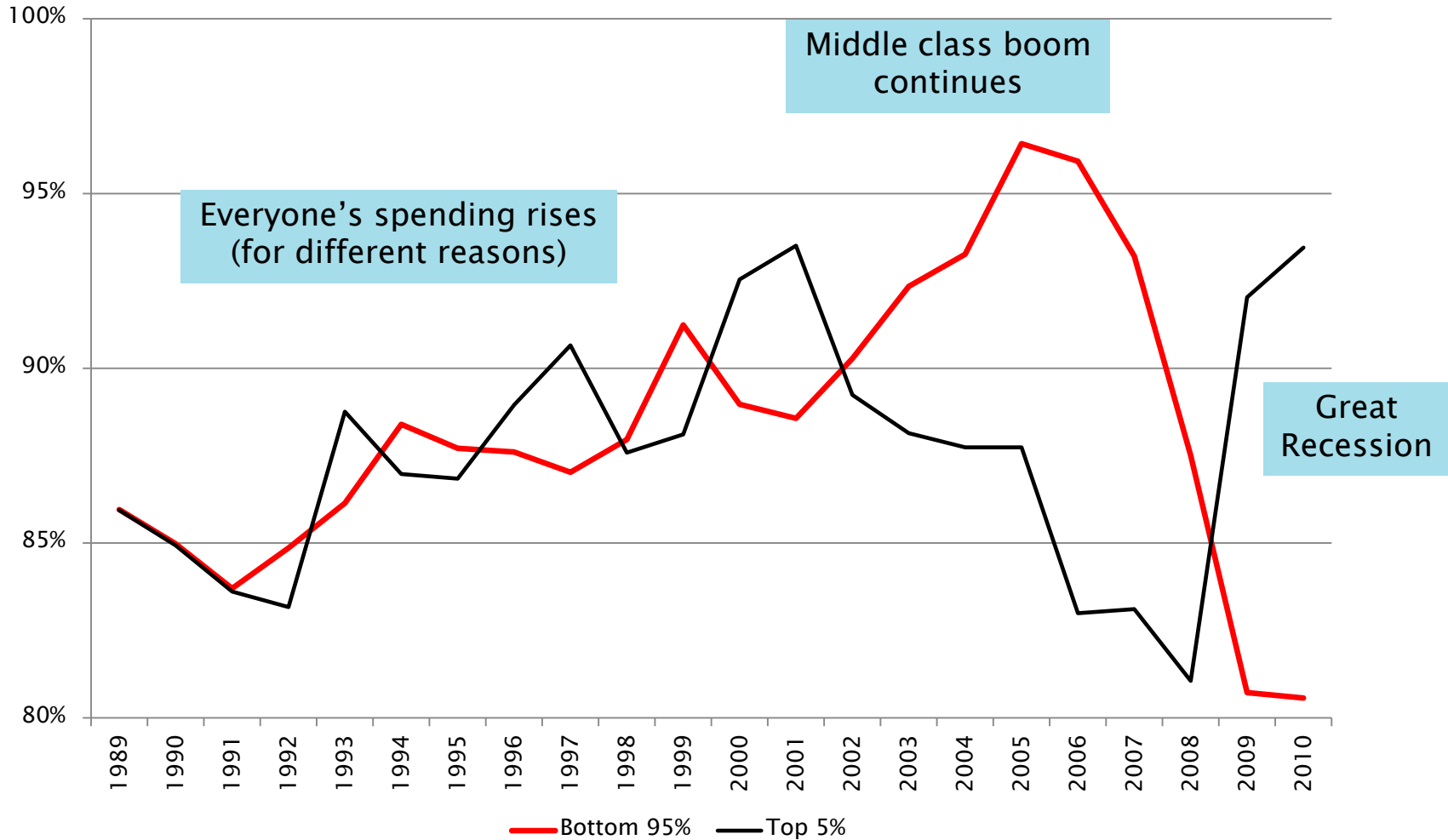
Resolving the Paradox

- ▶ 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

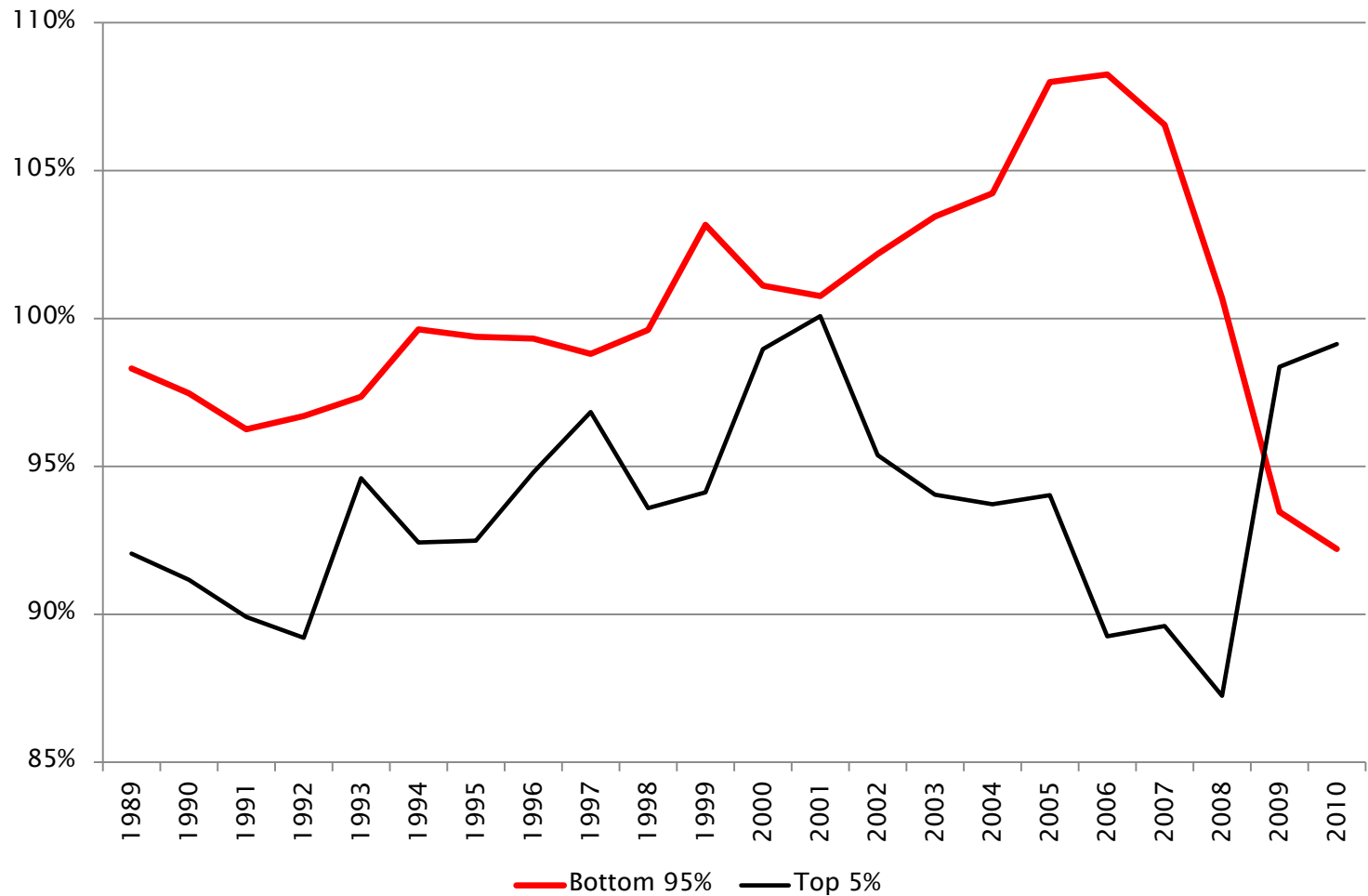
Who Was Borrowing? (SCF)



Disaggregated Demand Rates



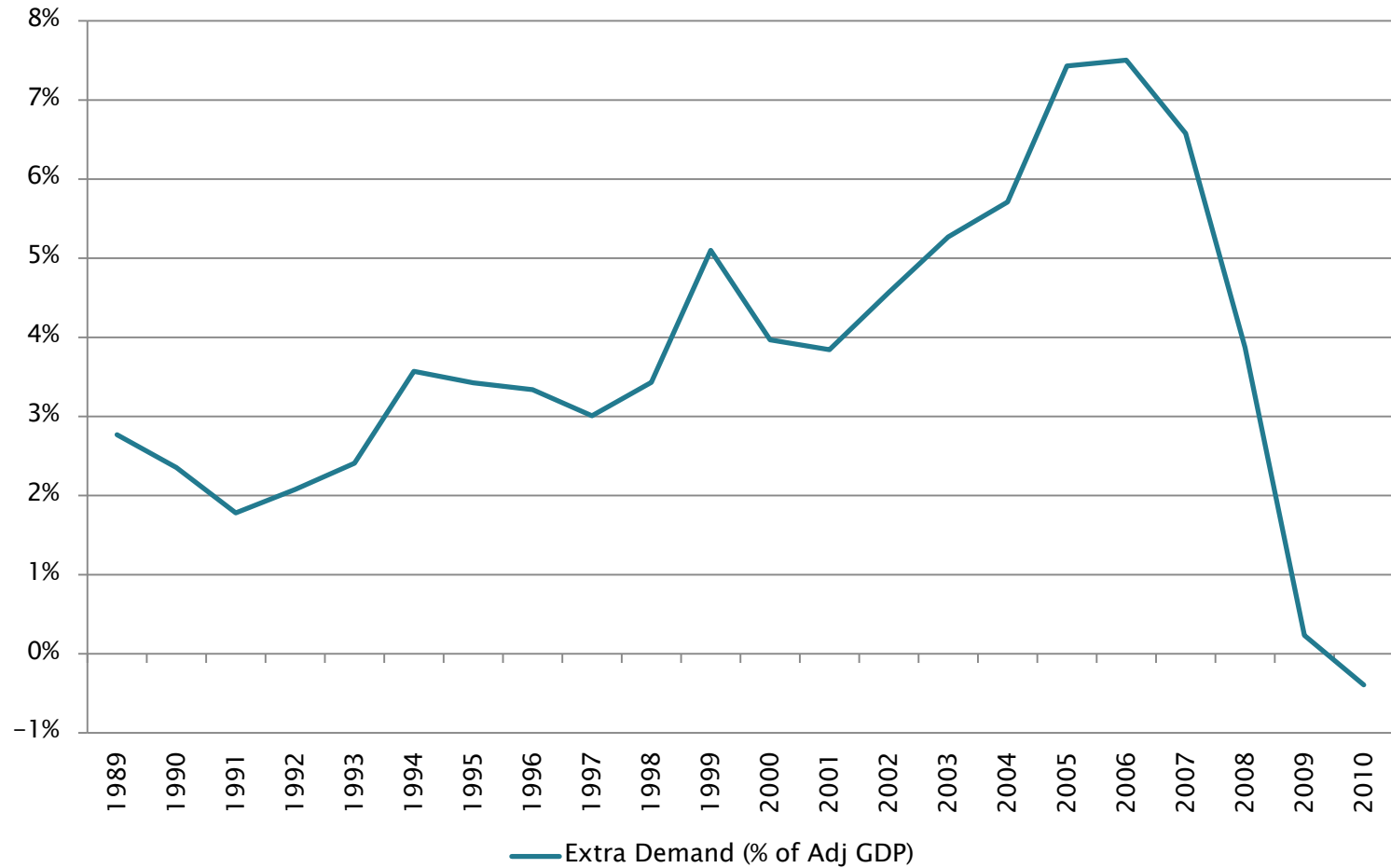
Outlays (Demand + Transfers): Precarious Finances of the Middle Class (Share of Adj. Disposable Income)



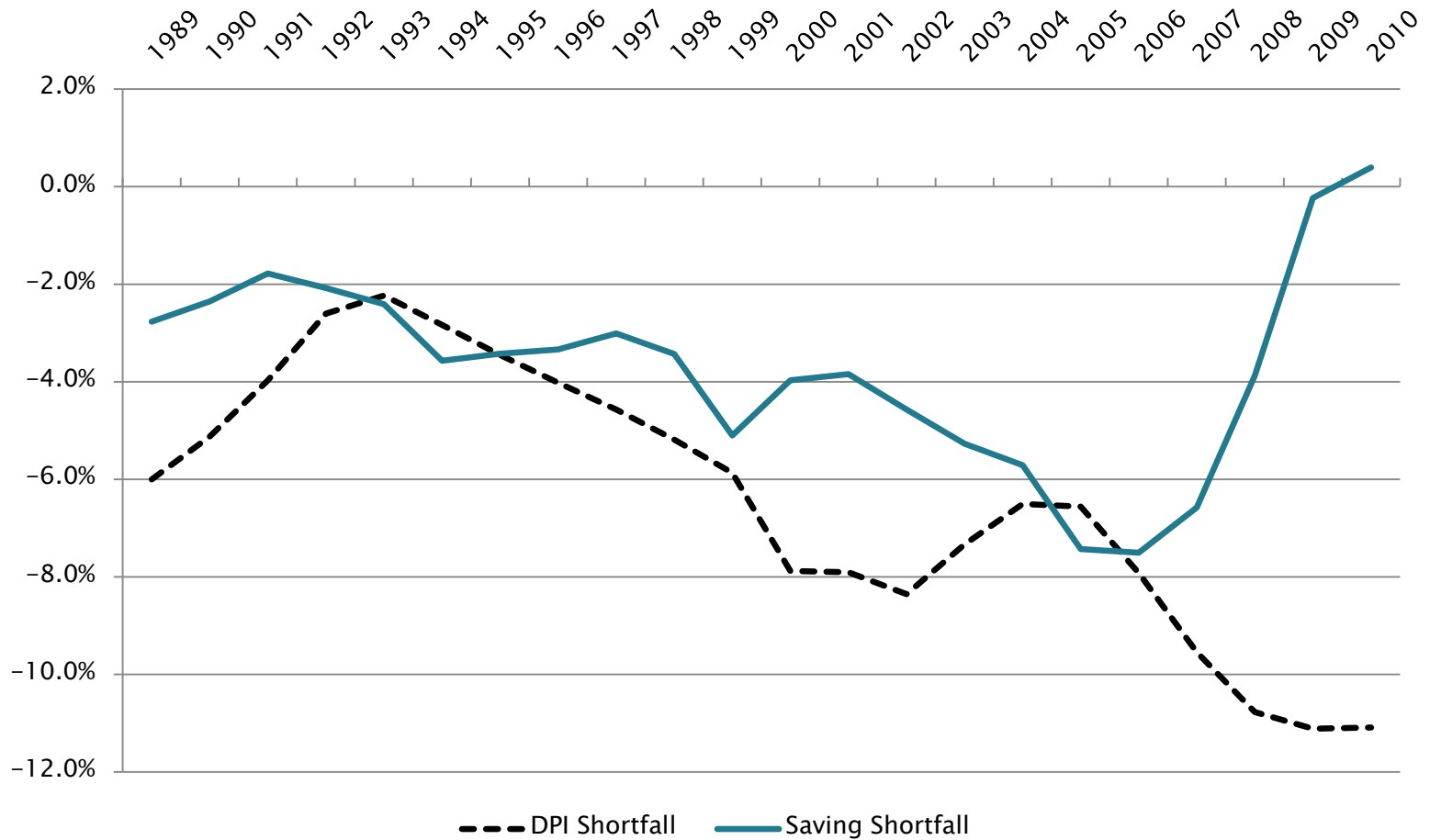
Macroeconomic Effects

- ▶ 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

