POLS/ECON 409
Political Economy from Great Recession to Pandemic

COURSE INTRODUCTION

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Shocks and Trends in the 21st Century

This course considers the political macro-economy in a time of great political & economic change: the 21st century

Our study period is bookended by two massive shocks:
the Great Recession & the COVID-19 Pandemic

But shocks this big can conceal, accelerate, or reverse deeper long-run trends

These trends can take many forms:
demographic shifts, rising political movements, technological change, shifts in capital or skills...

Our job in this course is to try to understand (and disentangle)
the shocks and the trends the make up today's political economy

To do so,
it helps to understand the broader context of how we got to the 21st century economy

The period from 1947–1973 was a "Golden Age of Capitalism" in the US and Europe:

Growth was high, inflation and unemployment low,
and wealth was spread more equitably than before

Source: David Leonhart, 2012, "Is simple demography behind weak economy?", *New York Times*, 17 August, `http://economix.blogs.nytimes.com/2012/08/17/demographic-changes-a-key-factor-in-slowing-economic-growth/`

A brief history of the economies of the US and Europe

What came before the "Golden Age"?

The Gilded Age of the late 19th century: Constant boom and bust; high inequality; frequent financial crises and bank runs

The 1920s Boom, which many thought indicated a permanent oasis of stable growth

The Great Depression: A massive market crash sets off a financial crisis – debt-deflation spiral takes more than a decade of massive government stimulus to resolve

World War II: An orgy of destruction leaves the US intact and economically preeminent; Europe rebuilds

A brief history of the economies of the US and Europe

What came after the Golden Age?

The stagflation of the 1970s: Oil shocks lead to high inflation and high unemployment, a combination of crises that stimulus can't solve

The modest booms of the 1980s and 1990s: Heralded as the Great Moderation – inflation falls and recessions moderate; central banks emerge as key economic actors

But signs of trouble – higher inequality, lower growth, and the return of financial crises (S&L in 1980s US; 1980s Latin American debt crises; Japan's Lost 1990s; 1998 Asian crisis; 2002 Enron collapse)

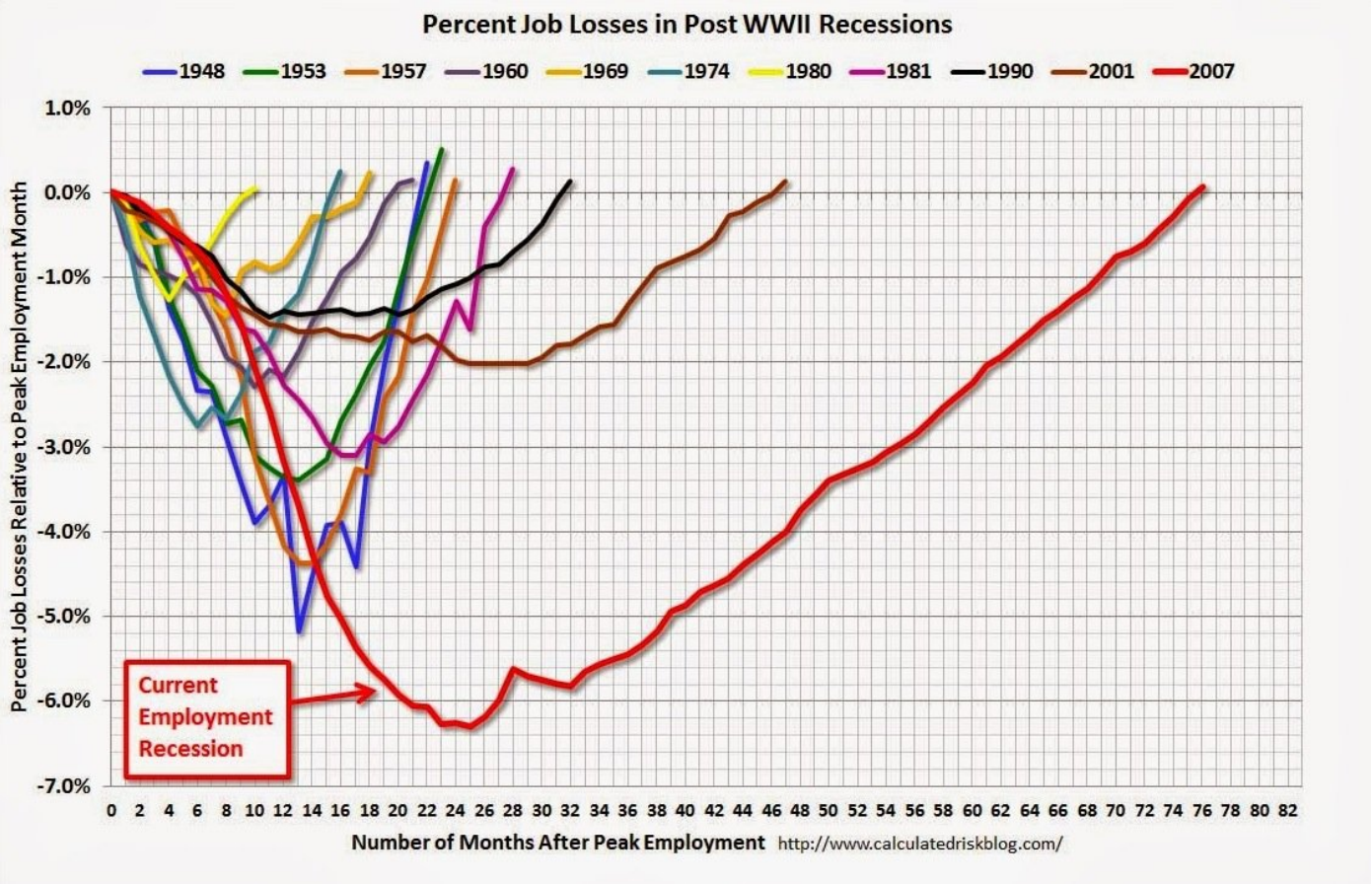
Most of all, asset bubbles emerge – first in stocks, then in housing

A brief history of the economies of the US and Europe

Great Recession: Just as some are declaring, once again, that the economy has reached a permanently high plateau, the housing bubble bursts, the economy enters recession, and the banking system teeters on the edge of collapse...

We'll examine the crisis in detail over the coming weeks.

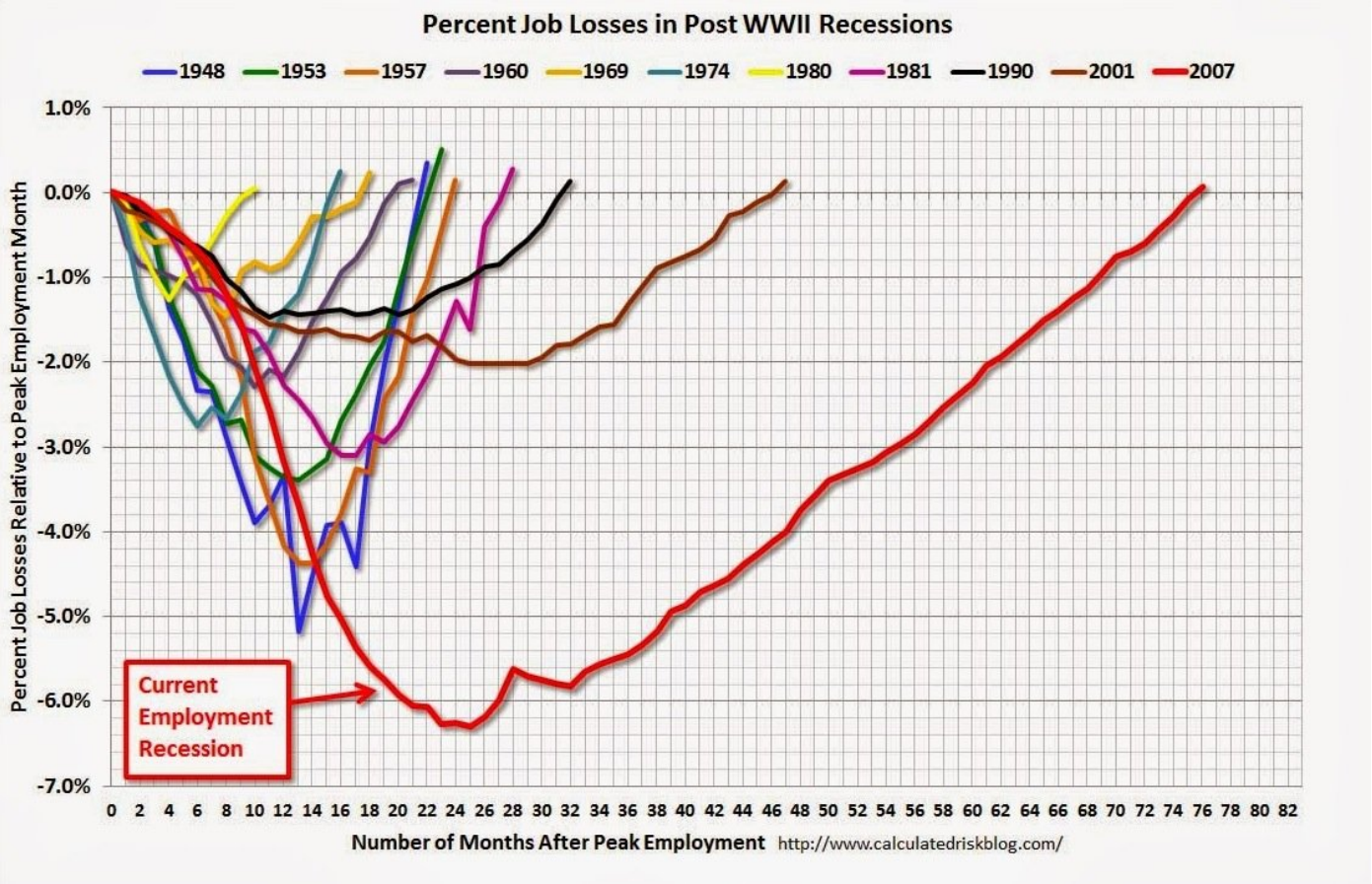
For now, let's get a big picture of the consequences...



The global recession that began in 2007 was much worse than other recessions of the postwar period in the US and Europe…

Unemployment soared to 10% in the US and recovered slowly

Source: Joe Weisenthal, 2014, "The Scariest Chart Ever Is Dead," *Business Insider*, June 6. `http://www.businessinsider.com/the-scariest-chart-ever-is-dead-2014-6`



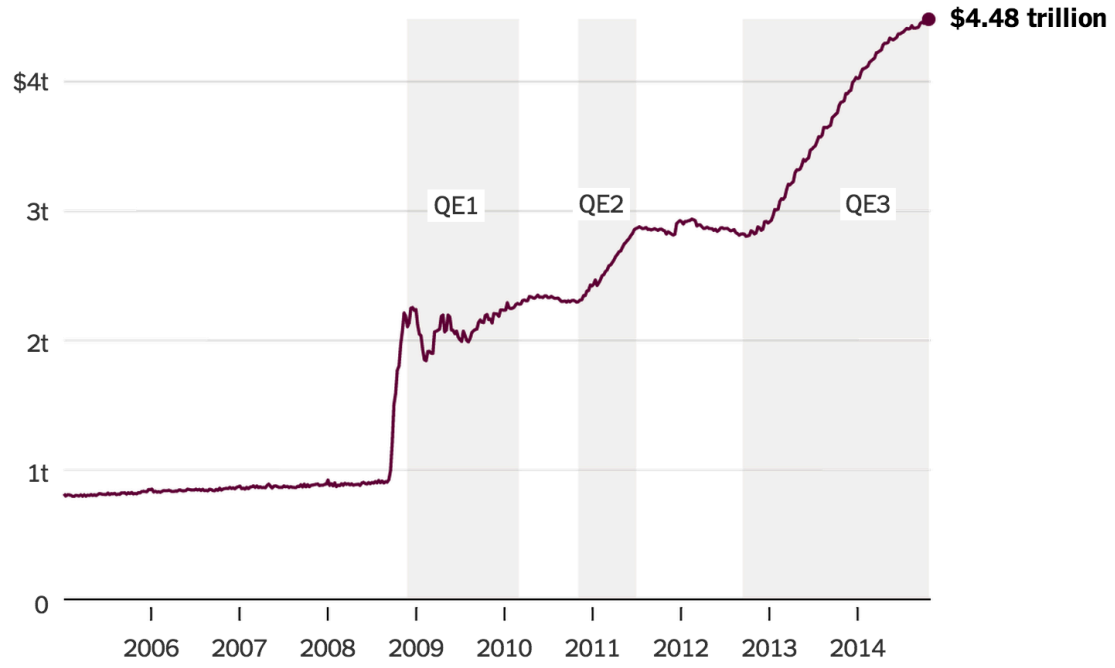
Job growth stubbornly refusing to accelerate – many looked at early versions of this chart in 2009 and correctly predicted 2014–2015 as the point at which jobs would return to pre-recession levels

Source: Joe Weisenthal, 2014, "The Scariest Chart Ever Is Dead," *Business Insider*, June 6. `http://www.businessinsider.com/the-scariest-chart-ever-is-dead-2014-6`

Quantitative Easing, in One Chart

In three phases since late 2008, the Federal Reserve has bought trillions of dollars in bonds using newly created money to stimulate the economy. QE3 is likely to end this month.

Total assets held by the Federal Reserve



Source: Federal Reserve

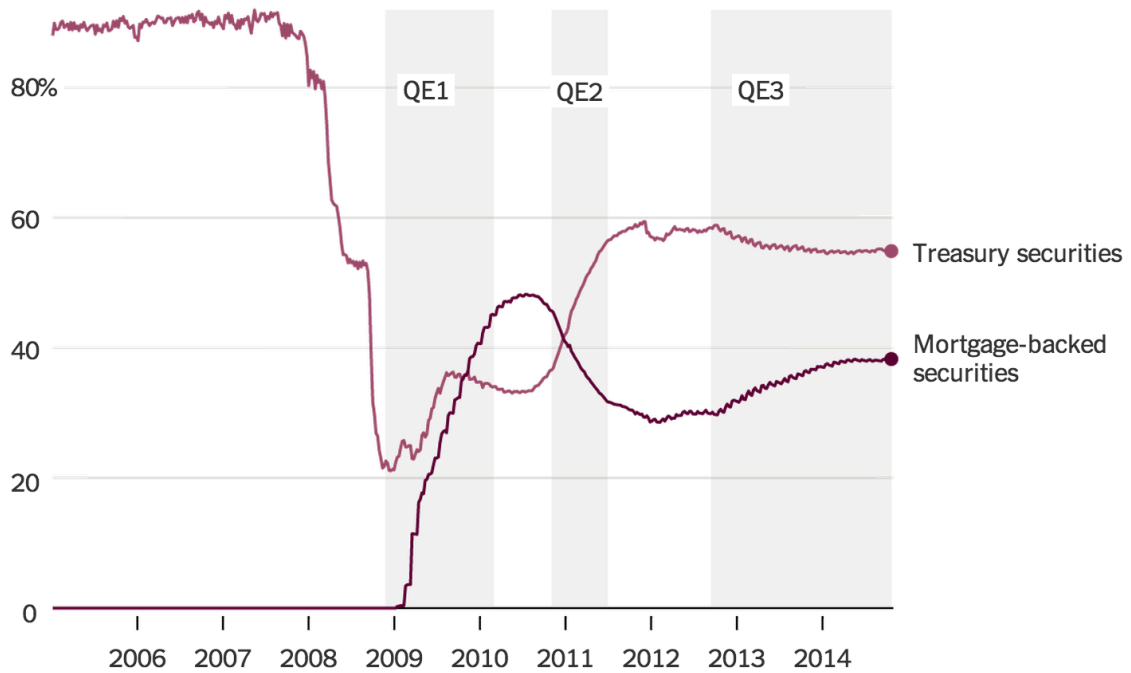
Source: Neil Irwin, 2014, "Quantitative easing Is ending. Here's what it did, in charts." *New York Times*, 29 October. http://www.nytimes.com/2014/10/30/upshot/quantitative-easing-is-about-to-end-heres-what-it-did-in-seven-charts.html

One of the most important policy responses to the crisis was quantitative easing – the creation of a vast pool of liquidity by the Federal Reserve and other central banks

The Fed Has Bought Vast Sums of Mortgage-Backed Bonds

In its first and third rounds of quantitative easing, the Fed bought not just the U.S. government debt it has traditionally owned, but securities backed by Americans' home mortgages.

Percentage of total Federal Reserve assets



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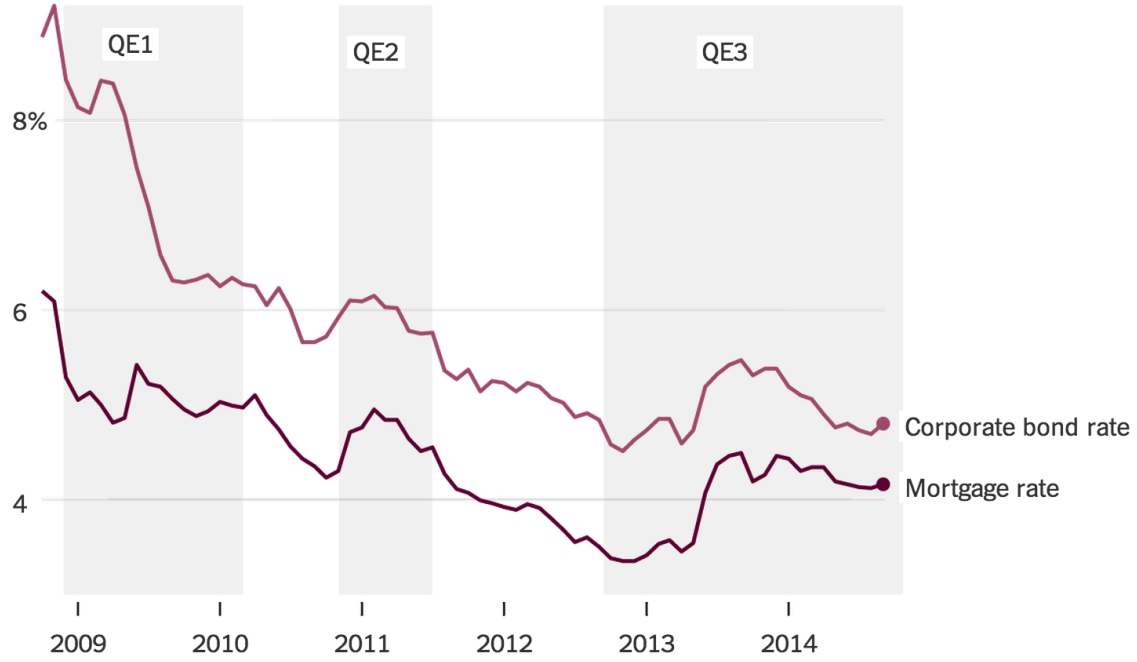
The Fed soaked up an enormous amount of mortgage-backed debt...

Consumer and Business Borrowing Costs Have Fallen

Amid the Fed's quantitative easing programs, interest rates for both American homebuyers and large businesses have fallen.

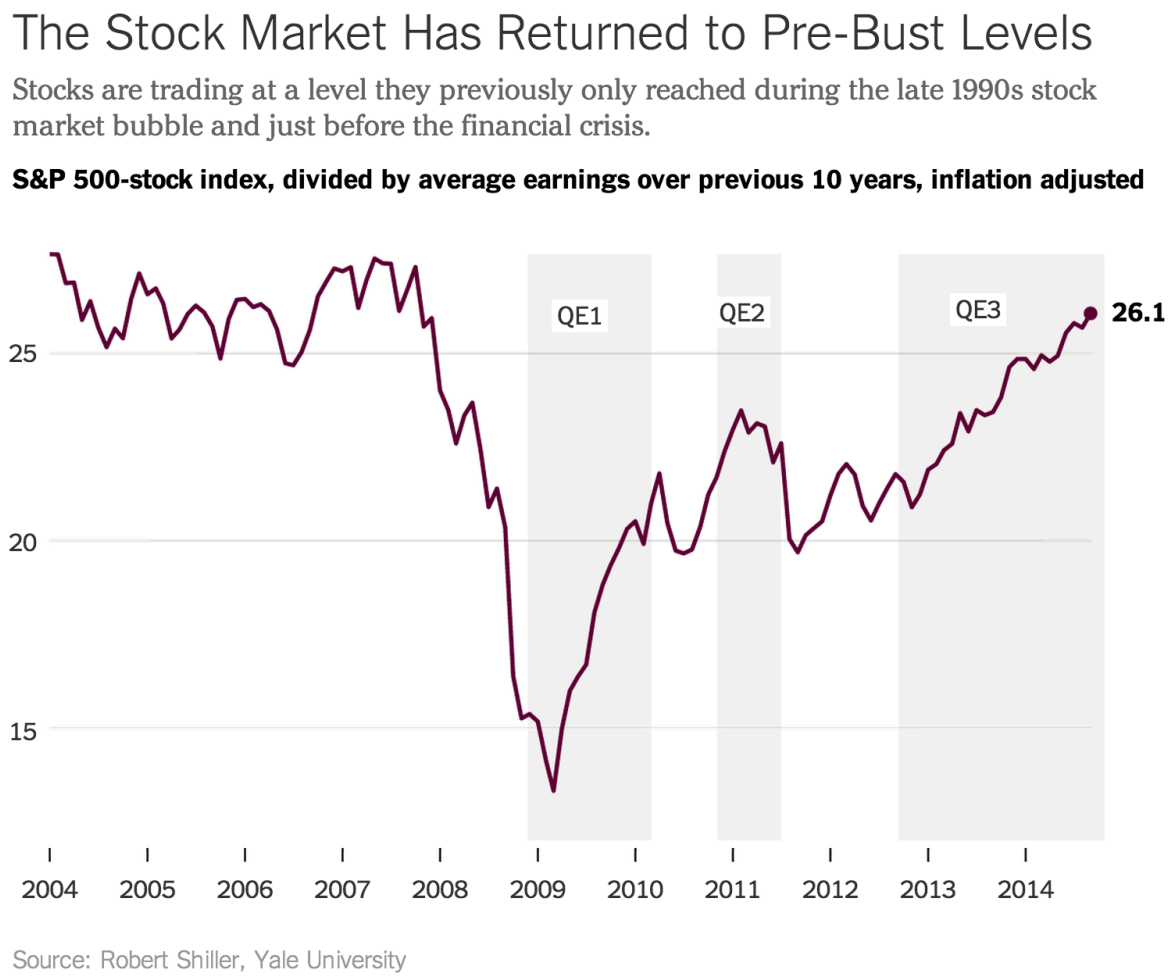


Mortgage rate is average 30-year fixed-rate mortgage. Corporate bond rate is yield on seasoned Baa-rated bonds.

Source: Moody's, Freddie Mac

Source: Neil Irwin, 2014, "Quantitative easing Is ending. Here's what it did, in charts." *New York Times*, 29 October. `http://www.nytimes.com/2014/10/30/upshot/quantitative-easing-is-about-to-end-heres-what-it-did-in-seven-charts.html`

QE has helped keep interest rates low, which encourages investment



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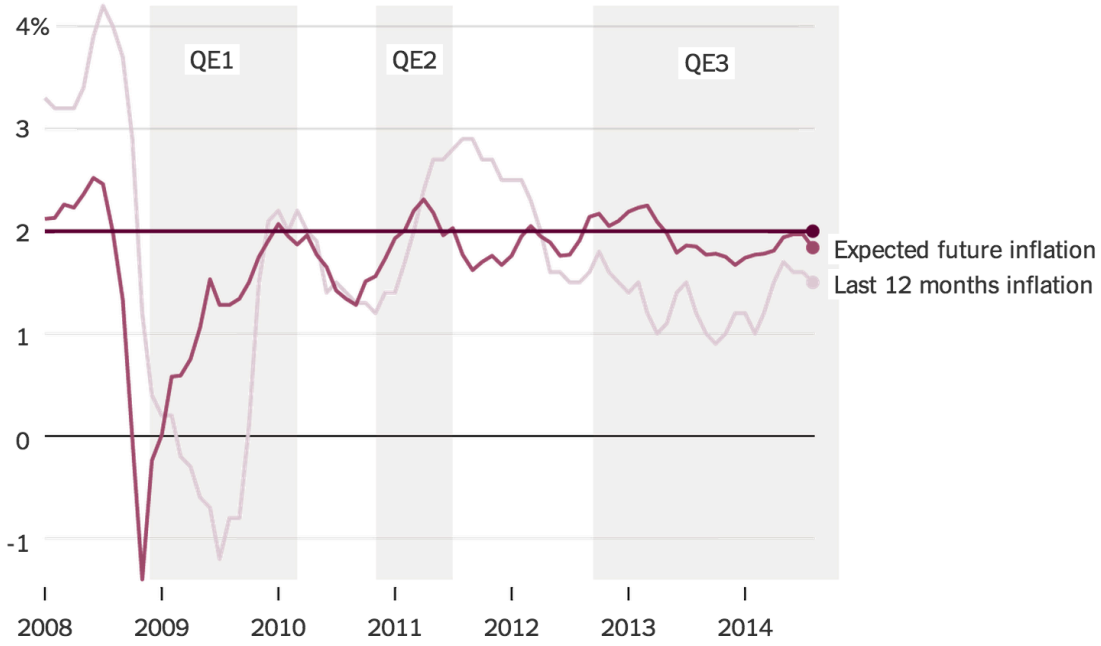
By keeping interest rates low and bonds in high demand, QE also provided massive stimulus to asset prices

Inflation Remains Below the Fed's Target

Both inflation and inflation expectations remain below the 2 percent annual rate the Fed aims for, despite three rounds of quantitative easing aimed at boosting inflation.



Expected future inflation is five-year breakeven between inflation-adjusted bonds and regular bonds. Last 12 months inflation is year-over-year change in the personal consumption expenditures price index.

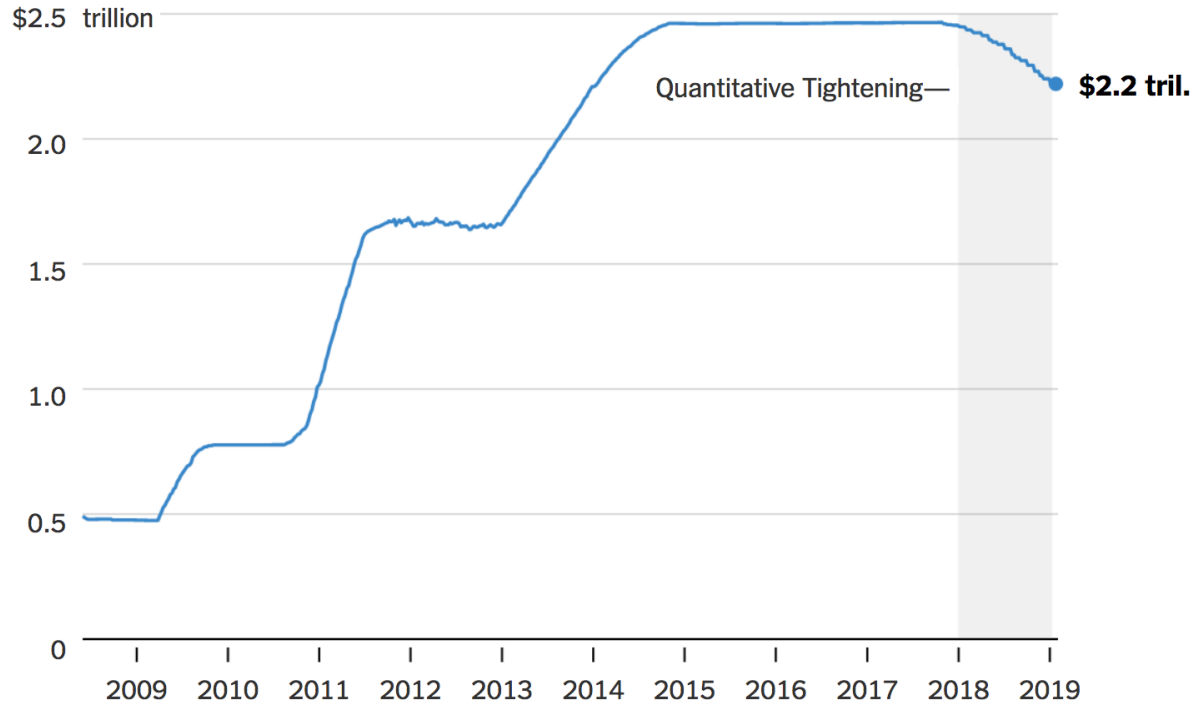
Source: Federal Reserve, Bureau of Economic Analysis

Source: Neil Irwin, 2014, "Quantitative easing Is ending. Here's what it did, in charts." *New York Times*, 29 October. `http://www.nytimes.com/2014/10/30/upshot/quantitative-easing-is-about-to-end-heres-what-it-did-in-seven-charts.html`

While some worried QE would produce high inflation, it only dented the massive deflation caused by the financial crisis and recession

Arguably, inflation was persistently too *low* for full recovery

Federal Reserve holdings of Treasury securities

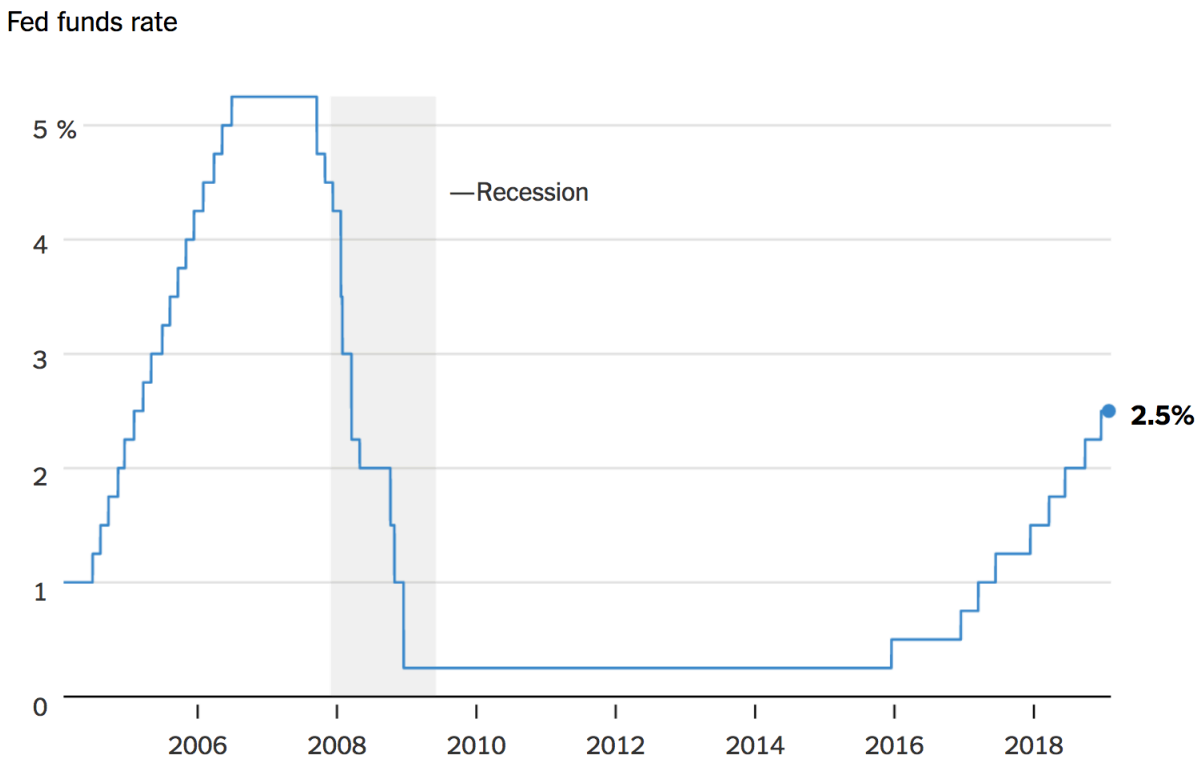


Source: Matt Phillips, 2019, "The Hot Topic in Markets Right Now: 'Quantitative Tightening."' *New York Times*, 30 January. `https://www.nytimes.com/2019/01/30/business/fed-quantitative-tightening.html`

By 2019, efforts to unwind QE (both Treasuries & MBS) had barely started, when the Fed signalled a halt to interest rate tightening

Most in the Fed believed the recovery was too fragile to handle unwinding Great Recession stimulus, even a decade later

And this was *before* the events of 2020



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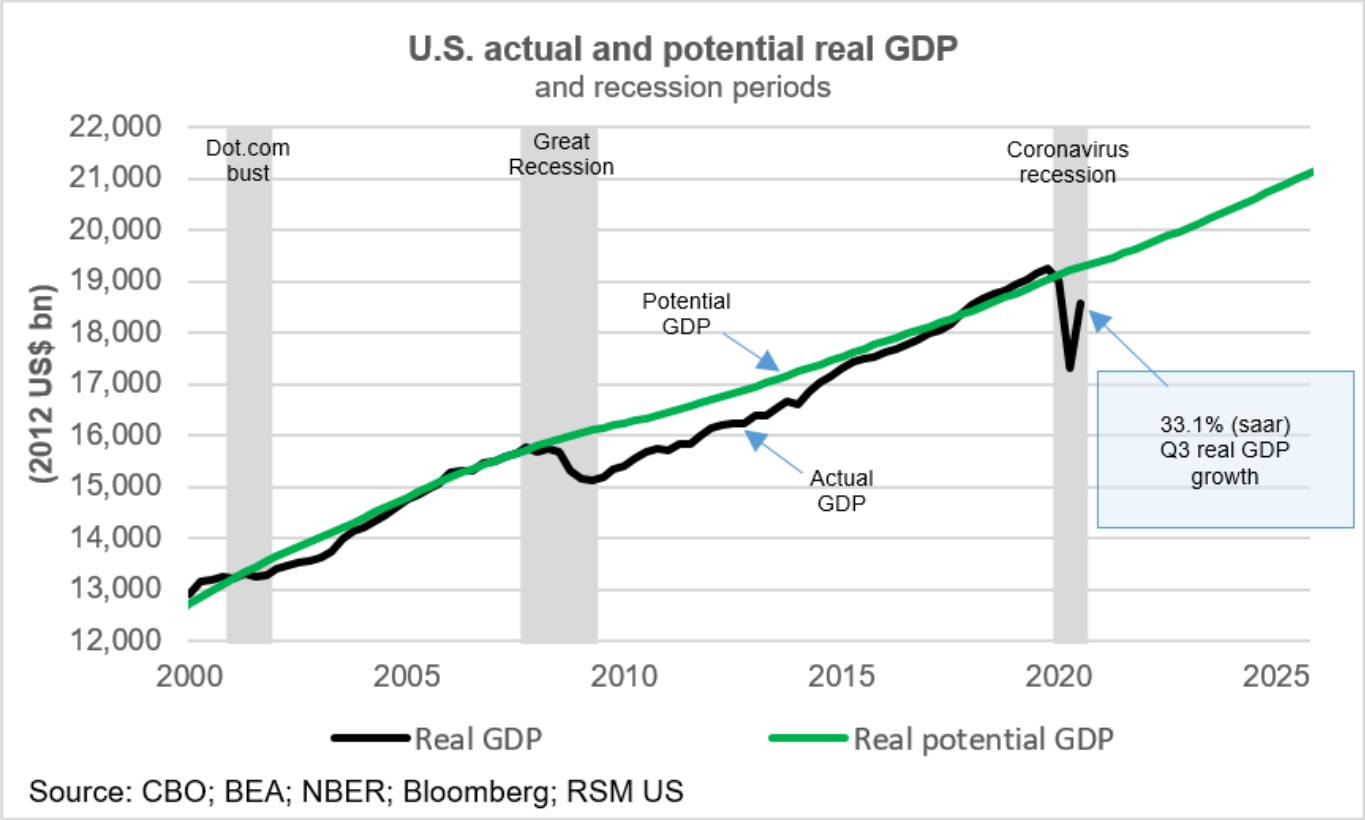
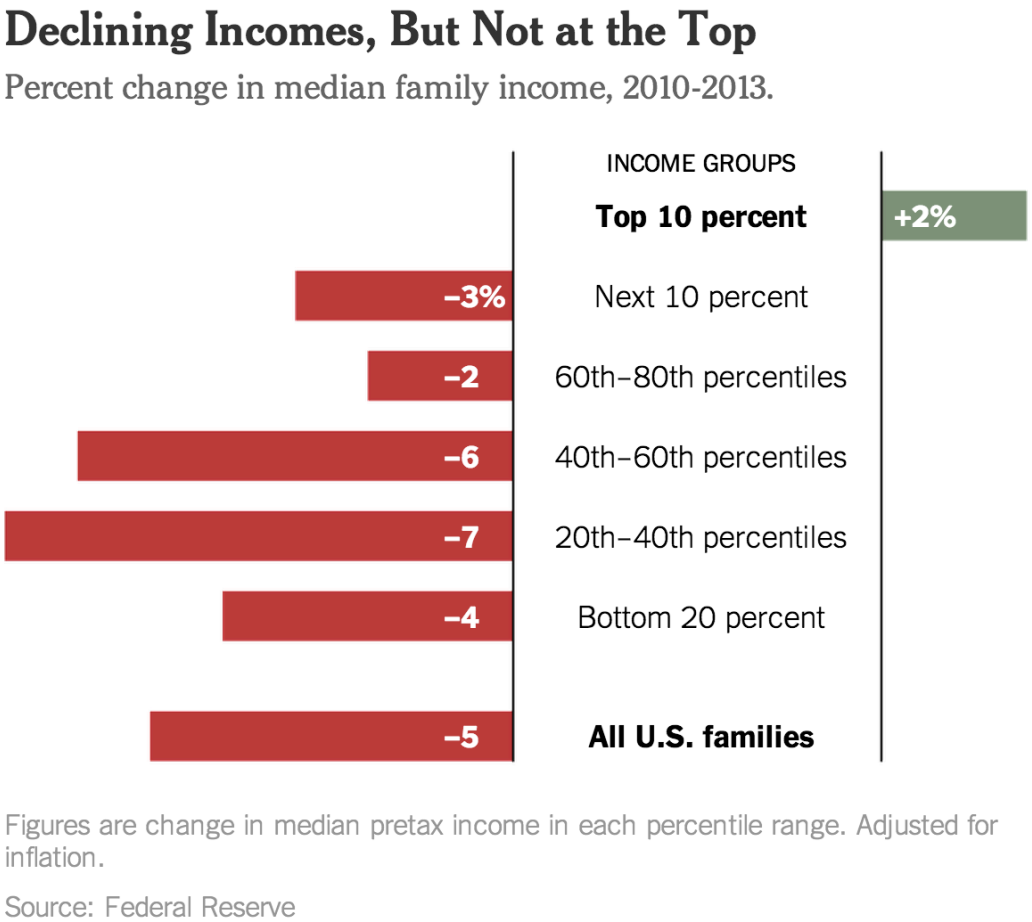


Source: Joseph Brusuelas, 2020, "Third-quarter GDP: Record growth, but closing the output gap will take years," The Real Economy Blog, 29 October, `https://realeconomy.rsmus.com/third-quarter-gdp-record-growth-but-closing-the-output-gap-will-take-years`

QE wasn't enough to produce a strong recovery in the real economy

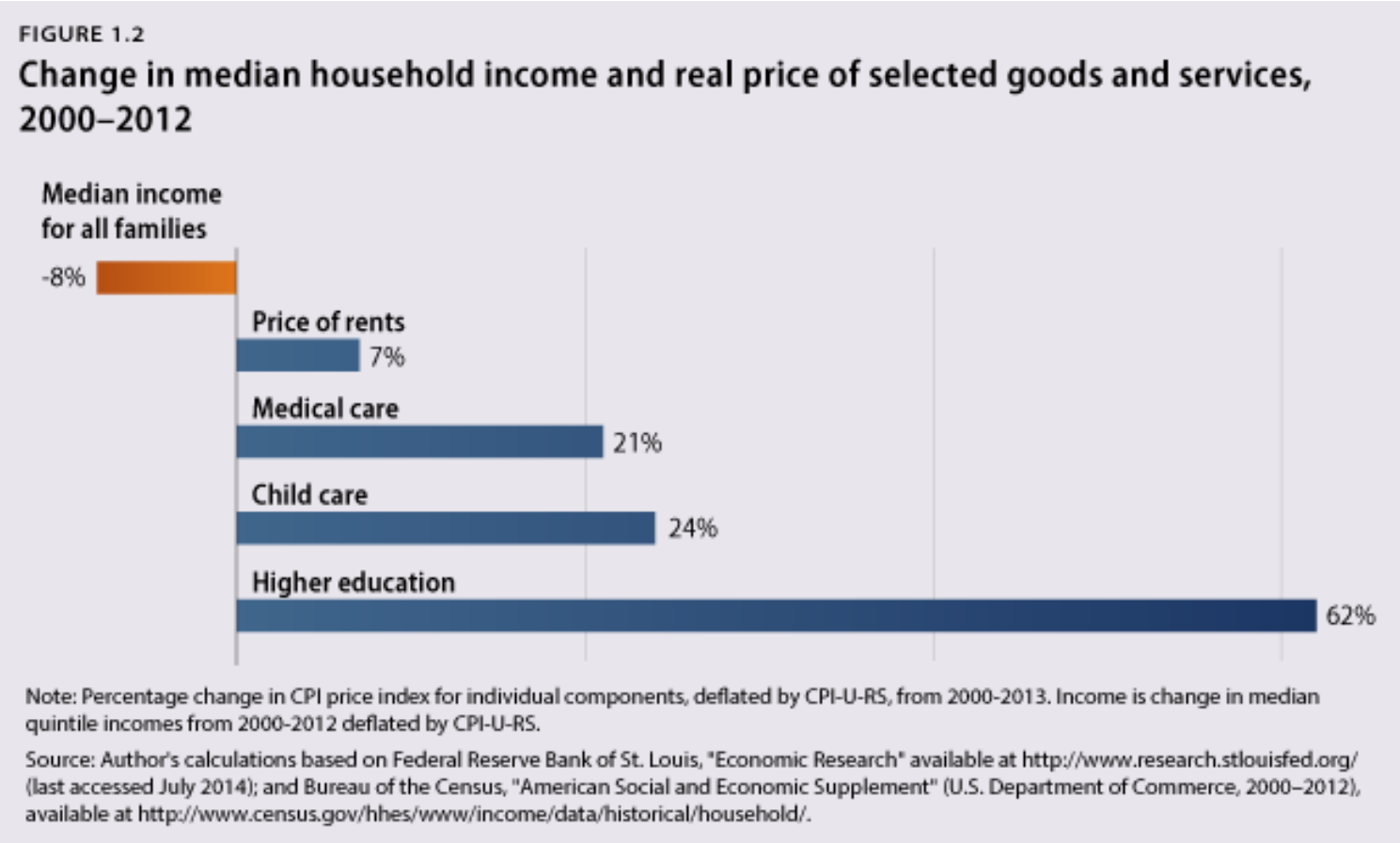
The US gap in output – the total amount of economic activity compared to the prior trend – took a full decade to recover, and would have to recover again



The Great Recession and the early years of the recovery magnified income inequality

Source: Steven Rattner, 2014, "Inequality, unbelievably, gets worse," *New York Times*, 16 November, `http://www.nytimes.com/2014/11/17/opinion/inequality-unbelievably-gets-worse.html`

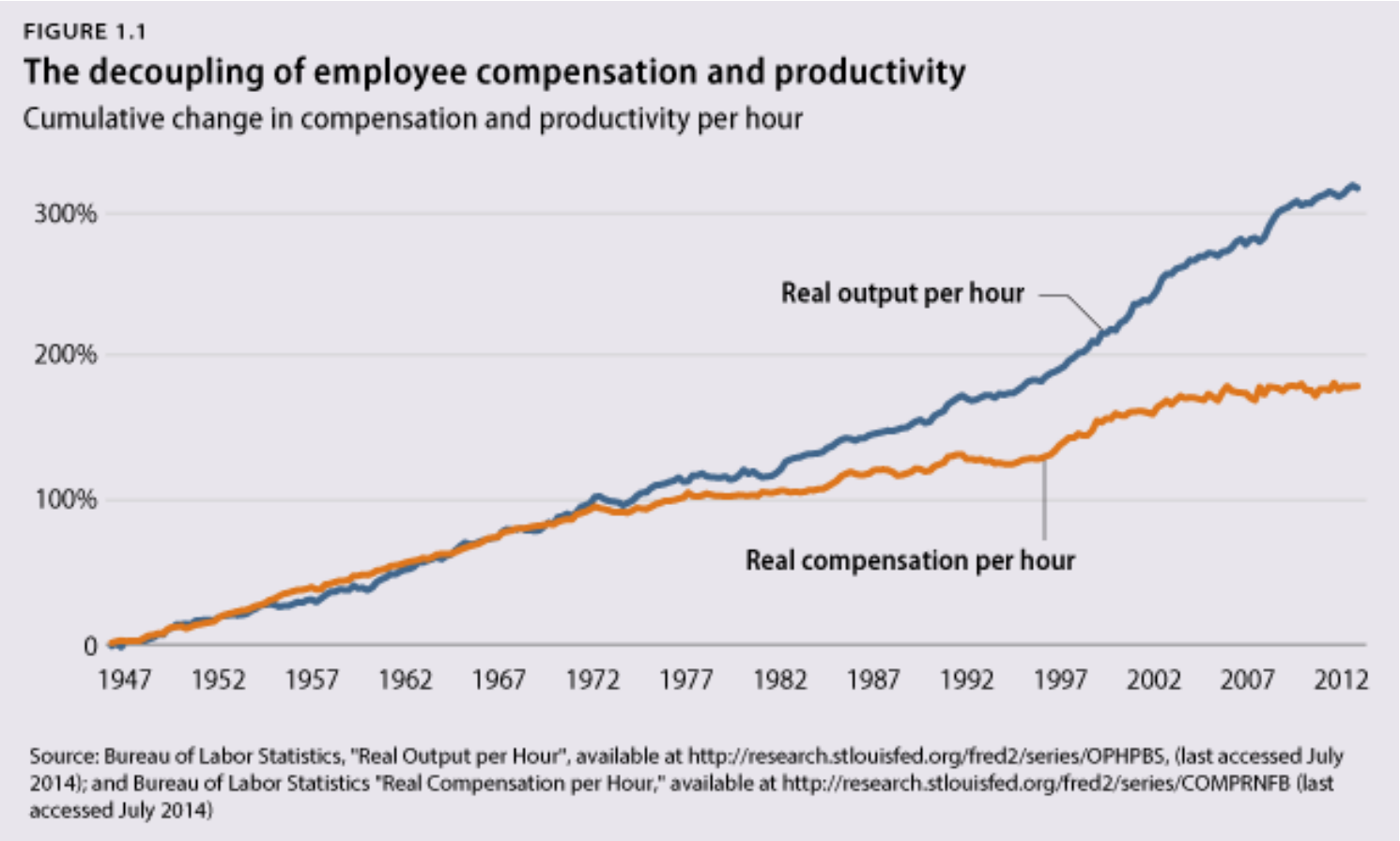
Although inflation was very low, cost shifting from employers and state governments meant the middle class paid more for college and health care, so the "recovery" felt like a very long recession for many



Source: Center for American Progress, 2014, "The middle class squeeze,"

https://www.americanprogress.org/issues/economy/report/2014/09/24/96903/the-middle-class-squeeze/

But take a longer view…
In the Golden Age, workers shared in growth equally with the rich



Source: Center for American Progress, 2014, "The middle class squeeze,"

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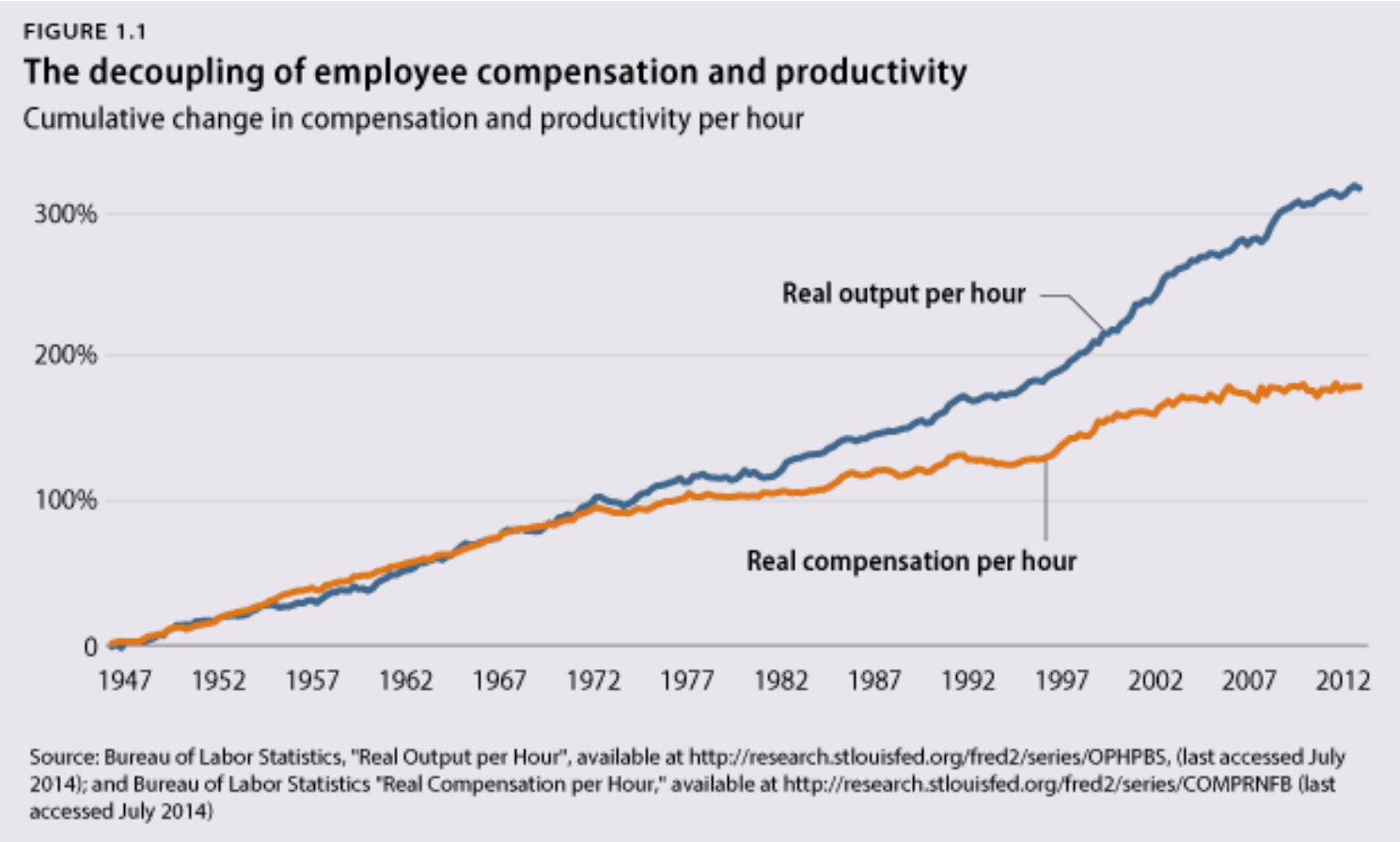
Since the 1970s, wages have fallen behind productivity growth: the economy was growing, but paychecks weren't



Source: Center for American Progress, 2014, "The middle class squeeze,"

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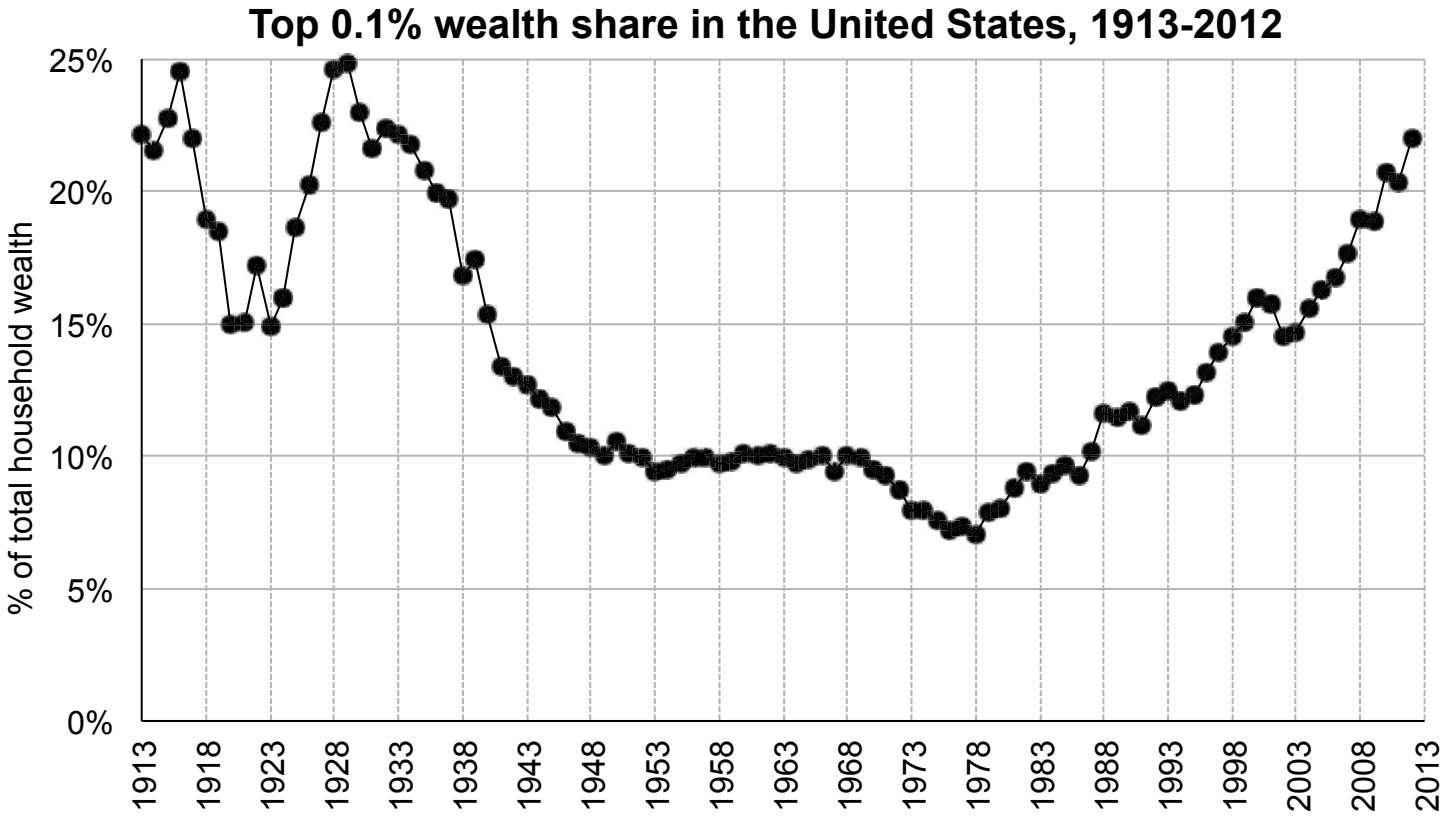
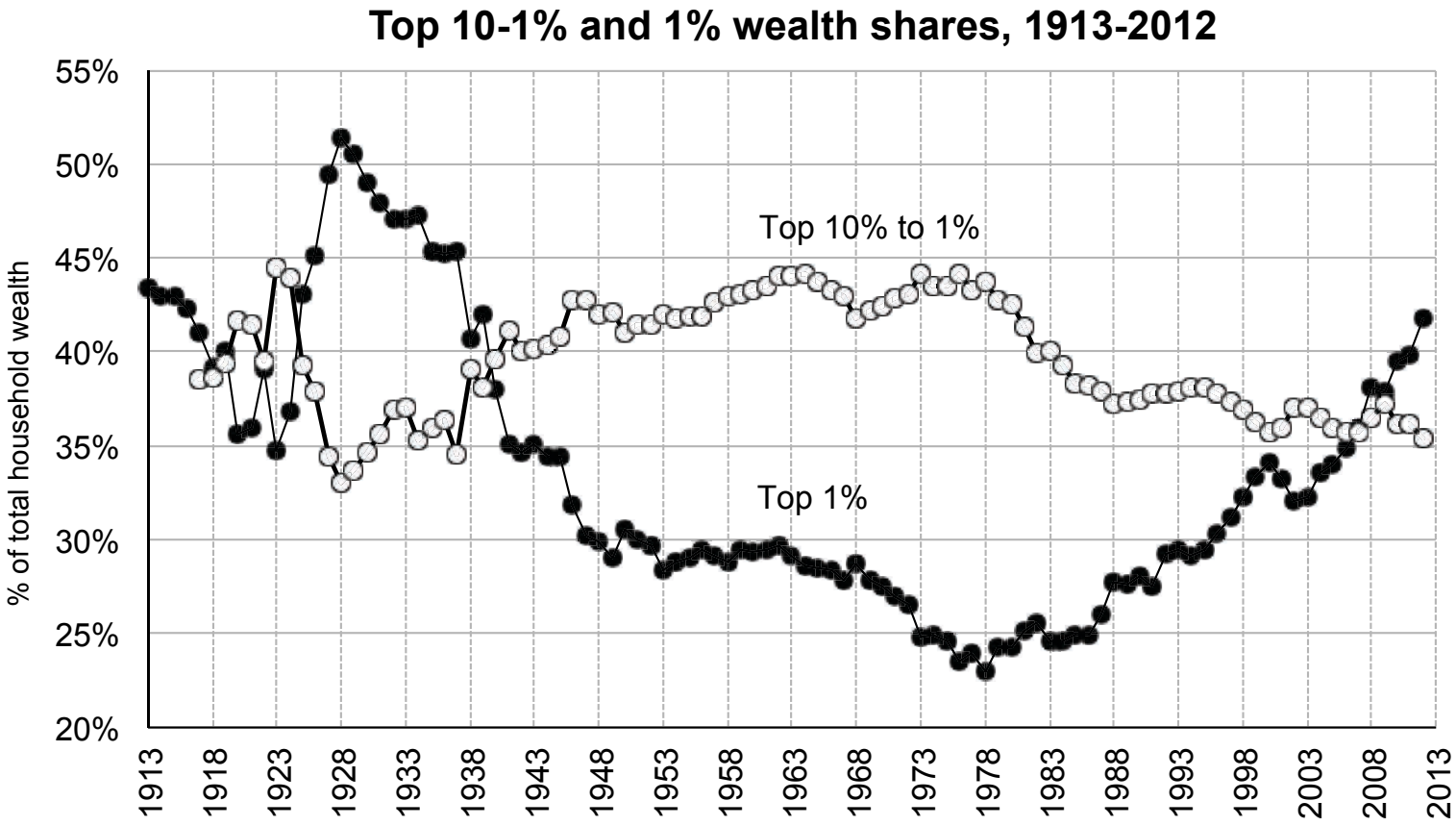
Wealth grew more concentrated – reverting to Gilded Age patterns



This figure depicts the share of total household wealth held by the 0.1% richest families, as estimated by capitalizing income tax returns. In 2012, the top 0.1% includes about 160,000 families with net wealth above $20.6 million. Source: Appendix Table B1.

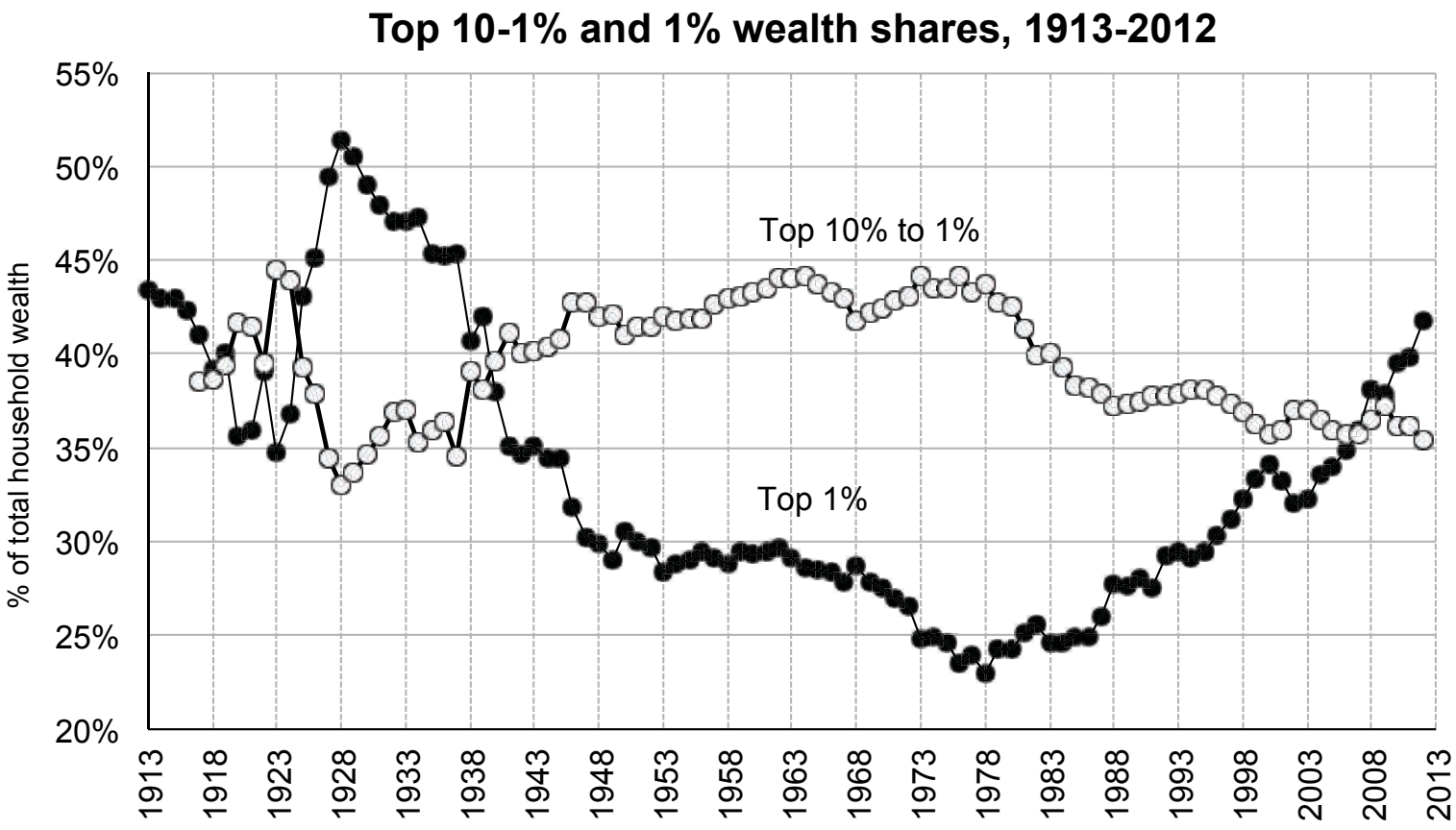
Source: Emmanuel Saez and Gabriel Zucman, 2014, "Wealth inequality in the United States since 1913: Evidence from capitalized income tax data", NBER Working Paper 20625, October, `http://www.nber.org/papers/w20625`

Even the upper echelons of the middle class were relatively wealthier in the mid-20th century



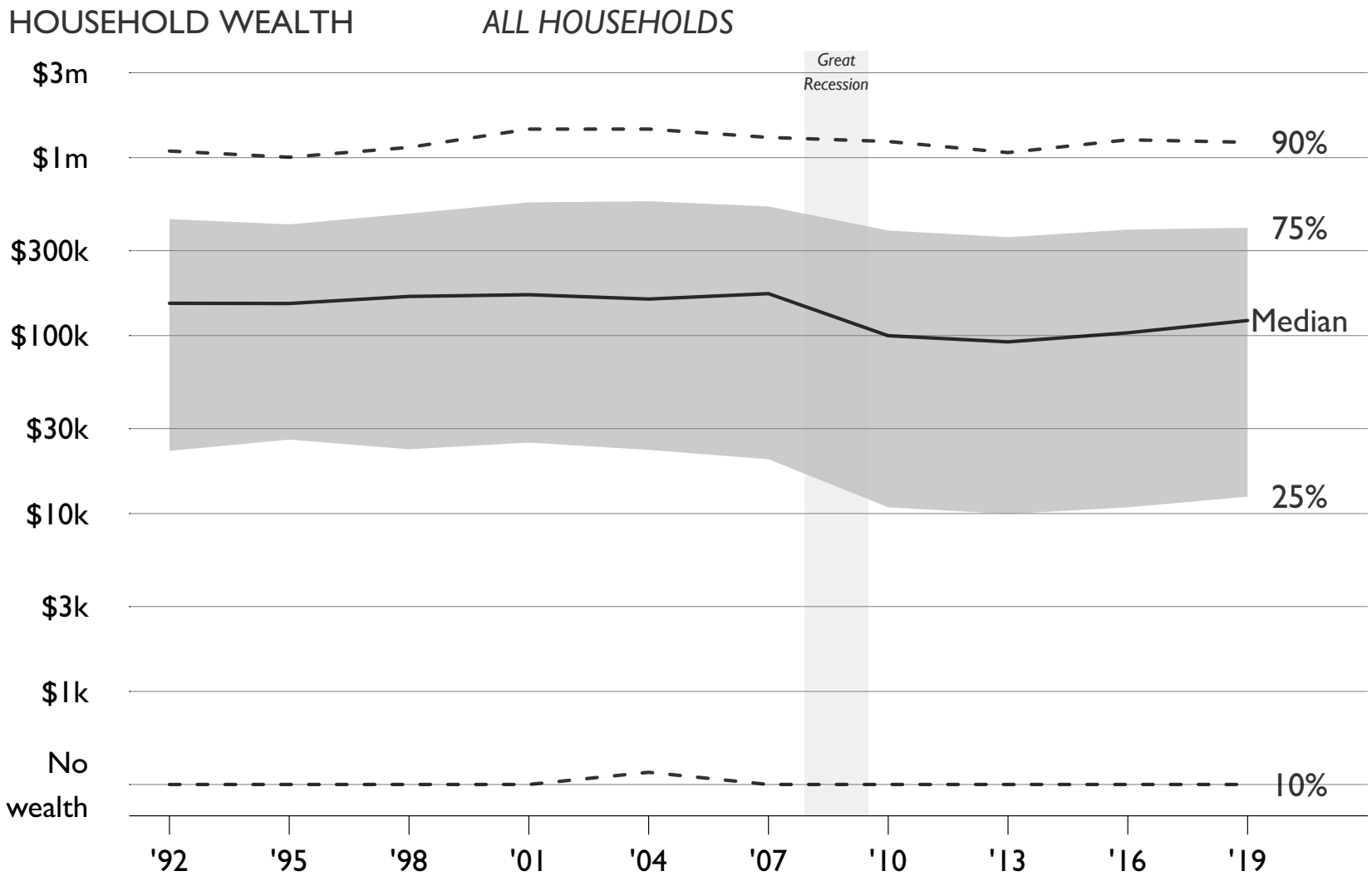
Source: Emmanuel Saez and Gabriel Zucman, 2014, "Wealth inequality in the United States since 1913: Evidence from capitalized income tax data", NBER Working Paper 20625, October, `http://www.nber.org/papers/w20625`

Something big has changed – and it started before the 2008 financial crisis, though that crisis seems to have accelerated matters



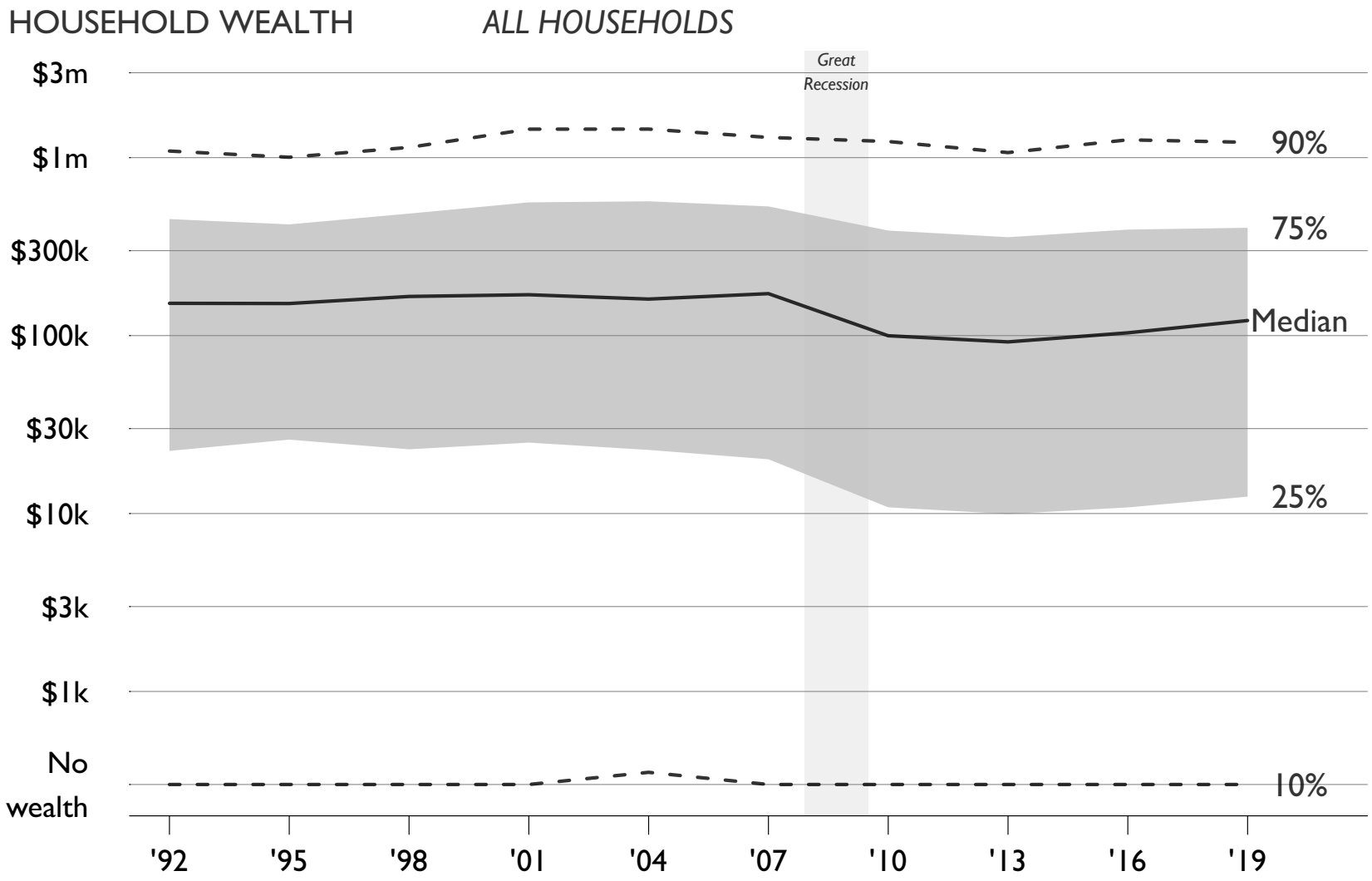
Source: Emmanuel Saez and Gabriel Zucman, 2014, "Wealth inequality in the United States since 1913: Evidence from capitalized income tax data", NBER Working Paper 20625, October, `http://www.nber.org/papers/w20625`

Let's drill into trends in wealth in the US over the last thirty years...



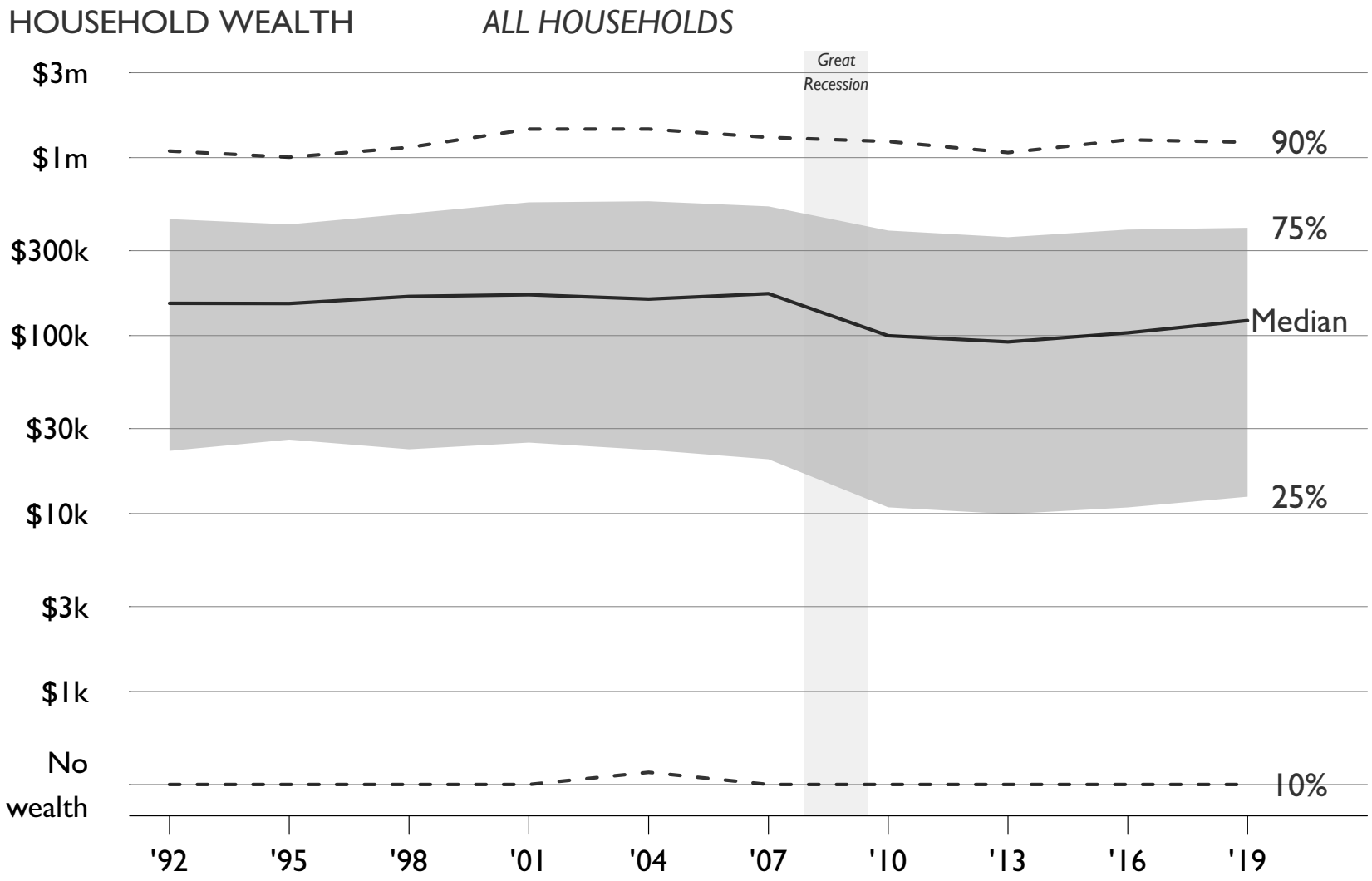
Source: My calculations from the Survey of Consumer Finances, 1992–2019

Why wealth matters: buffer against precarity; basis for opportunity & political power



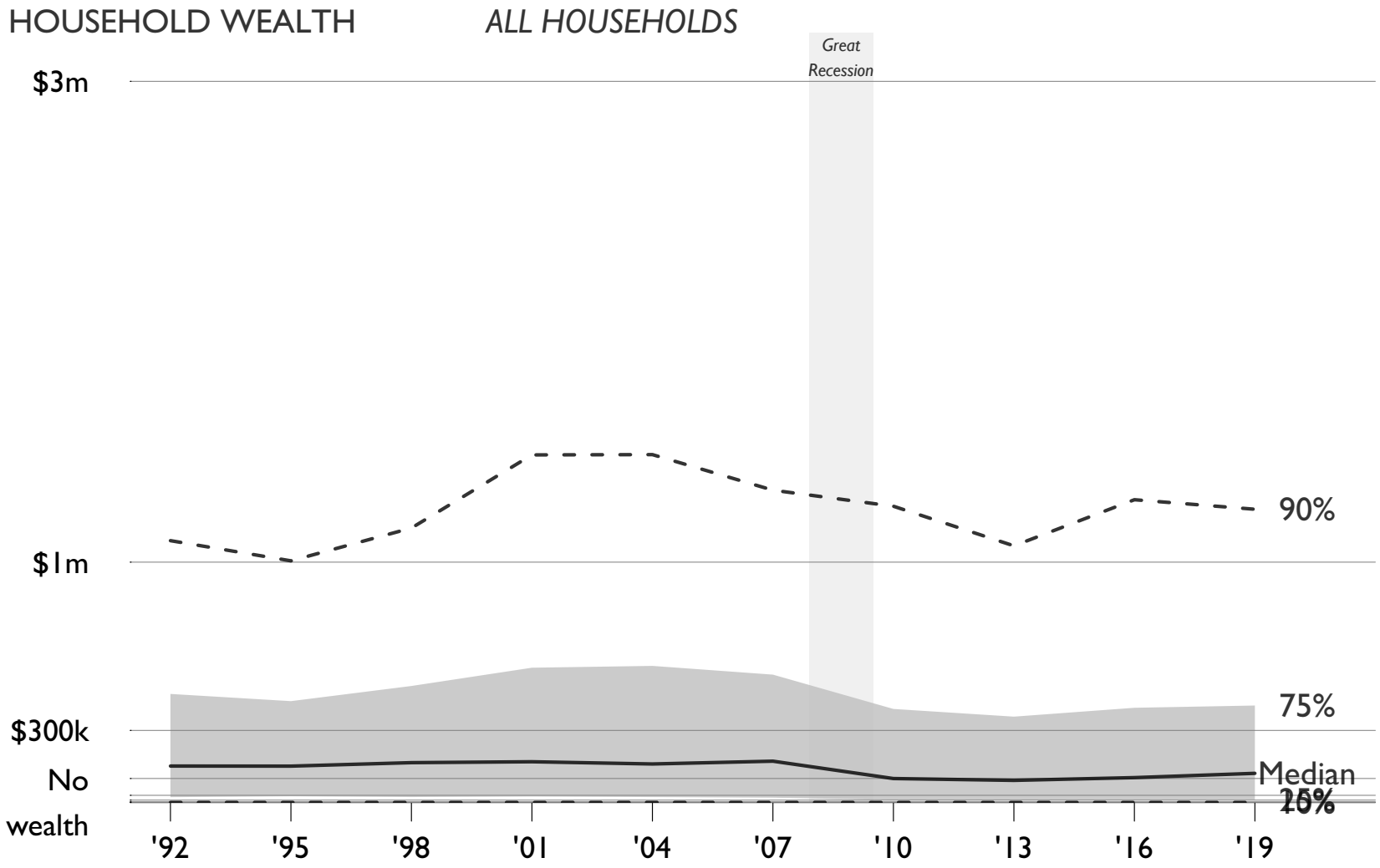
Source: My calculations from the Survey of Consumer Finances, 1992–2019

This plot is log-scaled, so we can discern relative changes for rich and poor alike



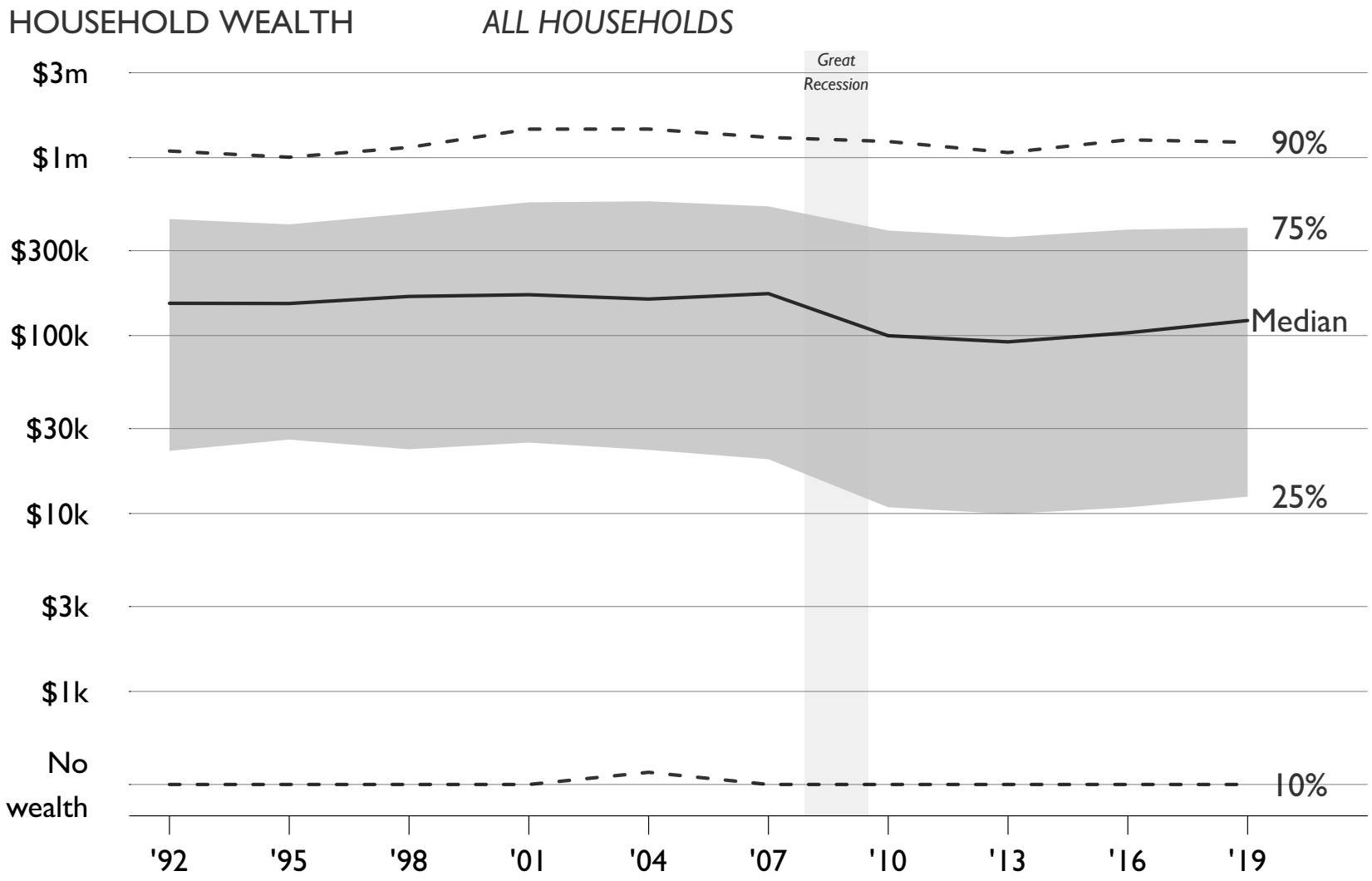
Source: My calculations from the Survey of Consumer Finances, 1992–2019

A linear scale reminds us where the biggest gaps are – but hides most change over time



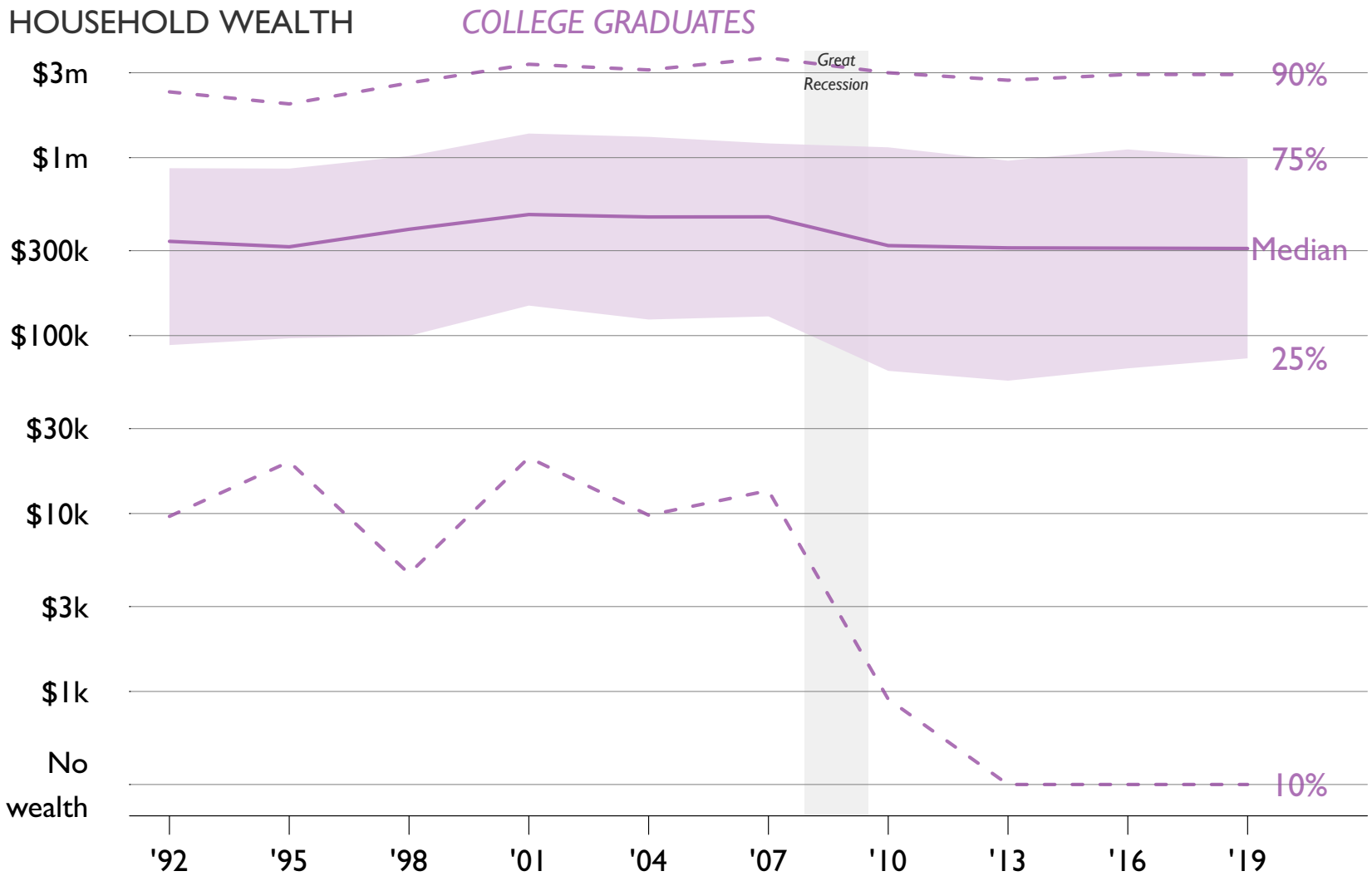
Source: My calculations from the Survey of Consumer Finances, 1992–2019

The Great Recession cut median household wealth in half – it only recovered halfway by 2019



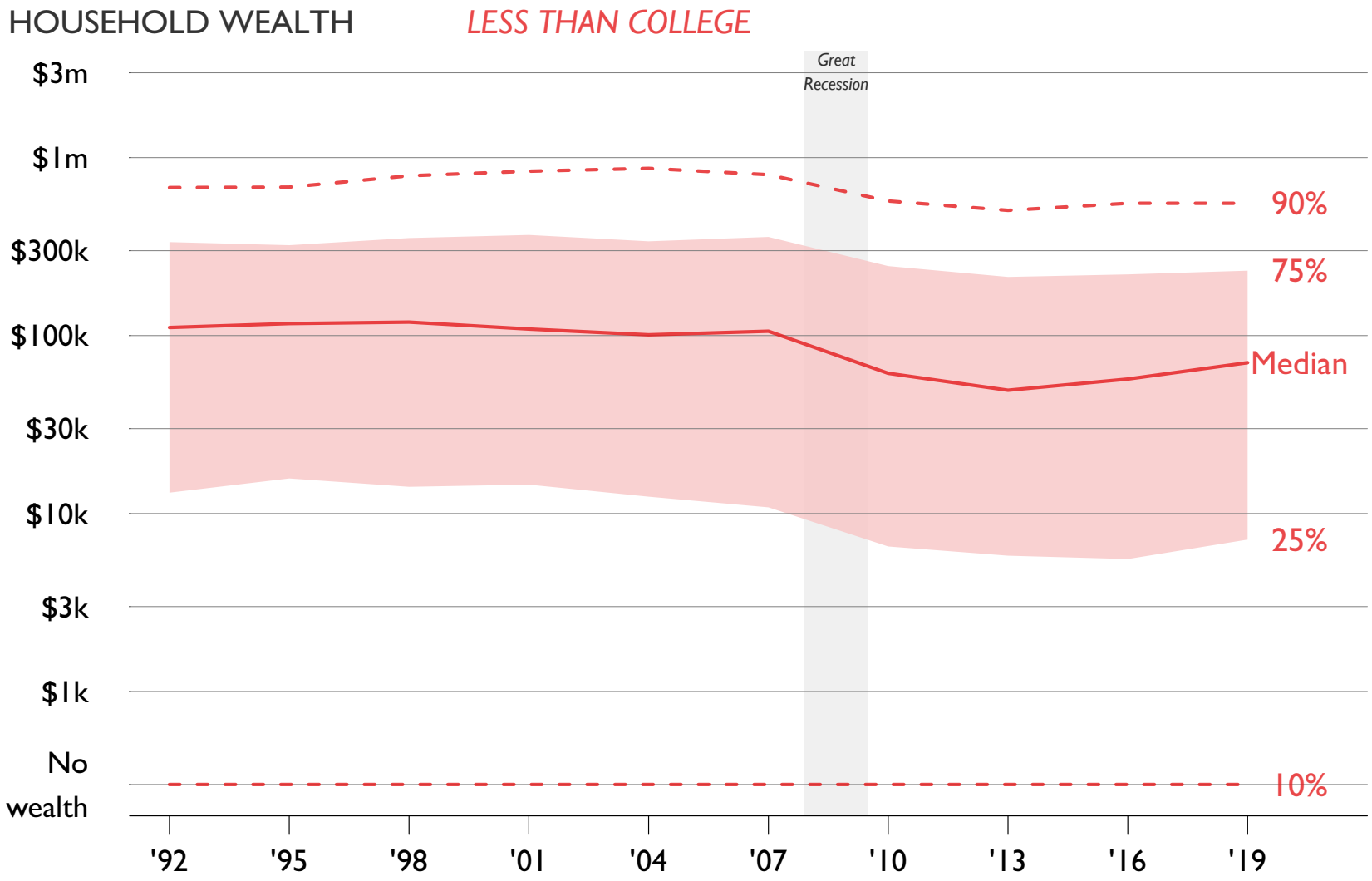
Source: My calculations from the Survey of Consumer Finances, 1992–2019

Less wealthy college graduates were hit harder than wealthy ones...



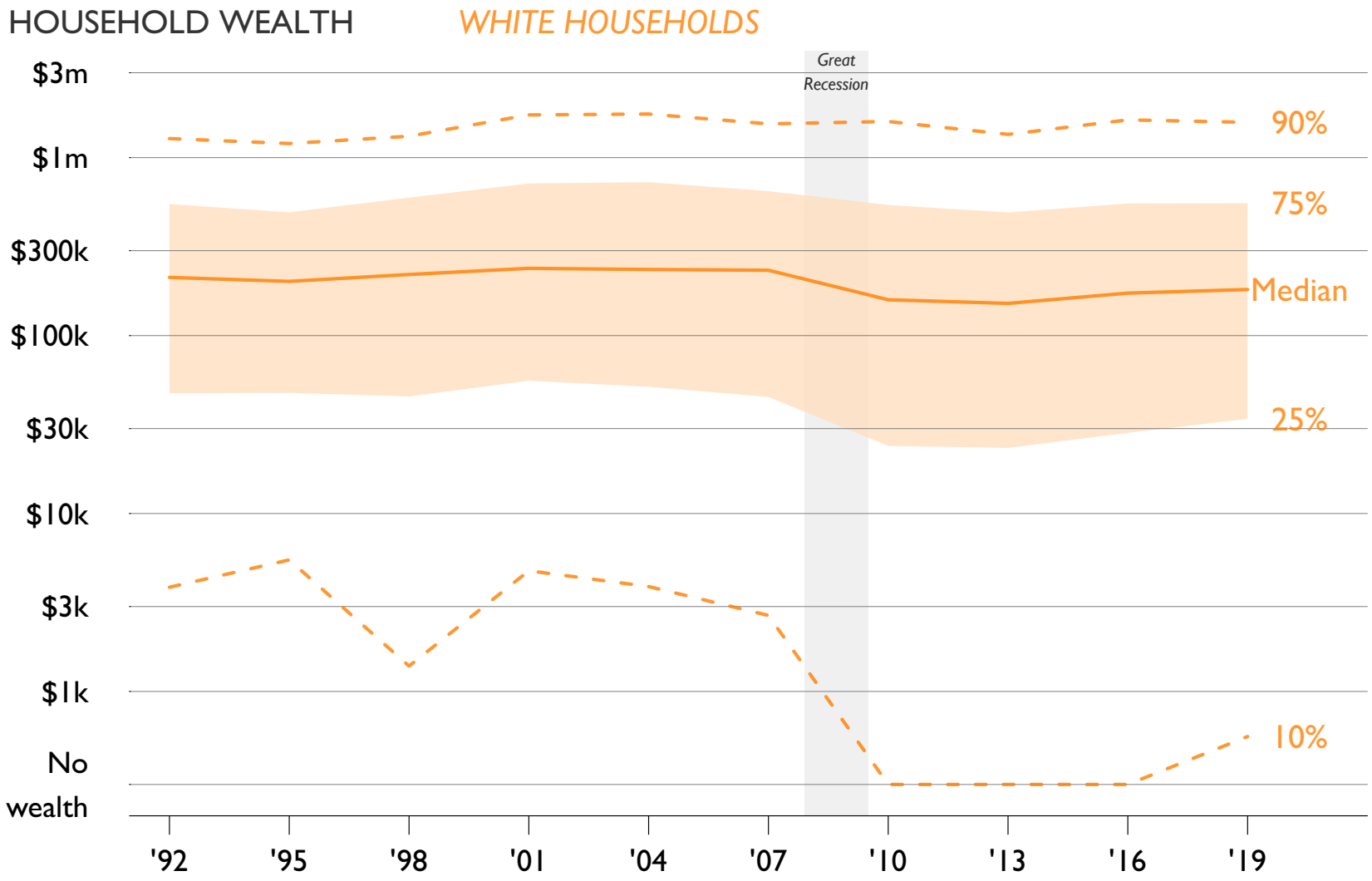
Source: My calculations from the Survey of Consumer Finances, 1992–2019

Less-than-college households of all wealth levels took a huge, enduring hit



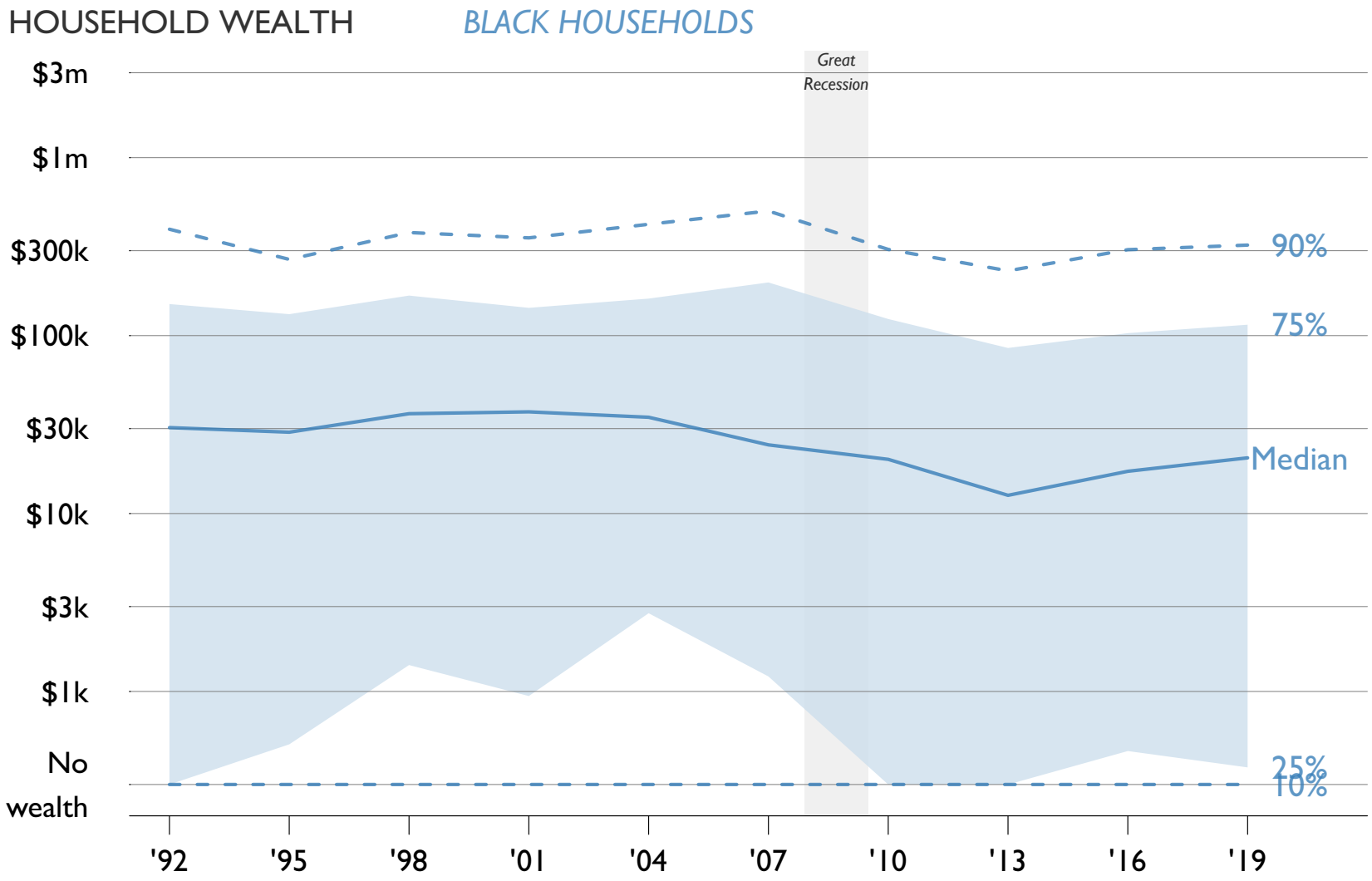
Source: My calculations from the Survey of Consumer Finances, 1992–2019

Racial disparaties in wealth are just as stark as educational ones



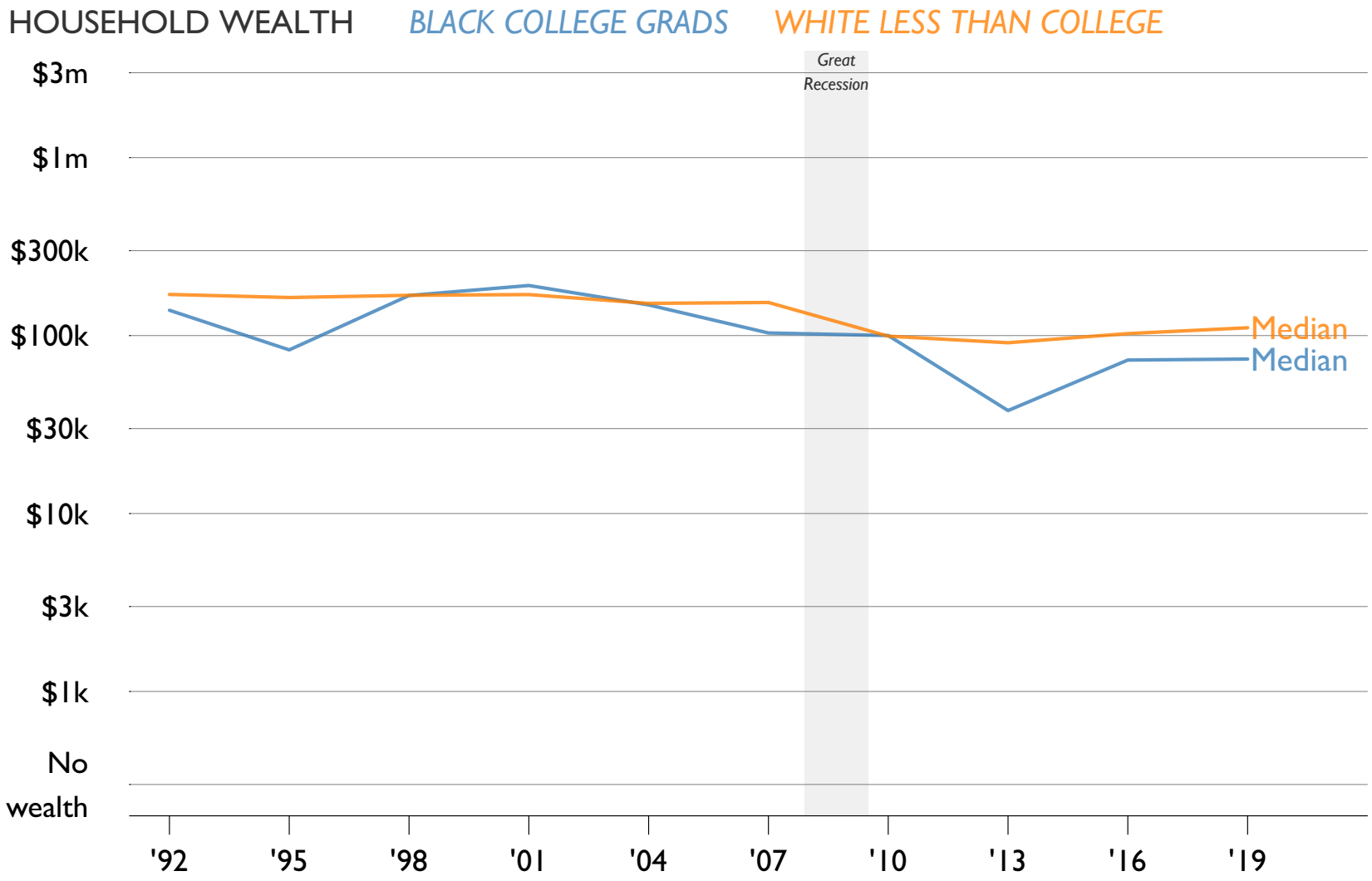
Source: My calculations from the Survey of Consumer Finances, 1992–2019

and black households lost a relatively larger share of wealth in the Great Recession



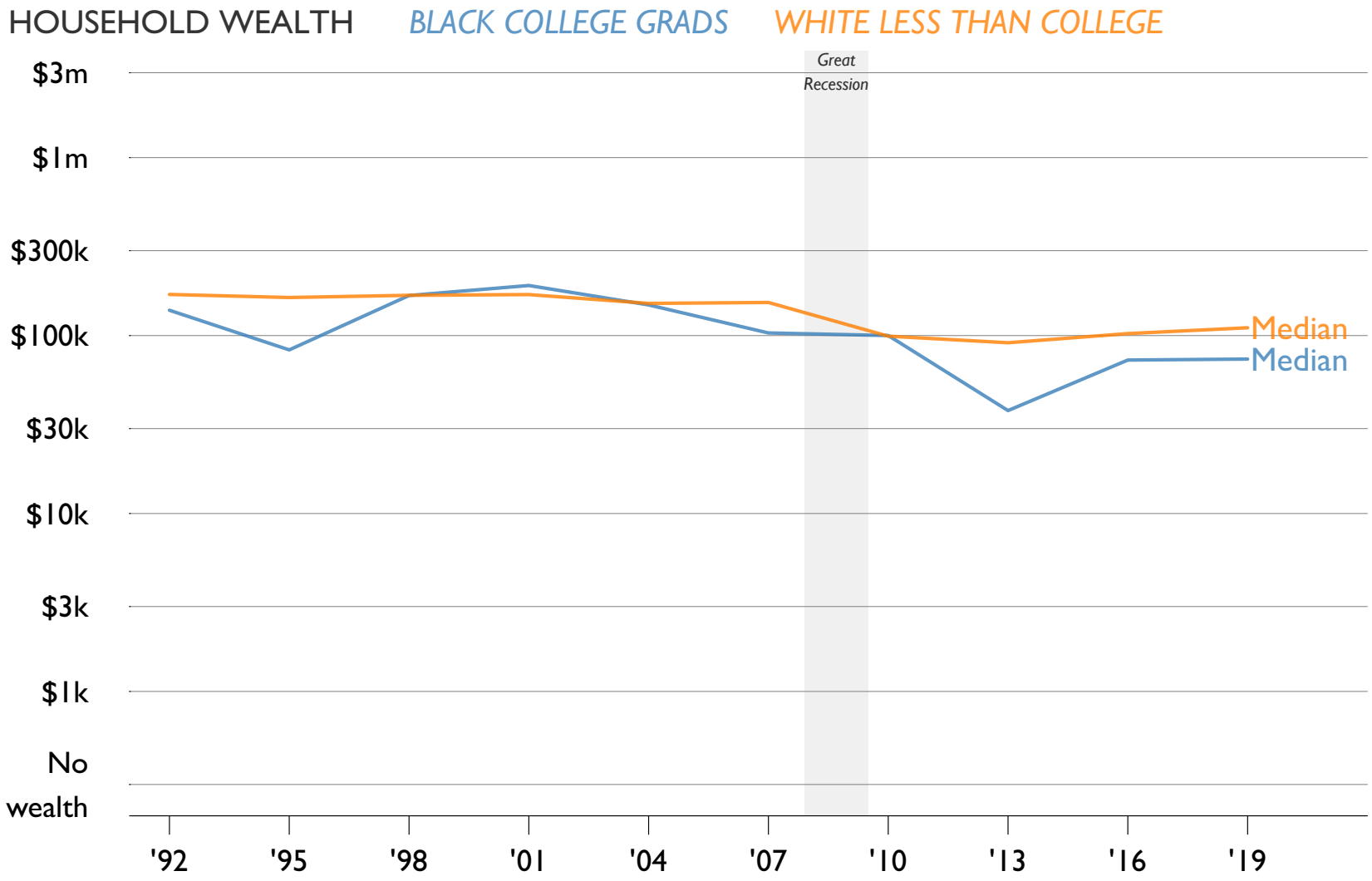
Source: My calculations from the Survey of Consumer Finances, 1992–2019

Consider this juxtaposition of wealth disparities by race and education



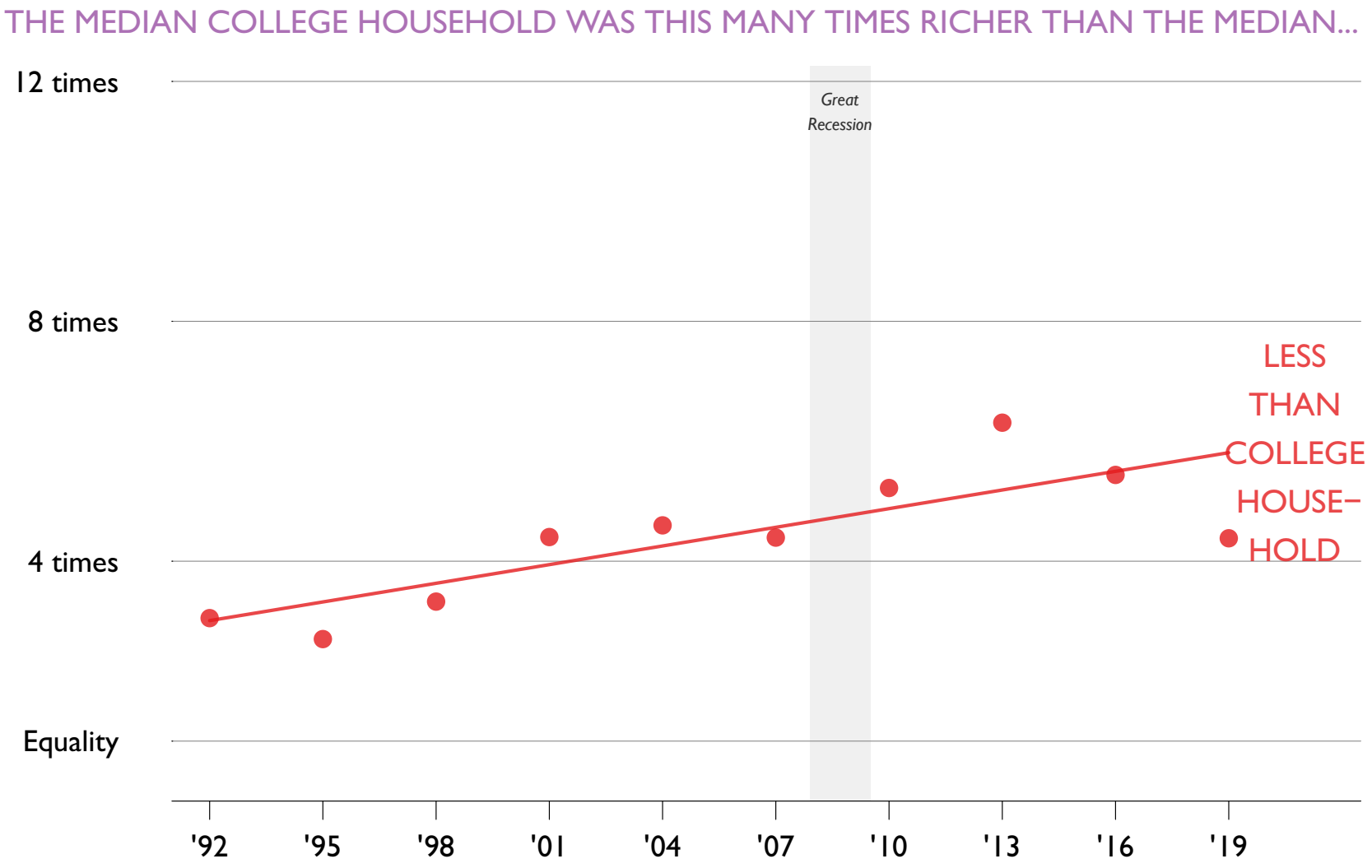
Source: My calculations from the Survey of Consumer Finances, 1992–2019

As we'll explore later in the course, wealth inequality can endure for centuries



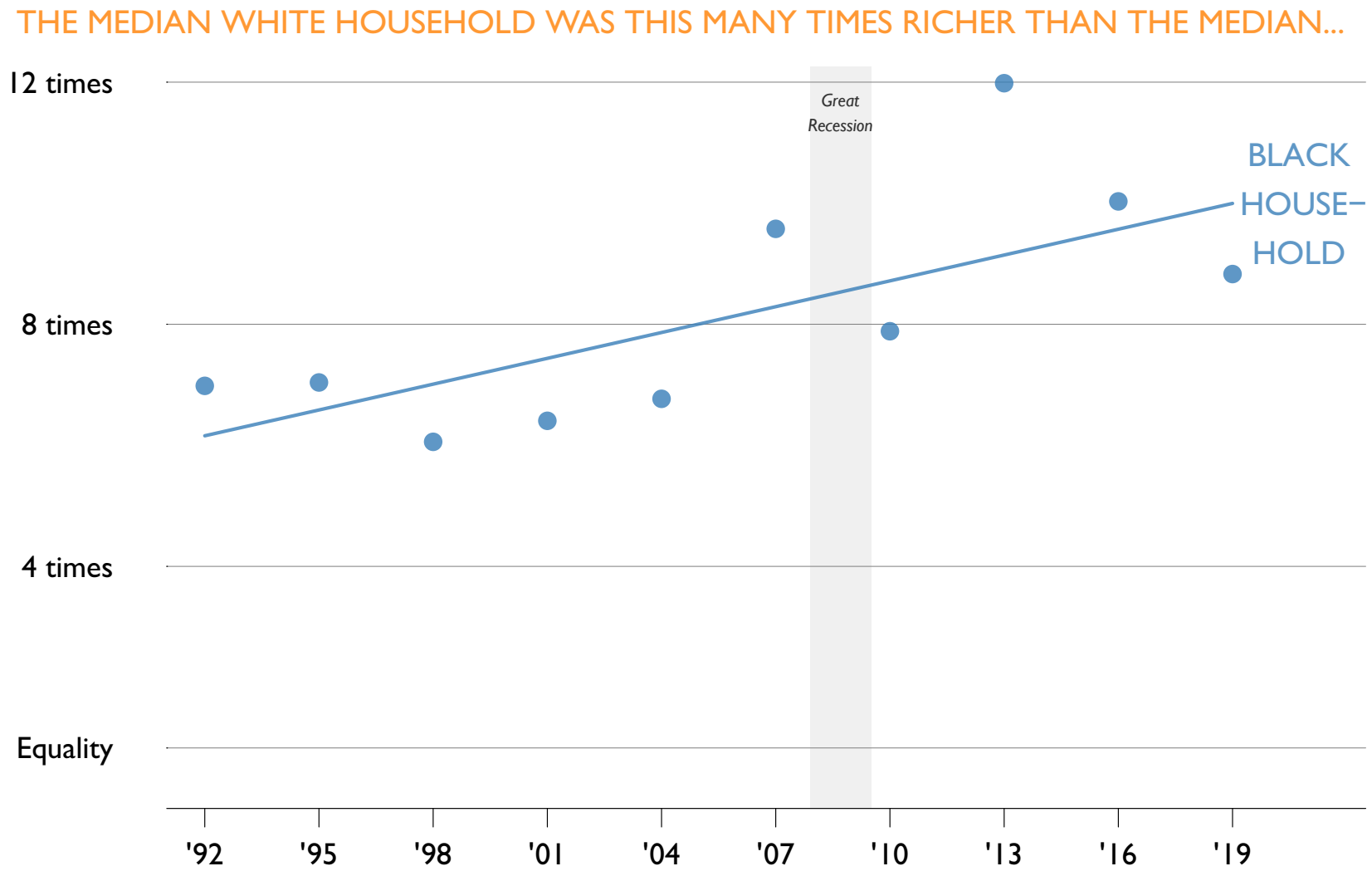
Source: My calculations from the Survey of Consumer Finances, 1992–2019

Before COVID-19, the education wealth gap was shrinking but stil historically high



Source: My calculations from the Survey of Consumer Finances, 1992–2019

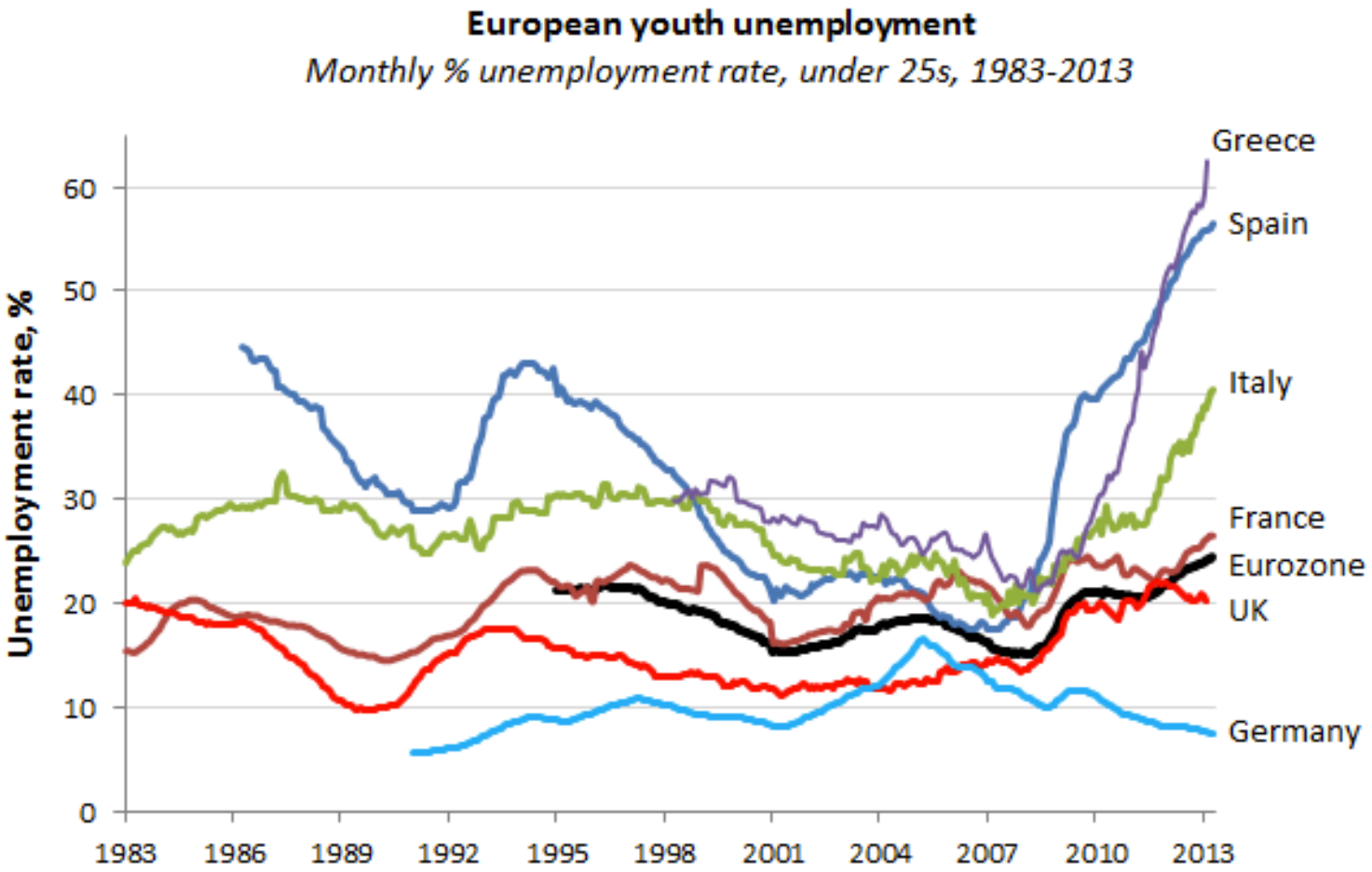
The black-white wealth gap remained far higher than pre-Great Recession



Source: My calculations from the Survey of Consumer Finances, 1992–2019

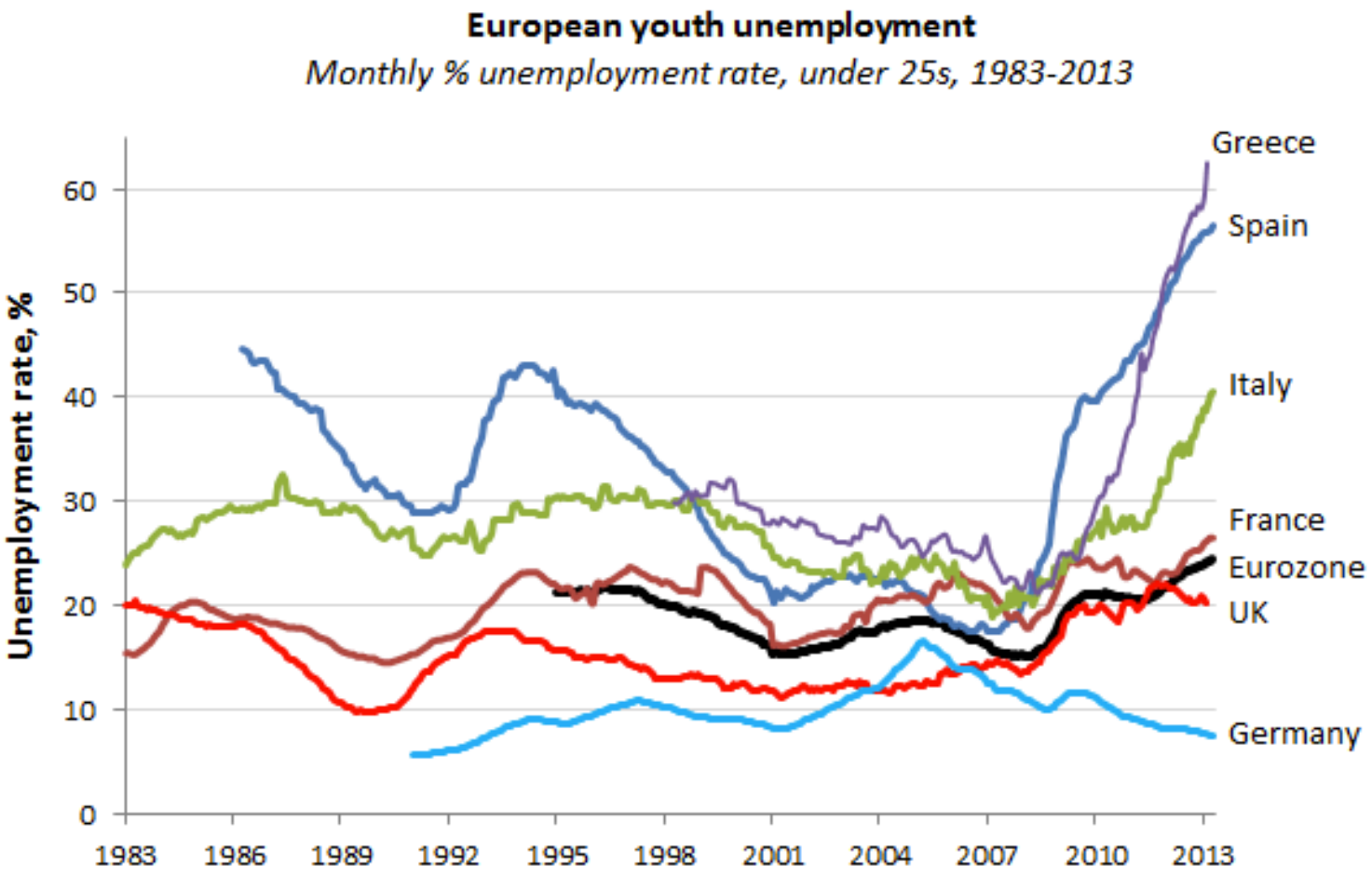
And the US is the relatively *good* case.

Thanks to the early 2010s crisis in the eurozone, Europe – especially southern Europe – stagnated



Source: James Plunkett, reprinted in *The Atlantic*, 2013. `http://www.theatlantic.com/business/archive/2013/05/europes-record-youth-unemployment-the-scariest-graph-in-the-world-just-got-scarier/276423/`

We'll investigate the eurocrisis in turn. Many of the same forces are at work, but chanelled by Europe's different political institutions



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The purpose of this course

This course is an experiment: POLS & ECON classes usually focus on theory and selected cases, not a sequence of events

But the financial crisis, the Great Recession, and the weak economic recovery are complex events quite unlike the recessions of the 1950s to 1990s

Much more like the Great Depression, only these events occurred in world supposedly aware of the lessons of that episode

Moreover, the Great Recession provided direct lessons for policy makers in addressing the Pandemic Recession

The Biden administration explicitly tried to avoid what it saw as the Obama administration's mistakes

We'll seek to understand how these historical experiences are shaping today's policies, and what's changing underneath the day-to-day shocks of the 21st century

The purpose of this course

Understanding how the financial crisis and Great Recession happened, and what emerged from them is *complex*:

1. exposes gaps in economic theory – or at least, gaps in how those theories were applied to political economy;
2. shows elite economic actors (and elite economists) struggling to adapt in real time to unexpected crisis;
3. created a newly vibrant debate over the relevant macroeconomic and political economic questions of the day in place of the previous consensus

The purpose of this course

This course takes us...

- first into the events of the financial crisis in the US and Europe,
- then to the bailouts, stimulus packages, and austerity plans which followed,
- considers several competing explanations for the pattern of slow, unequal growth that seems to be creating a new Gilded Age in the 21st century
- and finally explores whether and how the pandemic has scrambled, reversed, or accelerated these trends

Some questions to ponder...

What caused the financial crisis?

Was it simply a housing bubble led by too many subprime mortgages,
or were there deeper systemic problems, economically or politically?

Did the actions of the US and European governments stem the crisis?
Make no difference? Make it worse?

Is a similar financial crisis starting now, with the failures of FTX, Silicon Valley Bank, Credit Suisse, and others?

If it is, are governments reacting better than last time?

Why was the Great Recession so long and painful?

Was it merely the typical consequence of a financial crisis?

Or was the response of policy makers unusually clumsy?

Why did so many governments turn to austerity?

If the crisis began with the US housing market,
why was it worse in Europe, especially in countries on the periphery of the eurozone?

Why didn't the economy quickly return to "normal"?

Other postwar recessions ended quickly

Has something fundamental changed in the macroeconomy or in politics that makes growth slower or incomes and wealth more unequal than in latter half of the 20th century?

If so, what?

Put another way,
what was unusual about the Golden Age of Capitalism (1947–1973)?

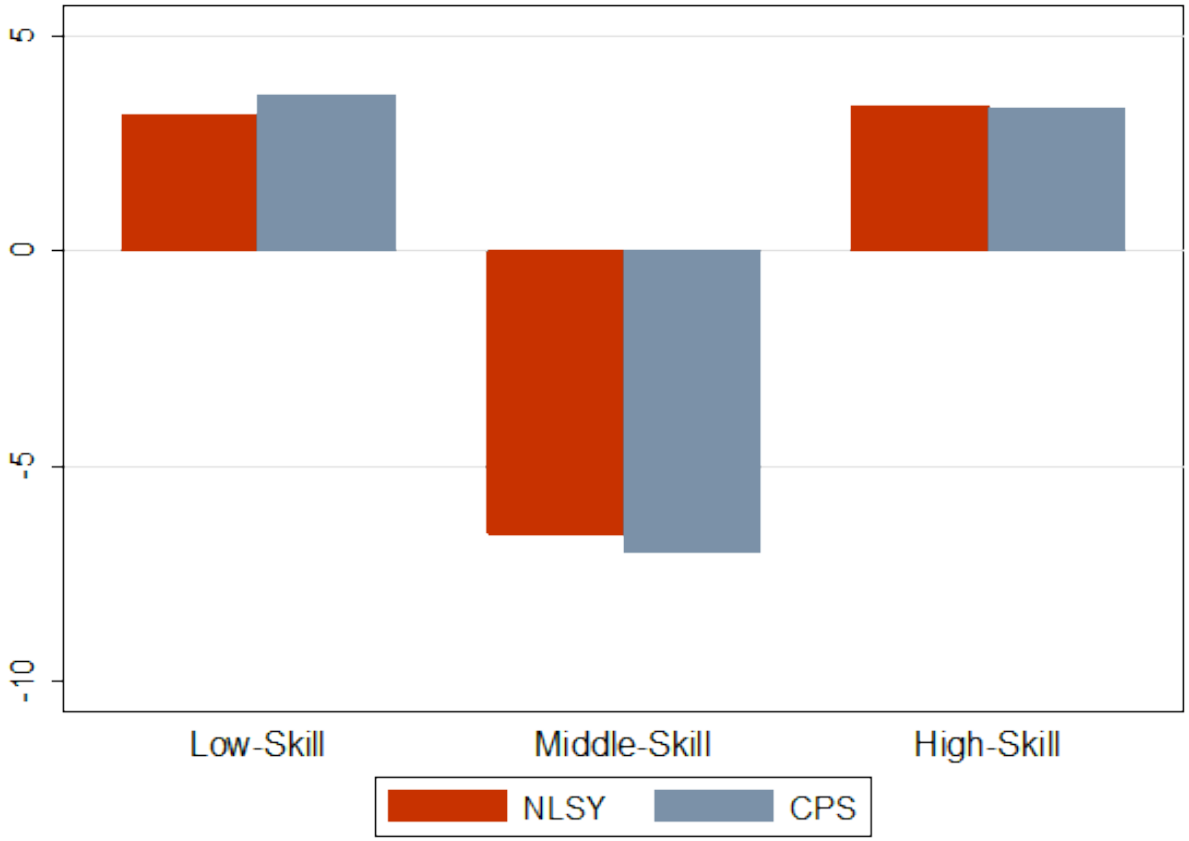
Source: Broadberry and O'Rourke, 2010, *The Cambridge Economic History of Modern Europe: Volume 2, 1870 to the Present.* Cambridge University Press.

Globalization?

International trade (and financial flows and migration) were low.

These flows have now returned to 19th century levels

And populist backlash has emerged as a powerful political force in the US and Europe

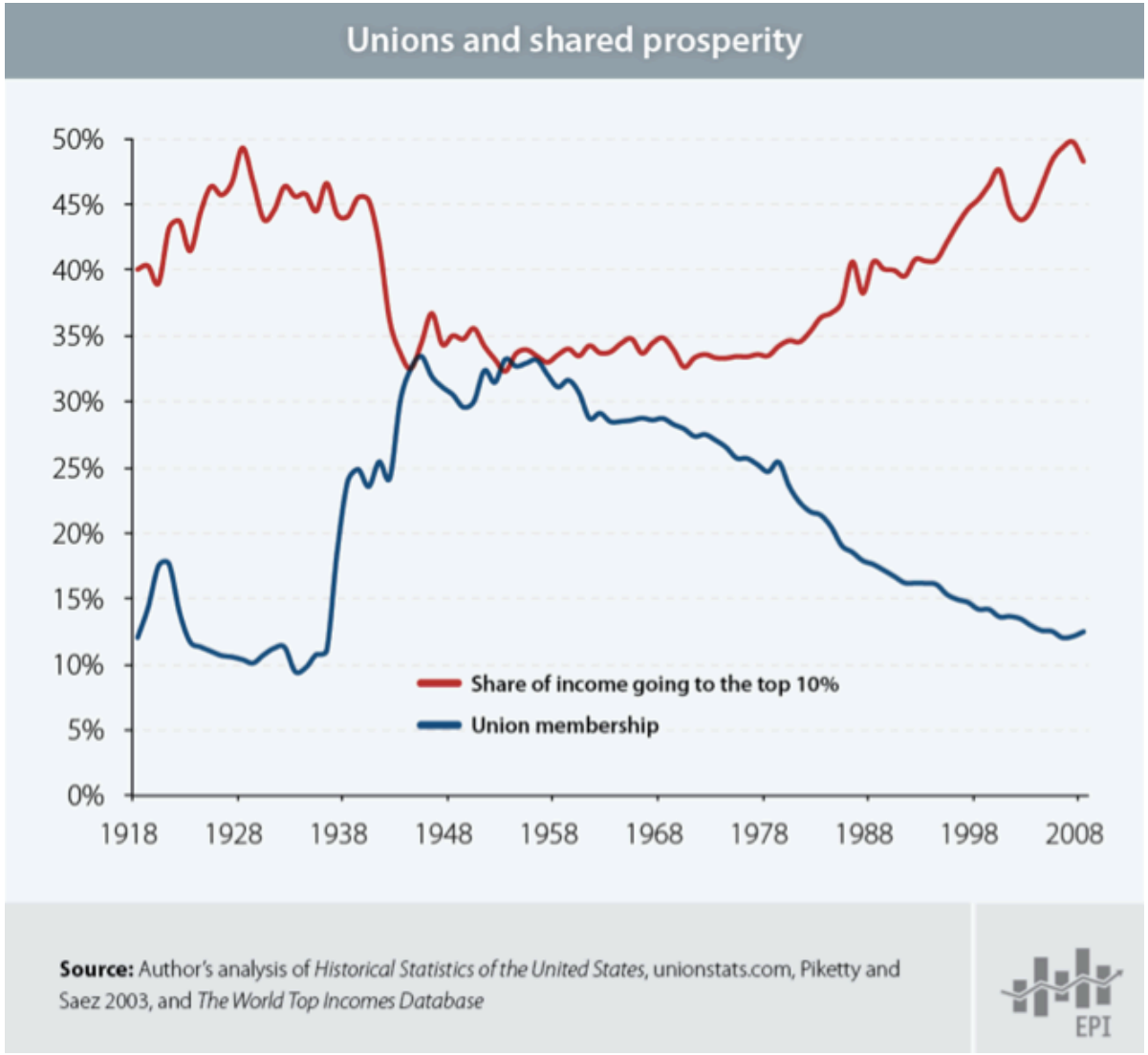


Source: Michael Boehm, 2014, "Job polarisation and the decline of middle-class workers' wages," *VOXEU*, 08 February, `http://www.voxeu.org/article/job-polarisation-and-decline-middle-class-workers-wages`

Technological Change?

In the mid-20th century, skilled labor and skilled jobs were plentiful and well-paid

Since then, computer-driven automation has decimated middle skill jobs, leading to a hollowing out of the wage structure

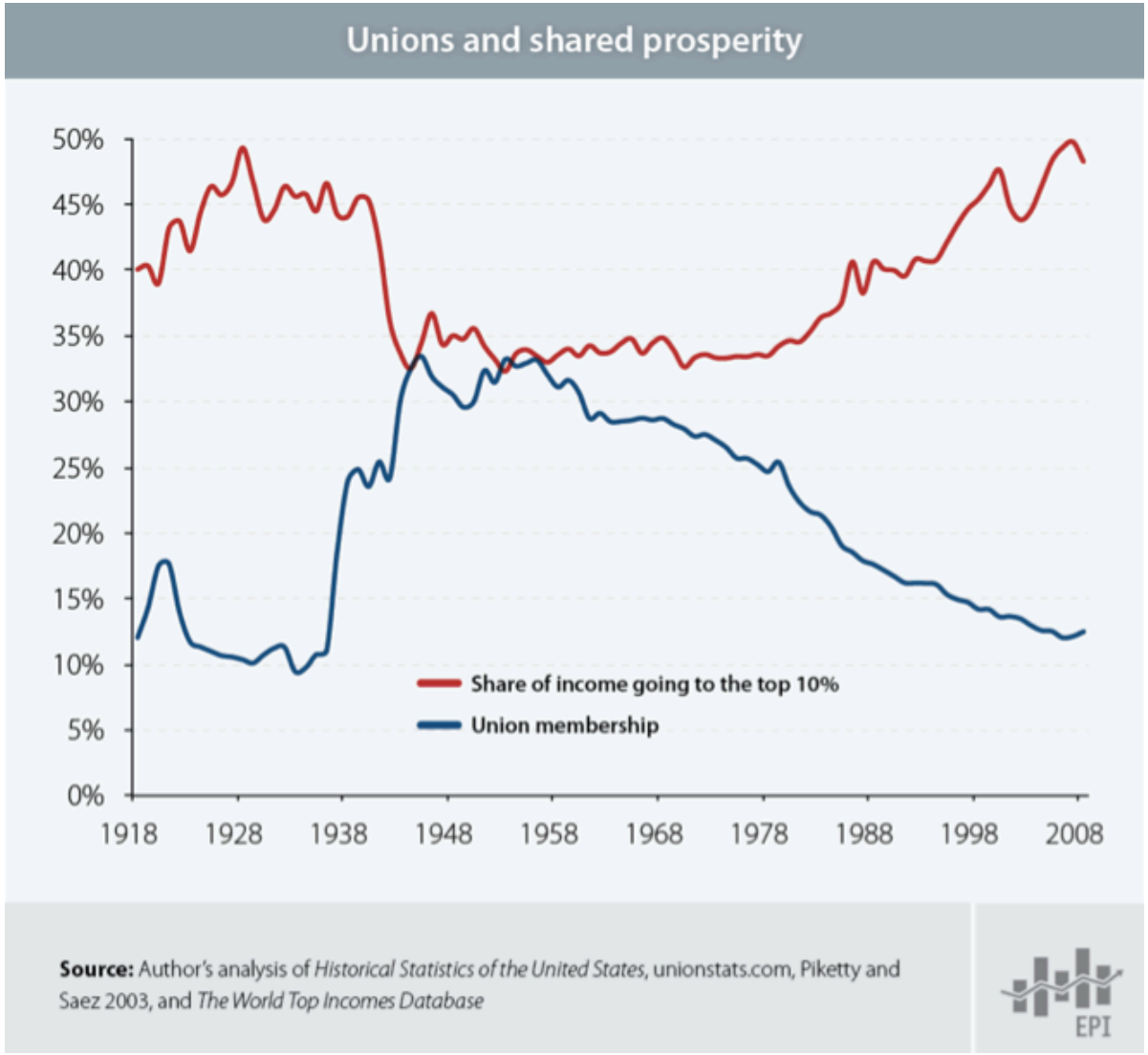


Labor unions?

By the middle of the twentieth century, much of the workforce in the US and Europe was unionized

Unions are in sharp decline in the US, though less so in Europe

Source: Felix Salmon, Economic Policy Institute.

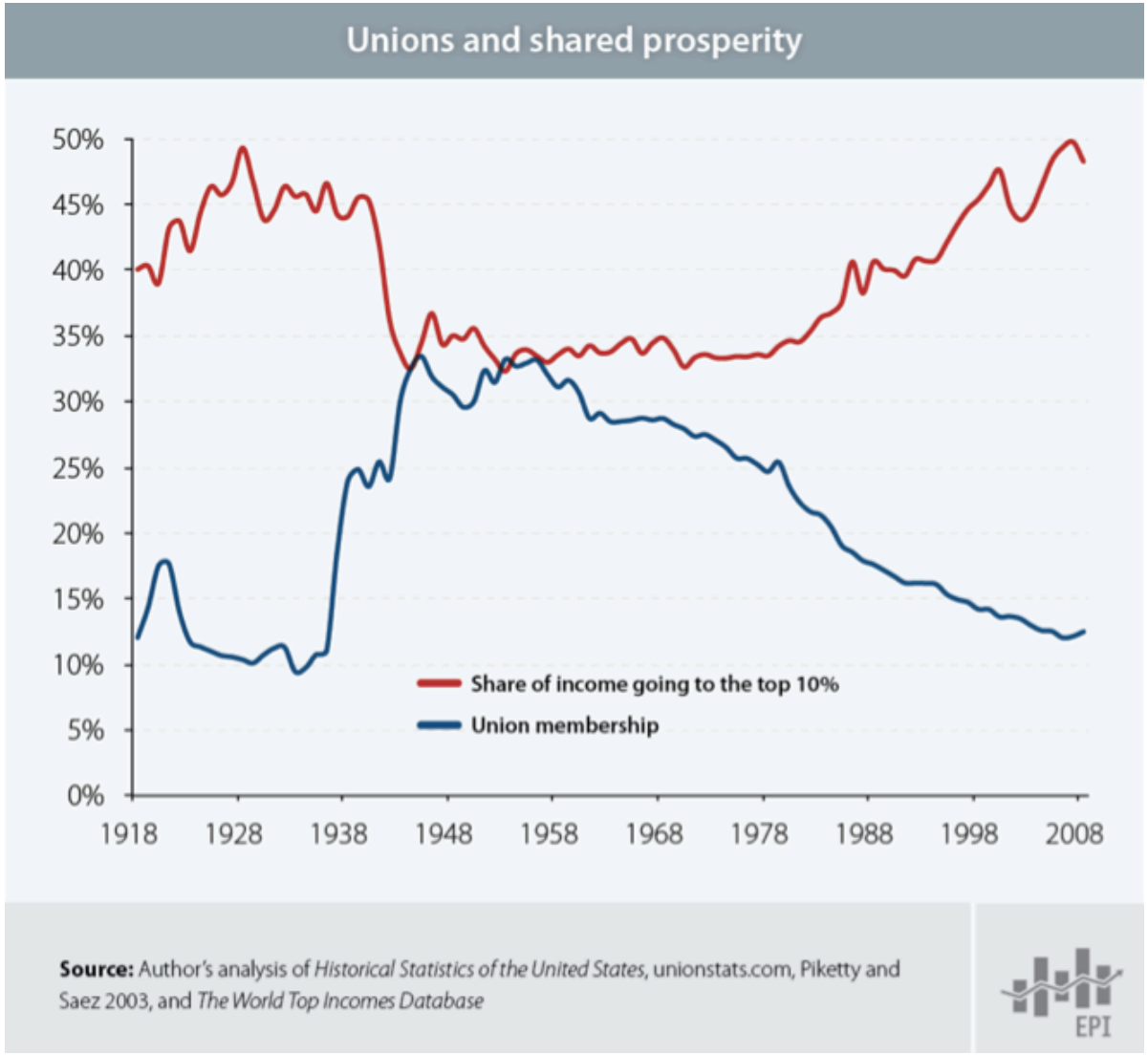


The Return of Capital?

Perhaps the change is a simply as the rising political power of the affluent...

which might have lead to policy changes reinforcing inequality and stagnation

Source: Felix Salmon, Economic Policy Institute.



There are many competing explanations, and they're often tied to political and partisan debates

Simple correlations won't be enough to settle these questions; we will need to go deeper

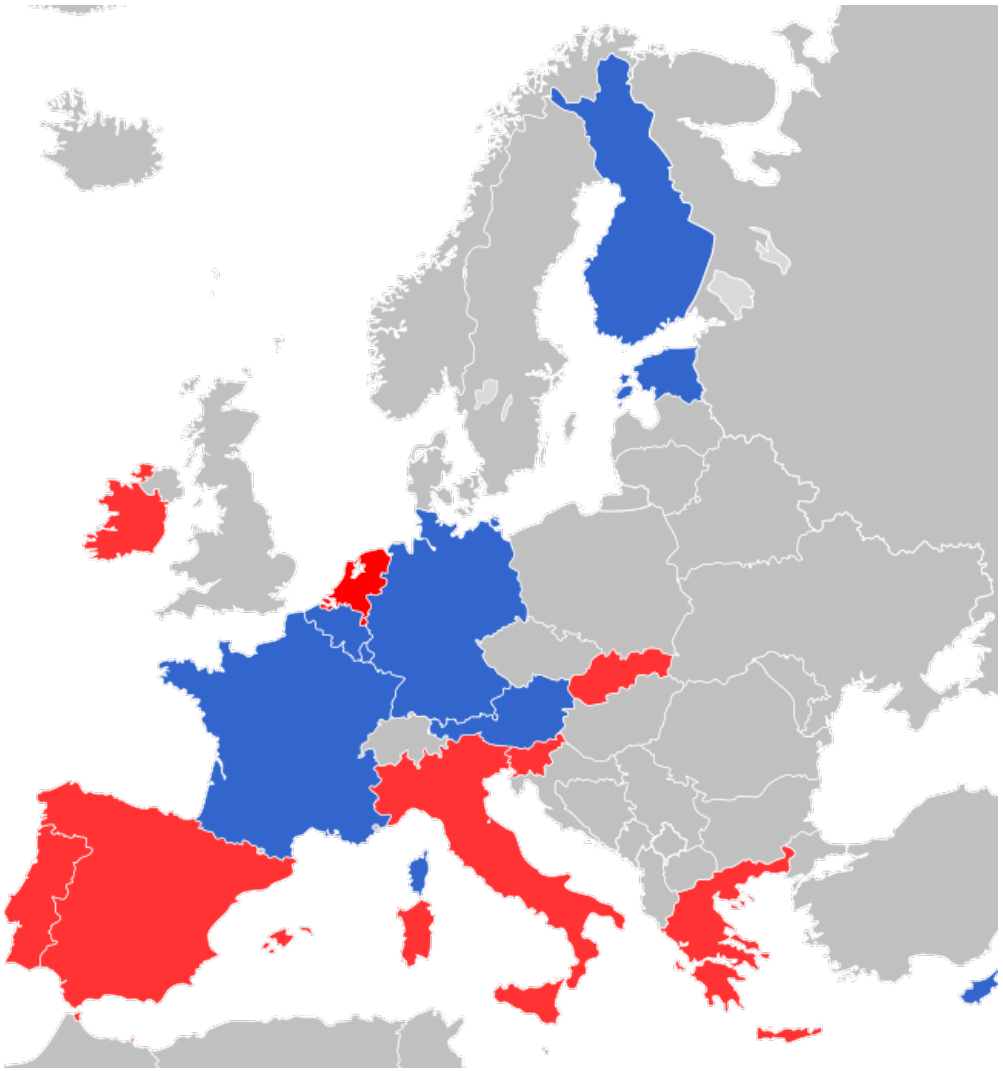
Source: Felix Salmon, Economic Policy Institute.

But what is normal?

Perhaps the Golden Age of Capitalism –
and the brief island of equality and growth it created –
are the real anomaly

The postwar boom coincided with the development of modern social science:
perhaps we too often take it as the normal state

What if the Golden Age was a hard-to-repeat oddity
brought about by the traumatic events of the early 20th century?



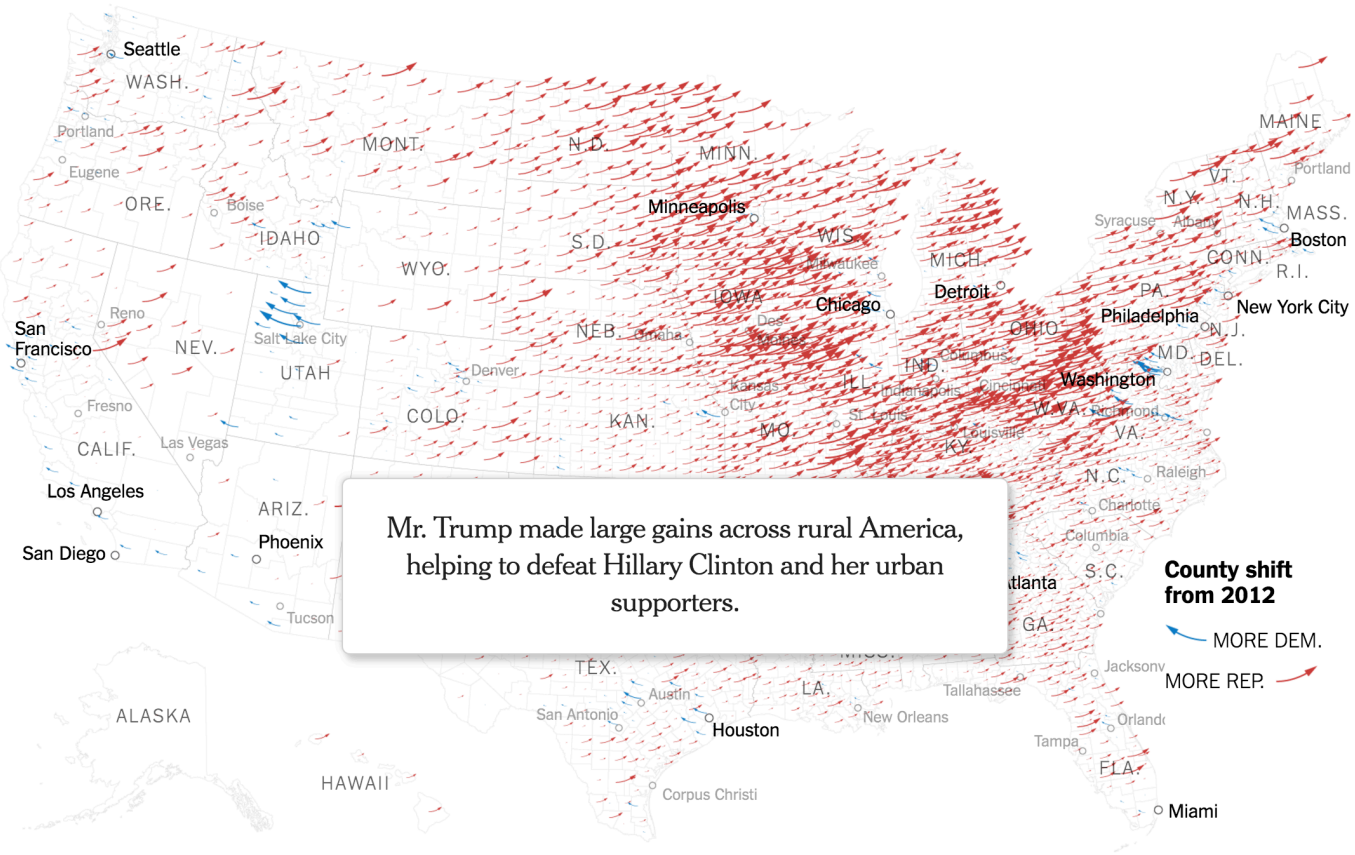
Are we seeing a return of the problems that come with such unequal growth – such as political instability and radicalism?

[Red– Premature change of government due to eurocrisis; Blue– other eurozone countries]

Source: "European Debt Crisis,", *Wikipedia*,

http://en.wikipedia.org/wiki/European_debt_crisis

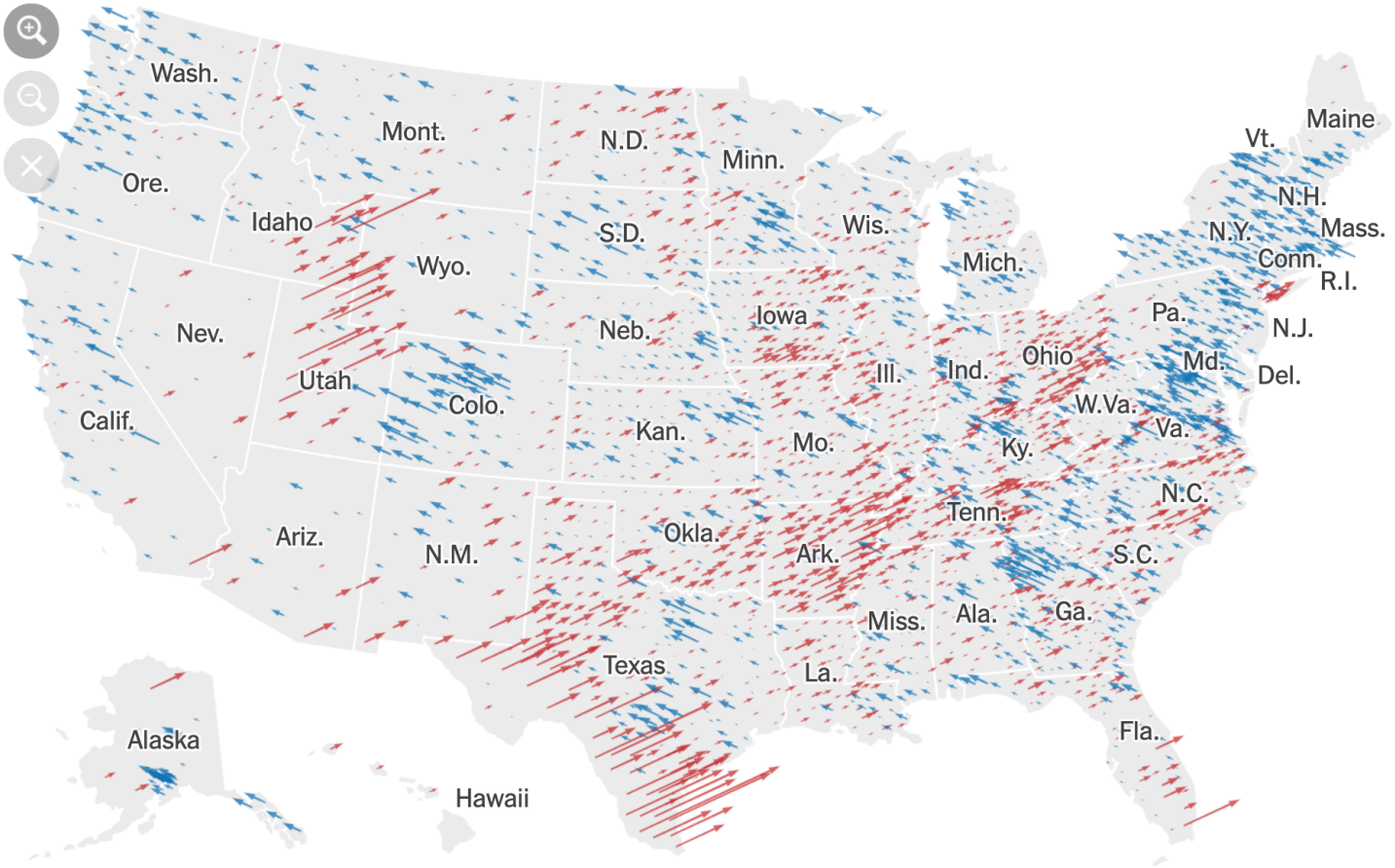
In the UK and US, the populist backlash continued in 2016 with Brexit & Trump: what's driving this backlash, and how long with it be a political force?



Mr. Trump made large gains across rural America, helping to defeat Hillary Clinton and her urban supporters.

Source: "How Trump Reshaped the Election Map," *New York Times*, 9 November 2016, `https://www.nytimes.com/interactive/2016/11/08/us/elections/how-trump-pushed-the-election-map-to-the-right.html`

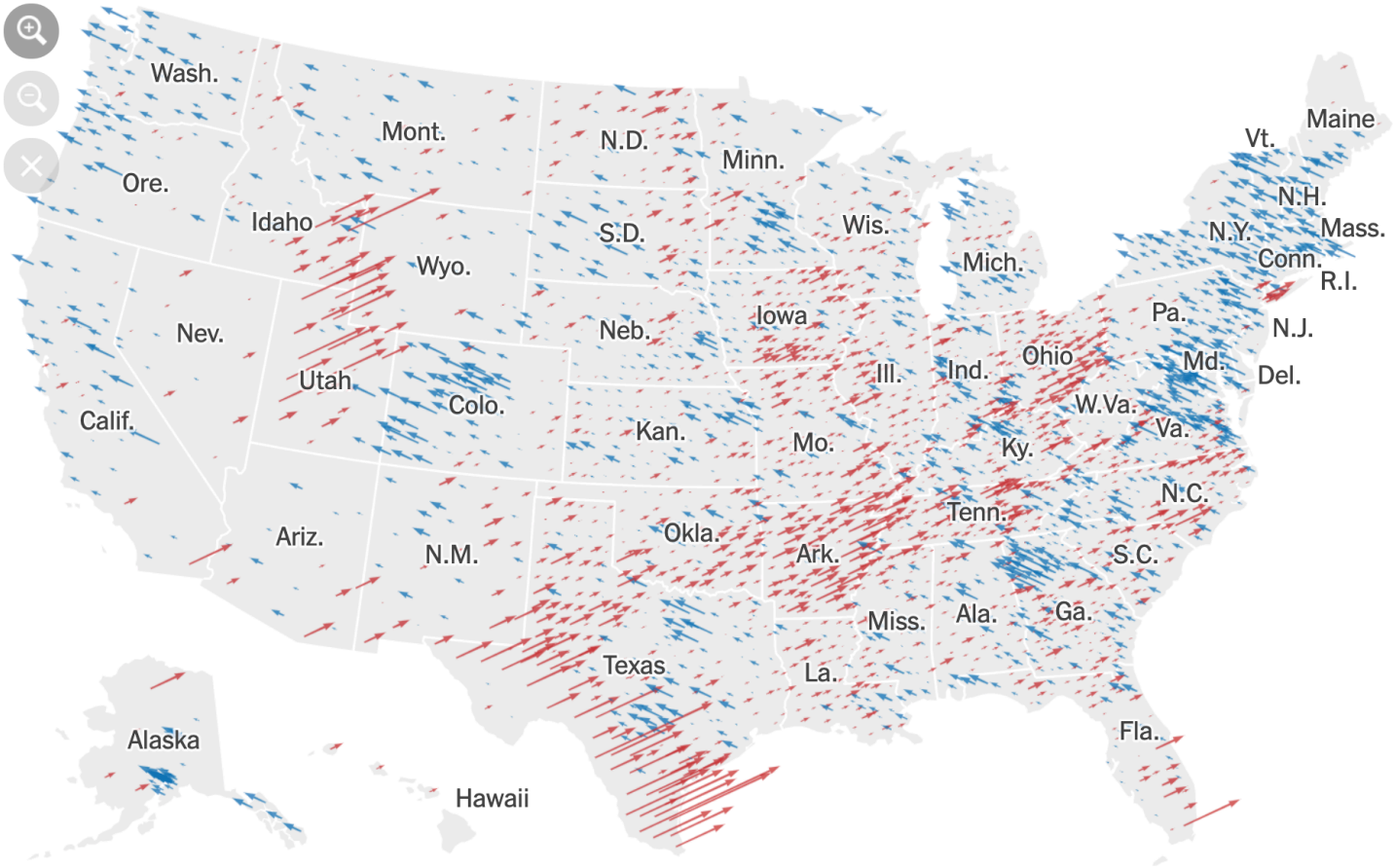
Did the 2020 election represent a repudiation of populism or a hardening of political divisions?



Source: "Presidential Election Results: Biden Wins," *New York Times*,

https://www.nytimes.com/interactive/2020/11/03/us/elections/results-president.html

Did the pandemic change everything? Or just interrupt a trend?



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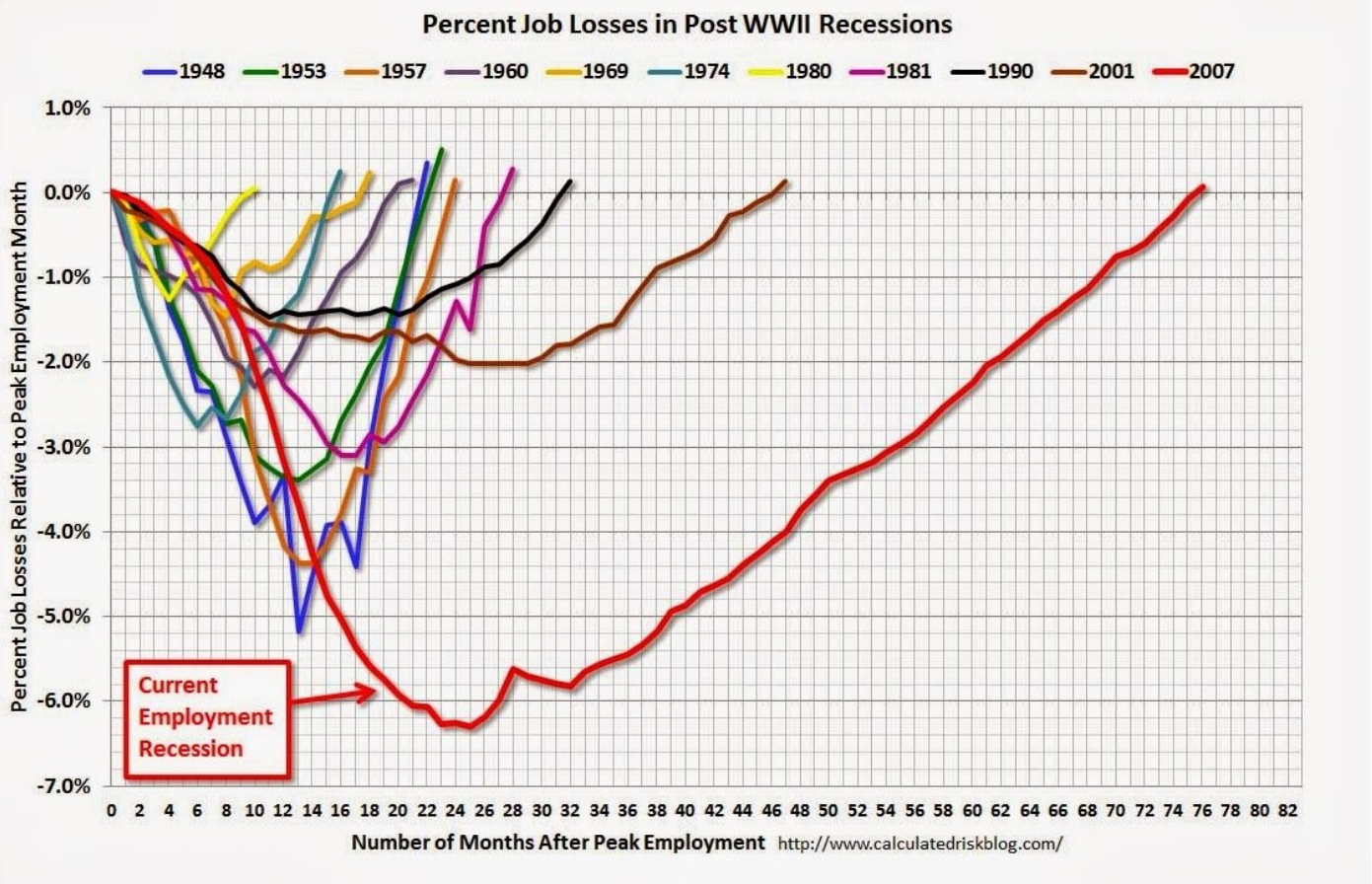
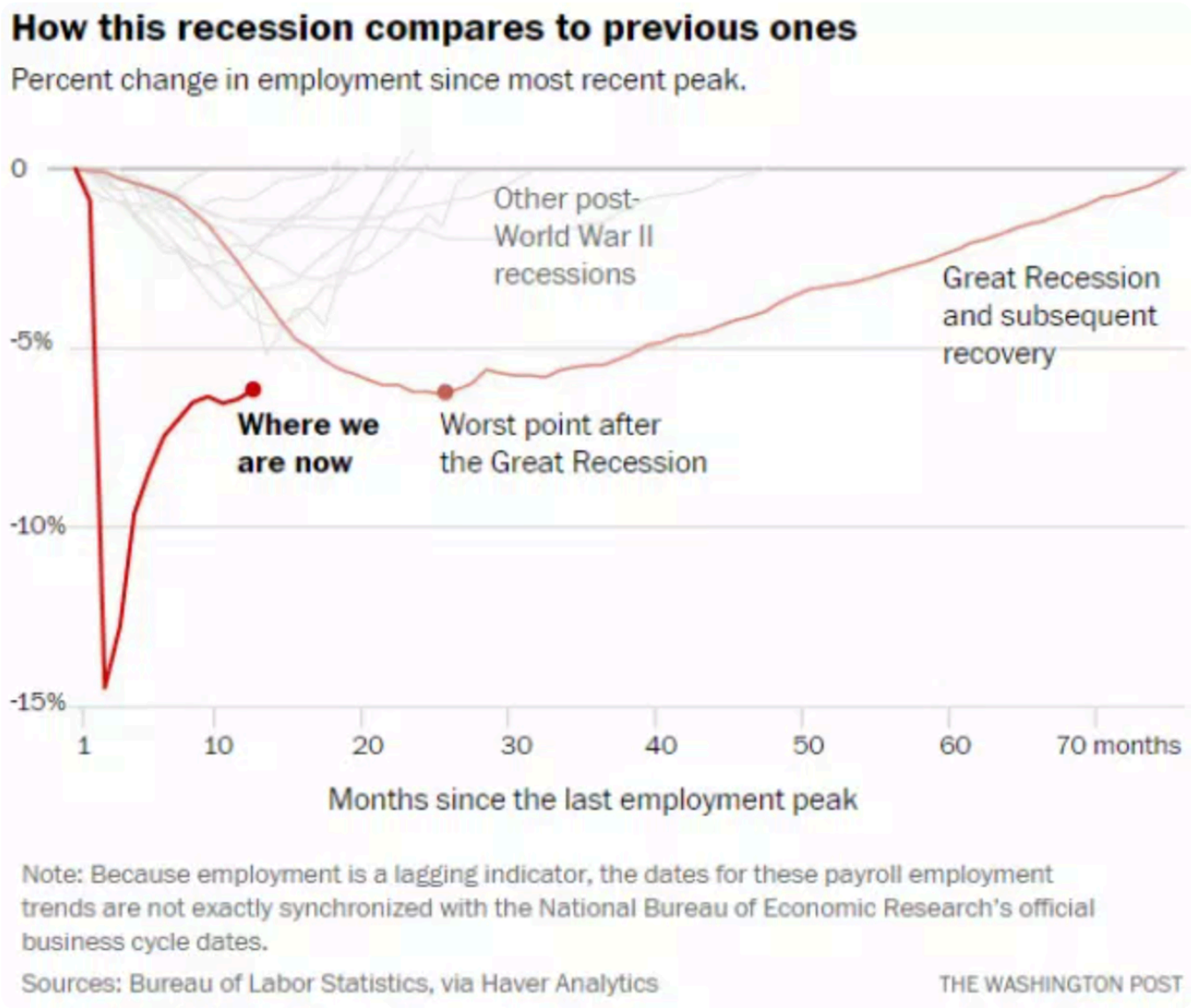


Recall this graphic – famously called the "scariest chart ever" back in 2009

How does the pandemic recession compare?

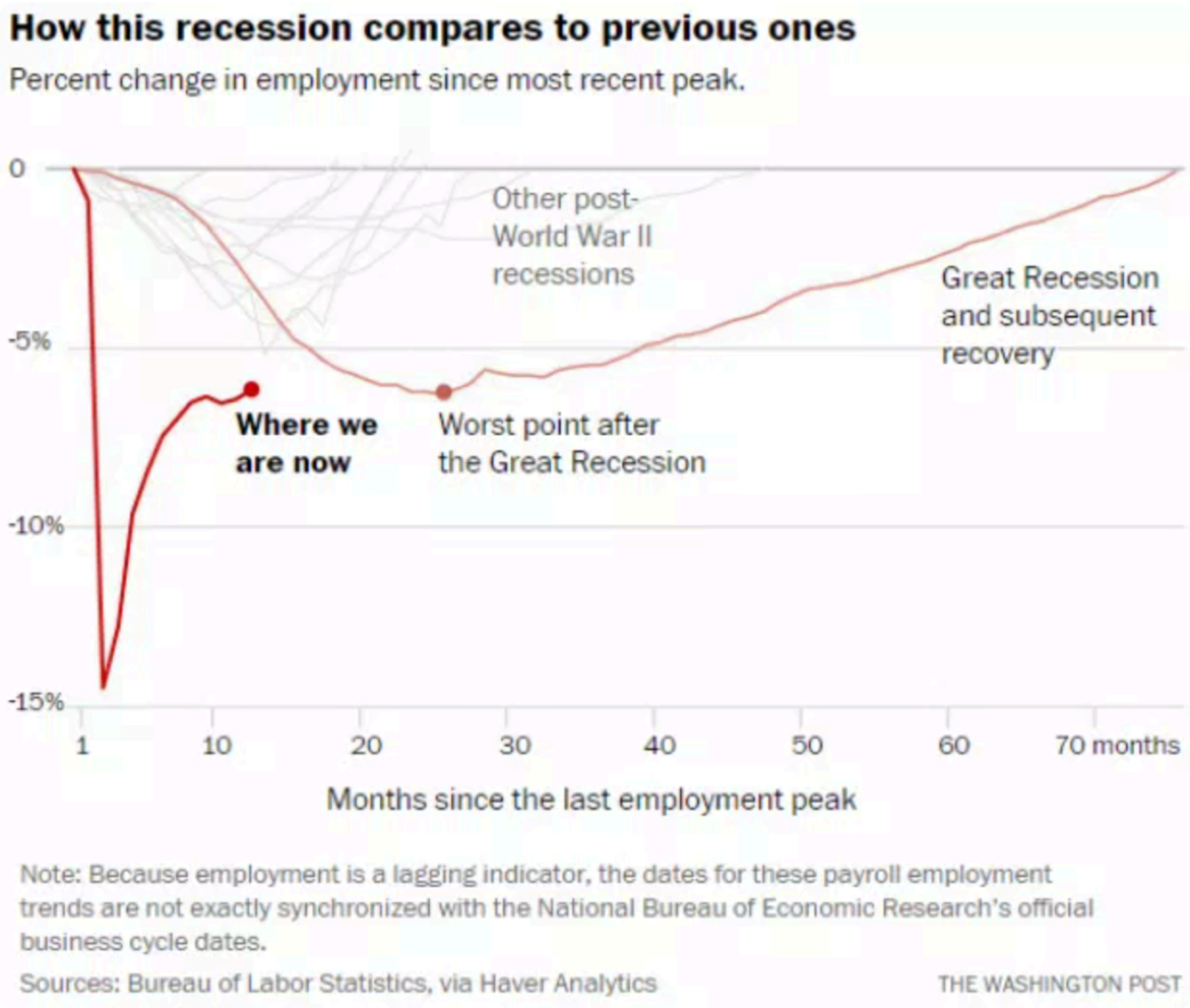
Source: Joe Weisenthal, 2014, "The Scariest Chart Ever Is Dead," *Business Insider*, June 6. http://www.businessinsider.com/the-scariest-chart-ever-is-dead-2014-6



The Pandemic Recession was simply unprecedented:

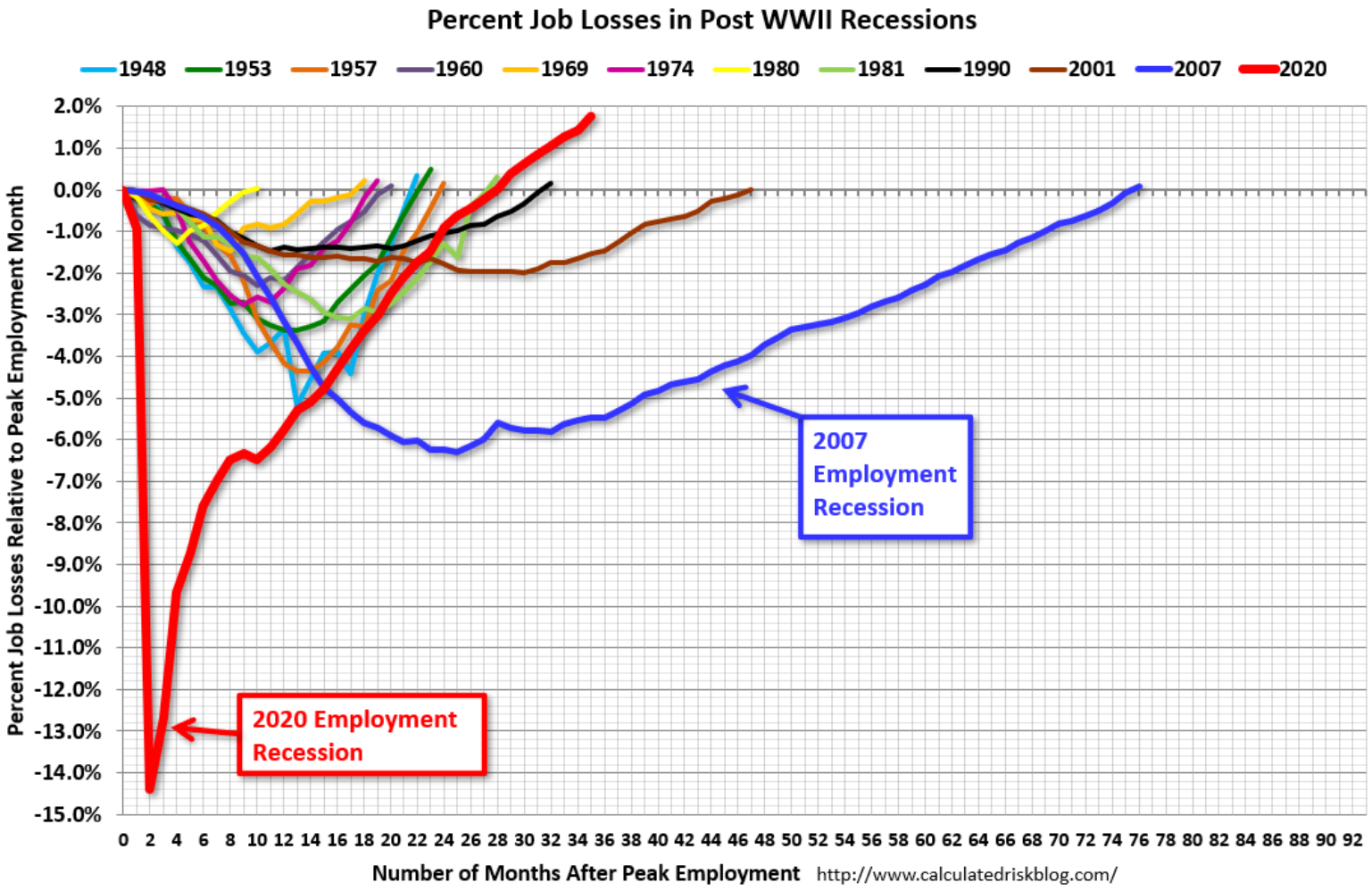
Shutting down much of the global economy led to far bigger and quicker unemployment loss than past recessions

Source: Washington Post, 2021



For more than a year, every weekly US unemployment claims exceeded the worst week of the Great Recession

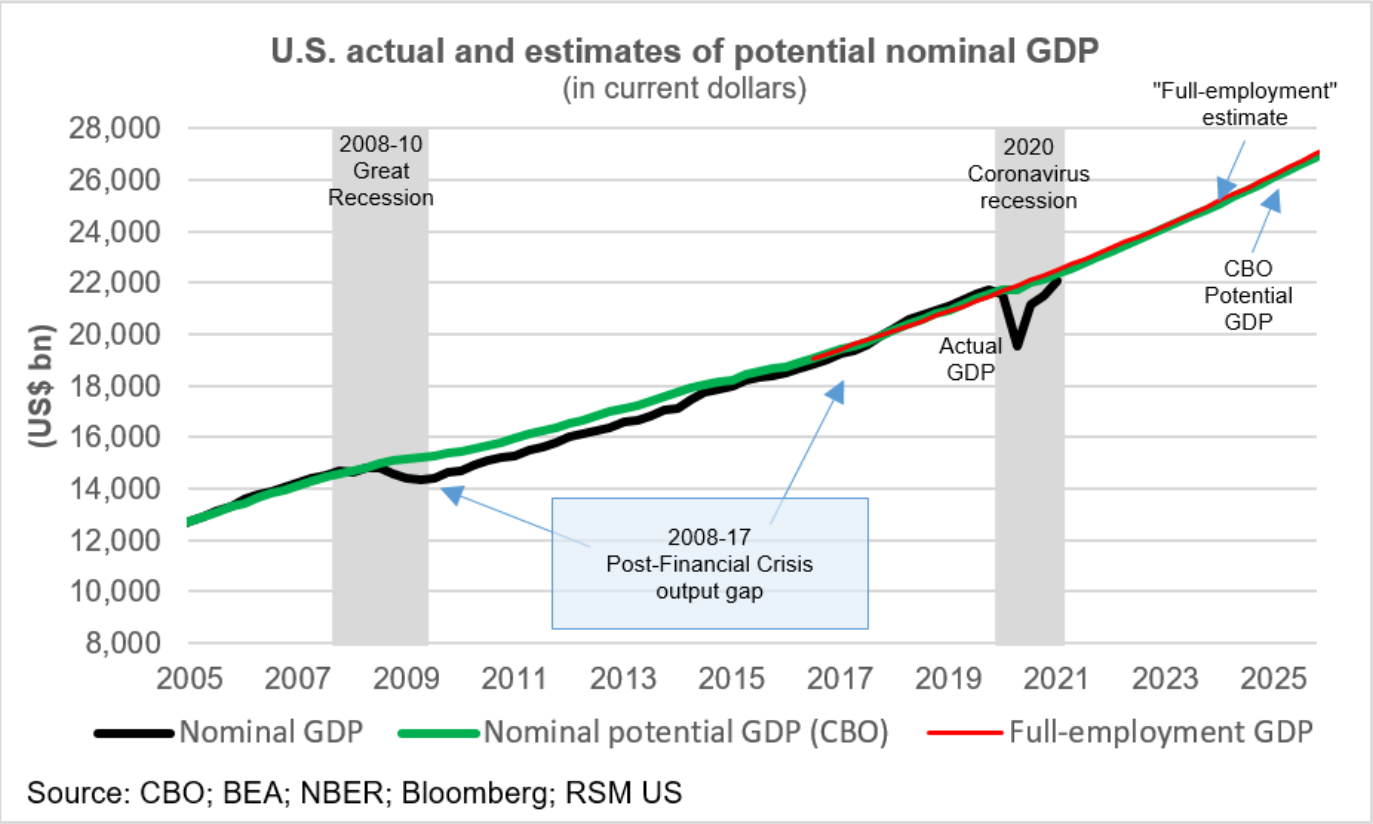
Source: Washington Post, 2021



Source: calculatedriskblog.com

But massive stimulus spending helped spur a swift recovery,
and industry pivoted rapidly to the changing spending habits of stay-at-home publics

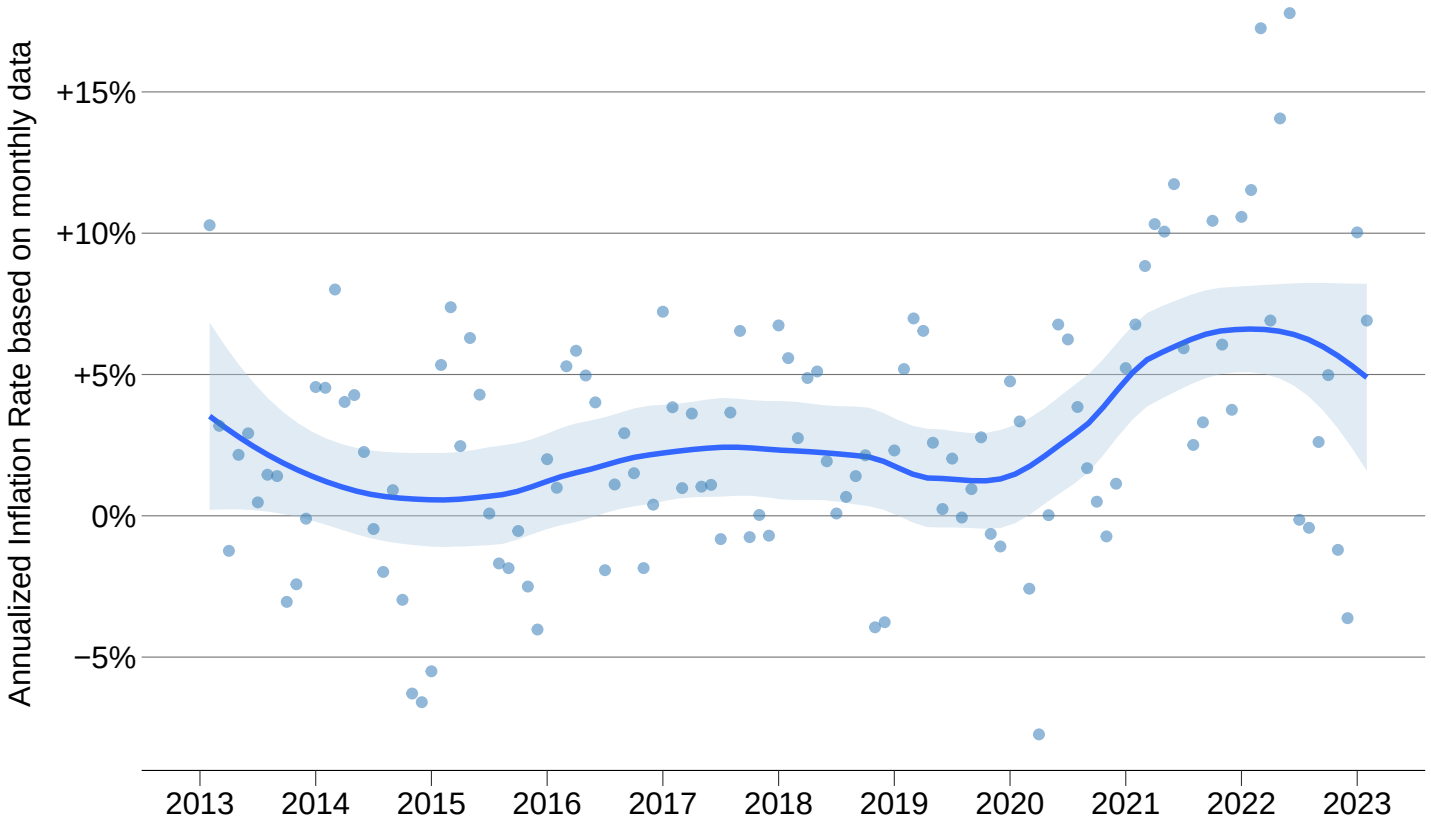
In less than 2.5 years, unemployment fell below pre-pandemic levels, and continues to fall



Source: Joseph Brusuelas, 2021, "Output gap to close in current quarter, an extraordinary achievement," The Real Economy Blog, 29 April, `https://realeconomy.rsmus.com/chart-of-the-day-output-gap-to-close-in-current-quarter-an-extraordinary-achievement/`

It's not just employment that recovered:

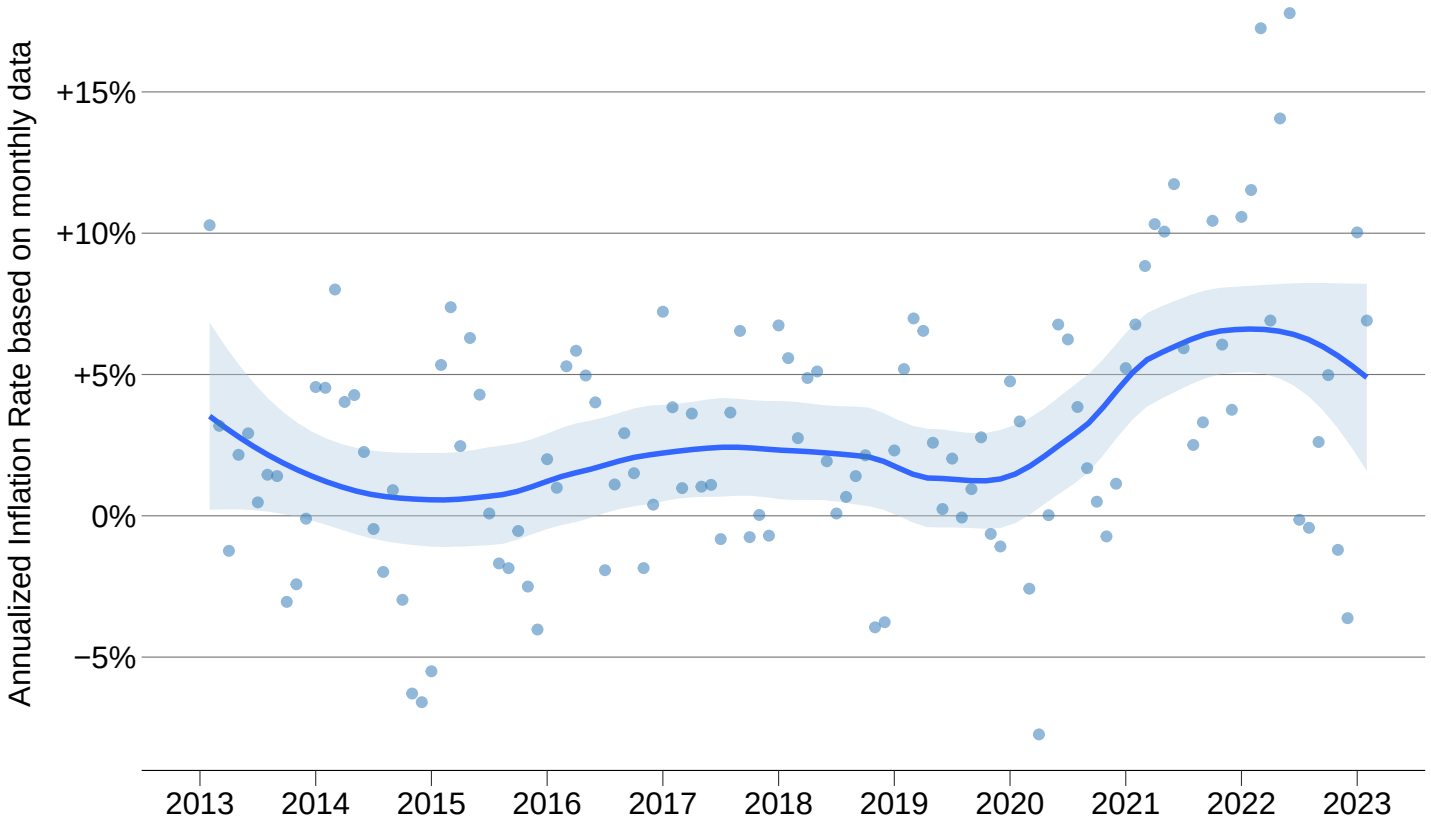
The output gap – which had set postwar records in the second quarter of 2020 – closed in just one year



Source: My calculations from Bureau of Labor Statistics data (March 2023). Curve is a loess fit with bandwith of 0.5; shaded region is a 95% confidence interval.

Inflation followed, which surprised many, but shouldn't have

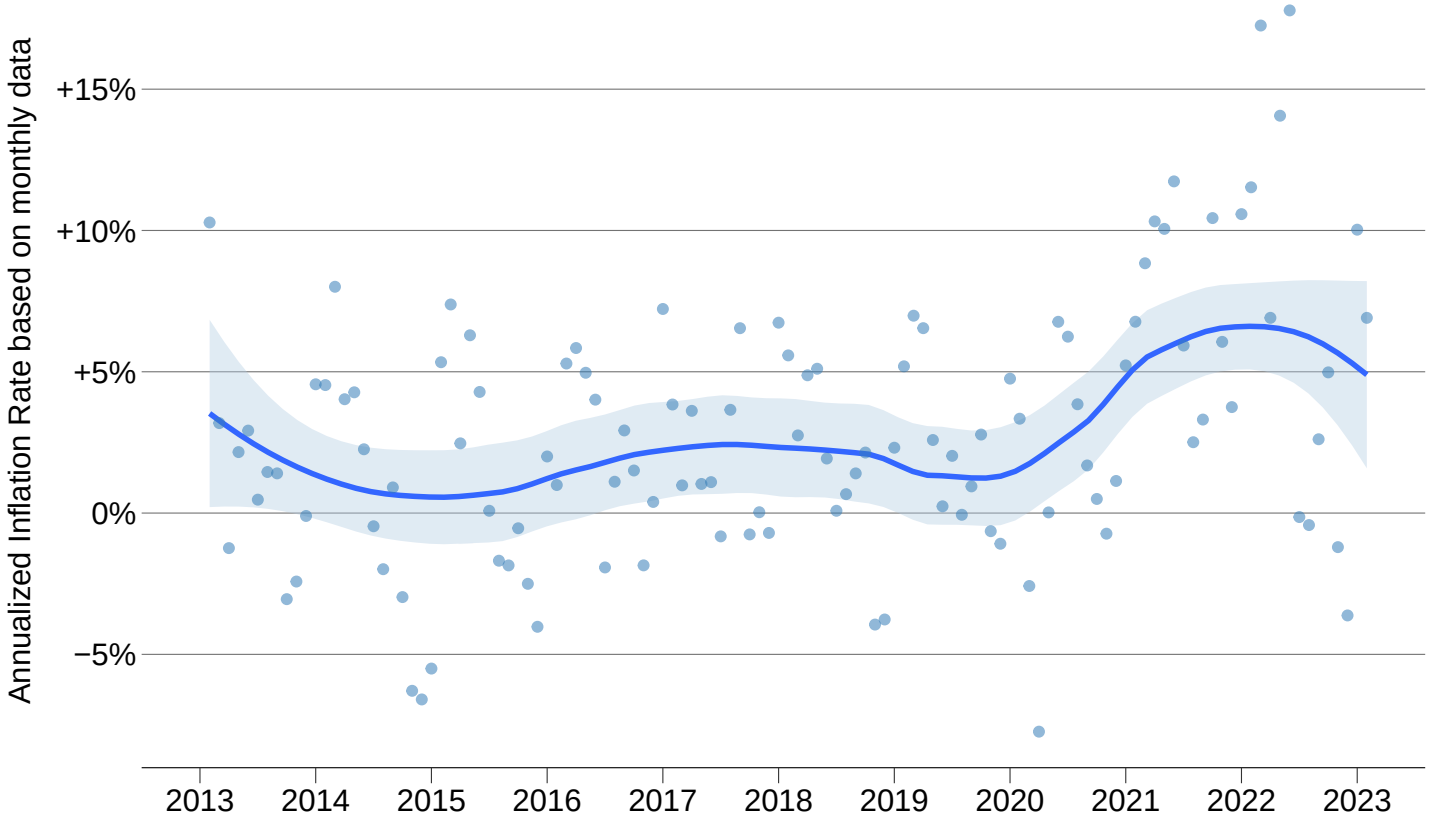
Keeping aggregate demand from falling during a massive reorganization of supply chains and goods demanded was bound to lead to higher prices



Source: My calculations from Bureau of Labor Statistics data (March 2023). Curve is a loess fit with bandwith of 0.5; shaded region is a 95% confidence interval.

Has inflation been tamed? Data from summer 2022 onwards says "maybe"

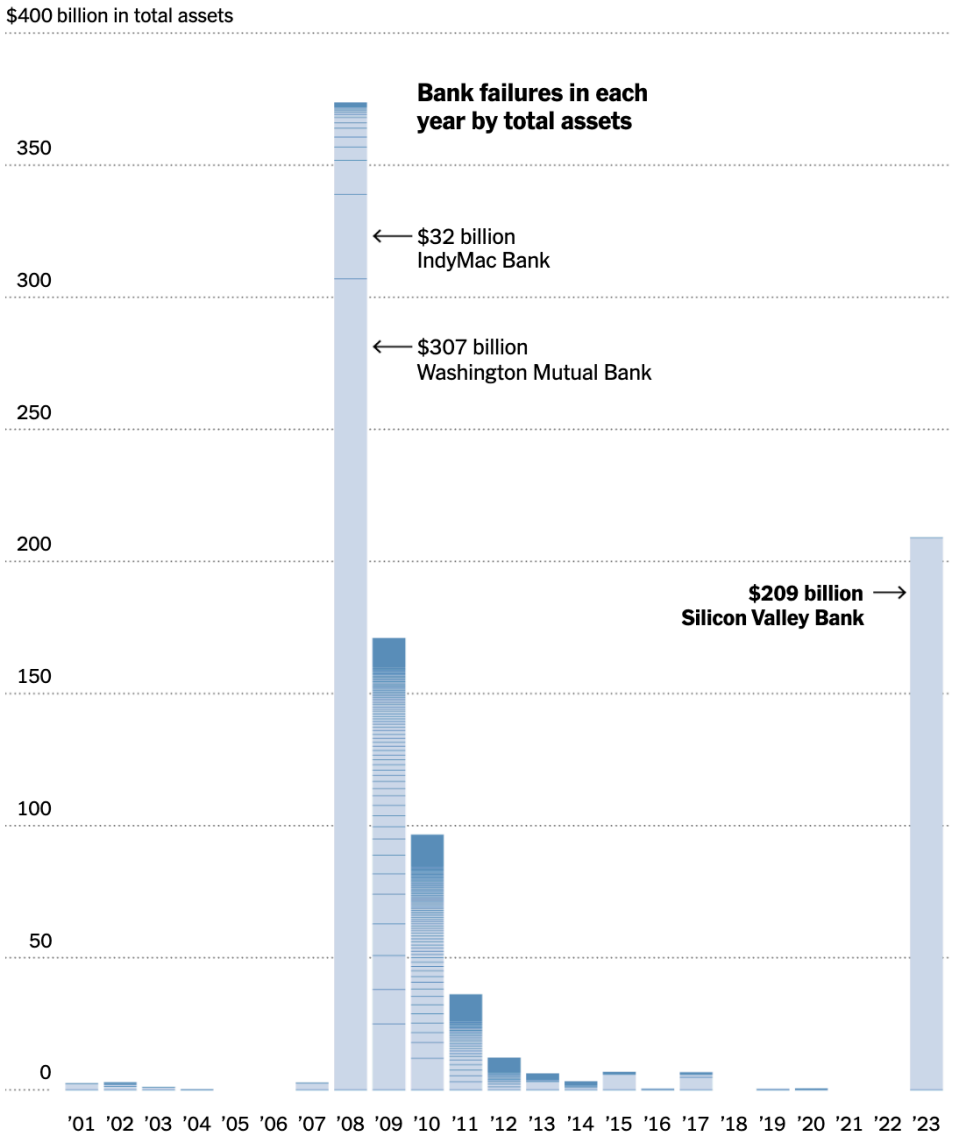
As we shall learn, the drivers of inflation seem to be evolving
from "too much money chasing too few goods" to sector-specific bottlenecks



Source: My calculations from Bureau of Labor Statistics data (March 2023). Curve is a loess fit with bandwith of 0.5; shaded region is a 95% confidence interval.

The question of inflation's causes and course is urgent:

The Fed, tasked with keeping inflation and unemployment low *and* banks well-regulated faces a crisis



Source: Federal Deposit Insurance Corporation • Note: Chart includes failures of federally insured U.S. banks and does not include investment banks. • By Karl Russell

After a quiet, mostly well-regulated decade, banks are failing again

The harbinger of a new global financial crisis? Or a containable problem?

Where are we headed?

When I offered this course in 2019, I ended my lecture with this:

Urgent that we learn what lessons we can from the last decade –
before it's too late to apply them to the next crisis

In 2020, that crisis arrived, and redefined our lives, the national agenda, and control of Congress & the Presidency

Will the political coalitions forged by the pandemic
push back against unemployment and inequality in the coming years?

Or will the trends of the 2010s re-assert themselves?

Where are we headed?

In 2009, the Obama administration compromised on stimulus, spending $0.8T

In 2020–1, the CARES Act ($2.2T) and American Relief Plan ($1.9T) went much bigger

Do these policies suggest a "New Normal" of robust Keynesianism with less fear of inflation and greater focus on economic inequality?

Or will the old debates over the role of government return?

What role will be played by economic trends accelerated by COVID-19:
automation, working from home, less travel?

Will we have a replay of the 2010s, with a new financial crisis, or a new Roaring Twenties?

We start our quest to answer these questions by turning back to the the financial crisis and the Great Recession...