POLS/ECON 409 · The Political Economy of the Great Recession and its Aftermath

COURSE INTRODUCTION

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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.

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


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


Chris Adolph (University of Washington)
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.

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.

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.


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


http://www.nytimes.com/2014/10/30/upshot/
quantitative-easing-is-about-to-end-heres-what-it-did-in-seven-charts.html
The Stock Market Has Returned to Pre-Bust Levels

Stocks are trading at a level they previously only reached during the late 1990s stock market bubble and just before the financial crisis.

S&P 500-stock index, divided by average earnings over previous 10 years, inflation adjusted

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.

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

Arguably, inflation remains far too low for full recovery.


Efforts to unwind QE (both Treasuries & MBS) have barely started – and the Fed has signalled a halt to interest rate tightening for now.

This may reflect political pressure.

But also clear most in the Fed believe the recovery is too fragile to handle unwinding Great Recession stimulus, even a decade later.

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Meanwhile, QE has not been 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 – remains hard to surmount at current growth levels.

And the tepid recovery has done little to help most American families – while some jobs have come back, the gains in wages are concentrated at the top.

Although inflation is very low, cost shifting from employers and state governments means the middle class pays more for college and health care, so the “recovery” feels like an endless recession for many.

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

Since the 1970s, wages have fallen behind productivity growth: the economy is growing, but paychecks aren’t

Wealth is growing more concentrated – and reverting to Gilded Age patterns

Even the upper echelons of the middle class were relatively wealthier in the mid-20th century.
Something big has changed – and it started before the 2008 financial crisis, though that crisis seems to have accelerated matters.

Let’s drill into trends in wealth in the US over the last quarter-century…

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

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

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

The Great Recession cut median household wealth in half – it hasn’t recovered

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

**Source:** My calculations from the Survey of Consumer Finances, 1992–2016
Less-than-college households of all wealth levels took a permanent hit

Racial disparities in wealth are just as stark as educational ones

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

Consider this juxtaposition of wealth disparities by race and education

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

Moreover, wealth gaps aren’t shrinking: they’re growing, fast

The median college household was this many times richer than the median...

- 12 times
- 8 times
- 4 times
- Equality

Moreover, wealth gaps aren’t shrinking: they’re growing, fast

THE MEDIAN WHITE HOUSEHOLD WAS THIS MANY TIMES RICHER THAN THE MEDIAN...

And the US is the relatively good case. Thanks to the early 2010s crisis in the eurozone, Europe – especially southern Europe – stagnated.

http://www.theatlantic.com/business/archive/2013/05/
We’ll investigate the eurocrisis in turn. Many of the same forces are at work, but channelled by Europe’s different political institutions.


The purpose of this course

This course is an experiment

Usually, we focus on theory and many cases in POLS and ECON classes, 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
Understanding how the financial crisis and great recession happened, and what emerged from them is more 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,
- and finally considers several competing explanations for the pattern of slow, unequal growth that seems to be creating a new Gilded Age in the wake of recession

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?

Could a similar crisis happen again?

If it did, would governments be able to react better than last time? Or would they be constrained even from doing what worked before?
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 usually clumsy?

Why did so many governments turn to austerity?

If the crisis began with the US housing market, why has it been worst in Europe, especially in countries on the periphery of the eurozone?
Why hasn’t the economy returned 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)?
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.

For the first time, skilled labor and skilled jobs were plentiful and well-paid

Computer-driven automation is eliminating middle skill jobs, leading to a hollowing out of the wage structure.

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.

Perhaps the change is simply as the rising political power of the affluent…

which might have lead to policy changes reinforcing inequality and stagnation

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.

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,
While the rich surge ahead, the middle classes of newly industrialized countries catch up, and the middle classes of the older industrial nations fall behind...

Are we headed to a convergence of the 1% and the 99% everywhere?

As we saw earlier, rising inequality intersects with division of race, ethnicity, and national origin.

In the US, mortality is rising for the “white working class,” driven by abuse of opioids.

**White non-Hispanic midlife mortality from “deaths of despair” in the U.S. by education**

Ages 50-54, deaths by drugs, alcohol, and suicide


Source: Anne Case and Angus Deaton, 2017, Brookings
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In the UK and US, 2016 saw a populist backlash with Brexit & Trump: but what’s driving it, and how long will it be a political force?

Where are we today?

The post-Great Recession recovery is 118 months old – the record is 120 months

What if there’s another recession? The economy still depends on post-GR stimulus

Not just QE: 2018 federal deficit was 3.8% of GDP & rising (1965–2017 avg.: 2.3%)

Eurozone’s scope for stimulus is similarly limited, and the euro remains problematic

Brexit has plunged UK into self-inflicted political chaos and economic gloom

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