America's Endless Recession

Robert E. Lucas, Jr.

SED Pre-conference

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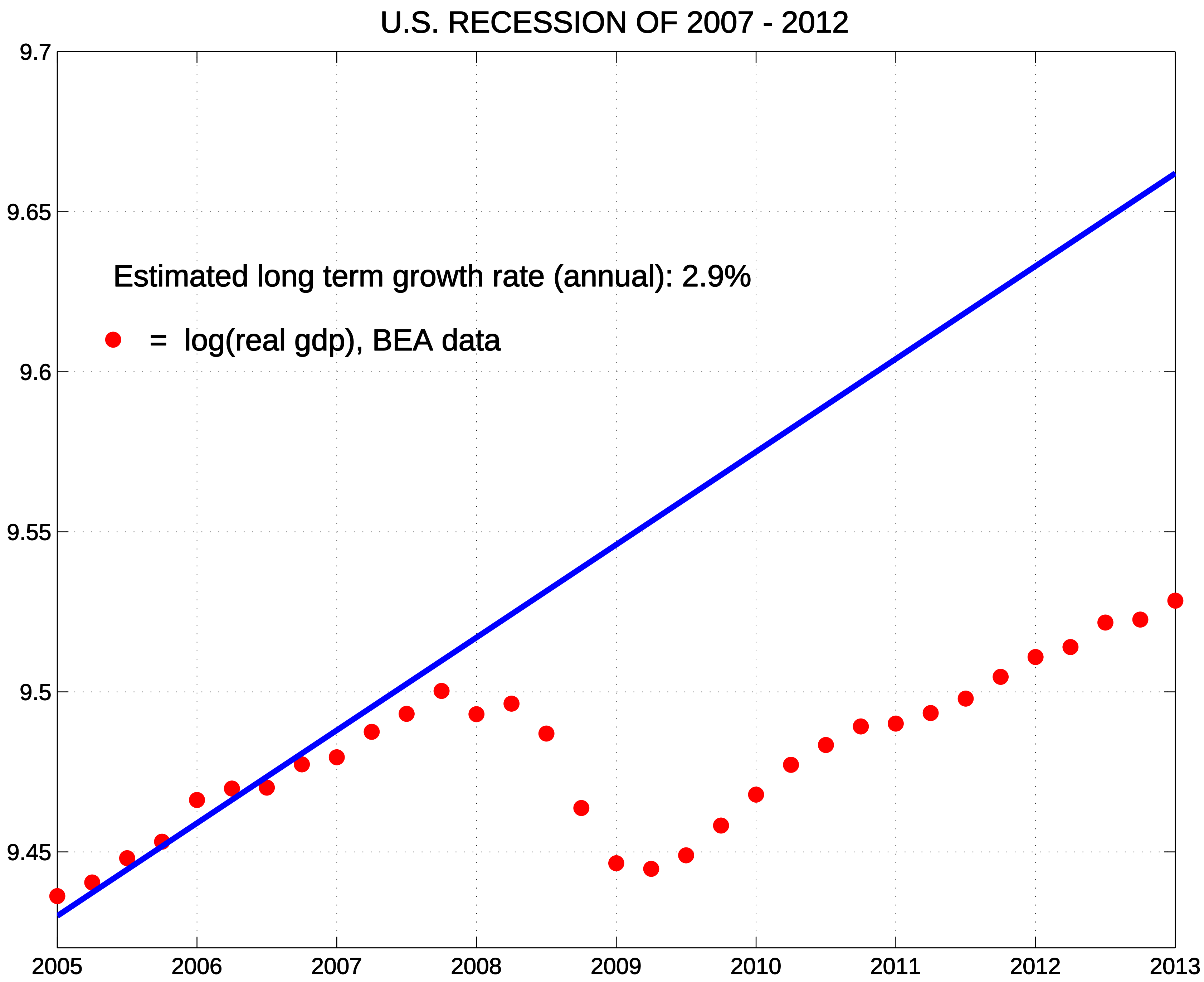
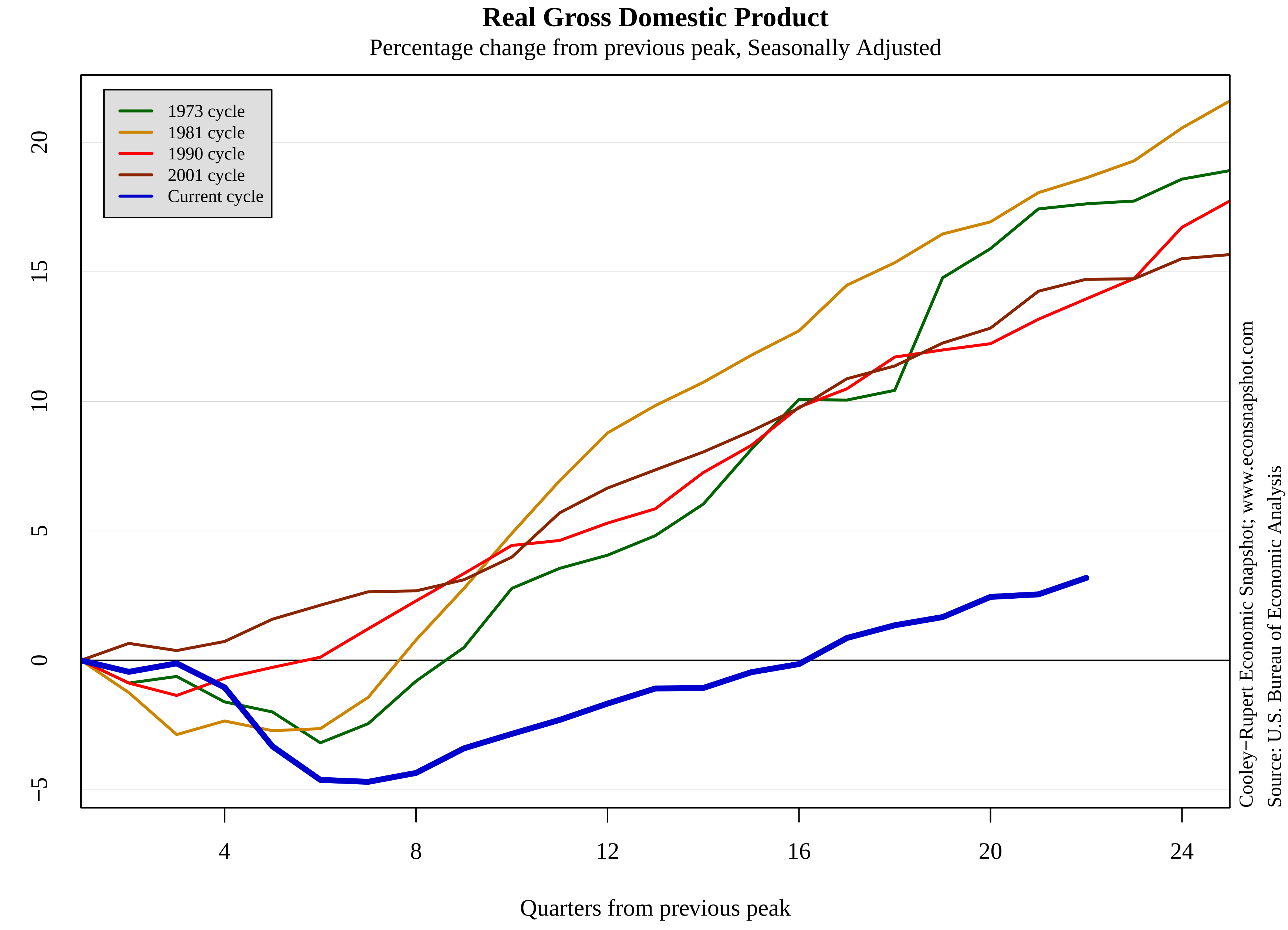
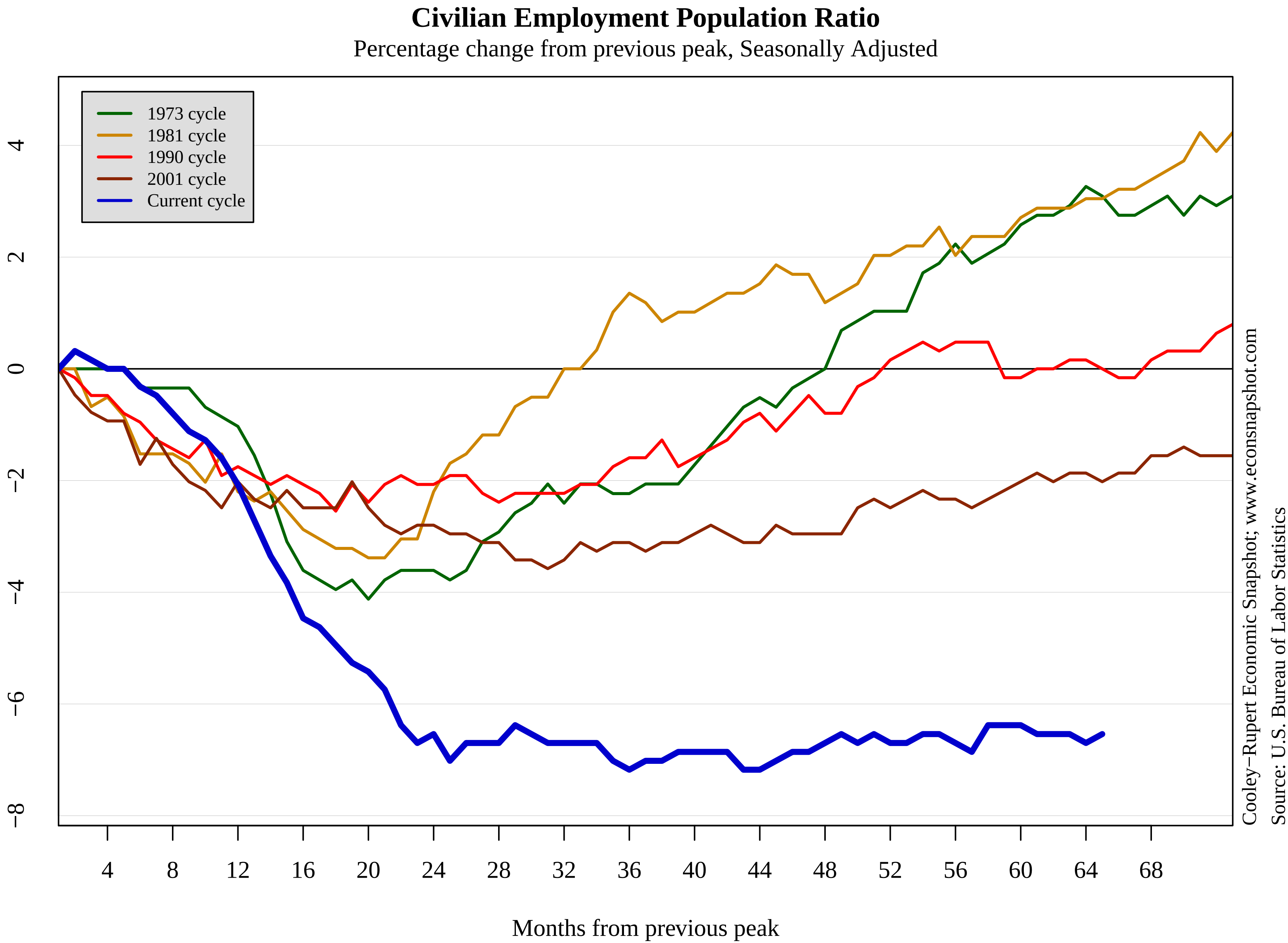
- Begin with three figures:
  - Quarterly real GDP data for US
  - Real GDP for last 5 recessions: Cooley-Rupert Snapshot
  - Employment/Population ratio in current recession: Cooley-Rupert


U.S. RECESSION OF 2007 - 2012
Estimated long term growth rate (annual): 2.9%
= log(real gdp), BEA data
9.7
9.65
9.6
9.55
9.5
9.45
2005
2006
2007
2008
2009
2010
2011
2012
2013



Real Gross Domestic Product
Percentage change from previous peak, Seasonally Adjusted
1973 cycle
1981 cycle
1990 cycle
2001 cycle
Current cycle
20
15
10
5
0
−5
4
8
12
16
20
24
Quarters from previous peak
Cooley−Rupert Economic Snapshot; www.econsnapshot.com
Source: U.S. Bureau of Economic Analysis



Civilian Employment Population Ratio
Percentage change from previous peak, Seasonally Adjusted
1973 cycle
1981 cycle
1990 cycle
2001 cycle
Current cycle
4
2
0
−2
−4
−6
−8
4
8
12
16
20
24
28
32
36
40
44
48
52
56
60
64
68
Months from previous peak
Cooley−Rupert Economic Snapshot; www.econsnapshot.com
Source: U.S. Bureau of Labor Statistics

- What is going on? Why is this recession so different from others in post-war U.S.?

- Current recession—like early 1930s—involved major liquidity crisis

- Assets thought to be liquid—convertible to cash at par—turned out not to be

- Turned minor recession into much more serious one

- But Fed in 2008 crisis acted quickly, forcefully—unlike 1930s

- Liquidity crisis **completely** resolved by 2009-1

- Now it is 2013-2: Still no recovery in sight

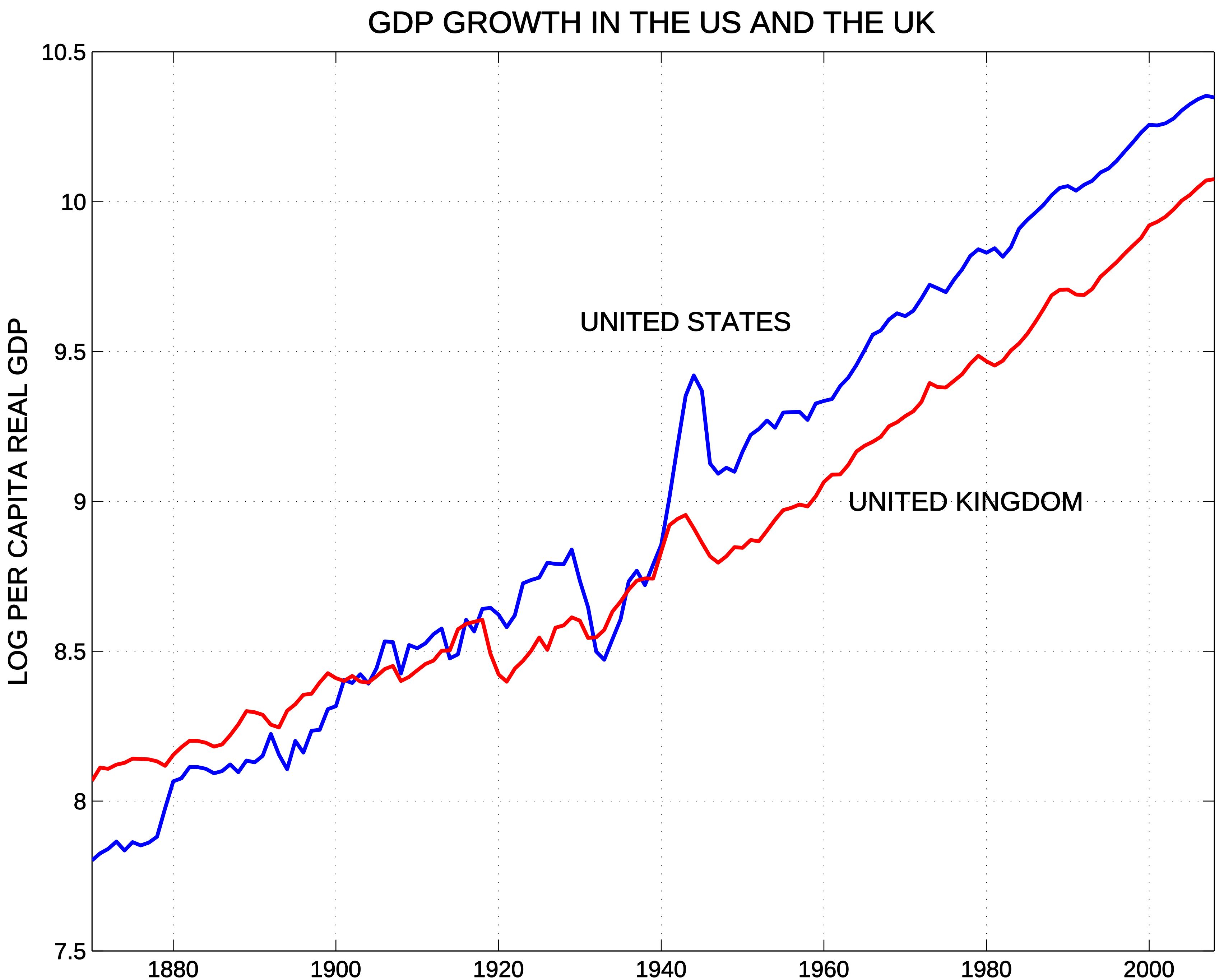
- Again, reminiscent of 1930's: liquidity crisis solved by 1933; depression lasted until 1942

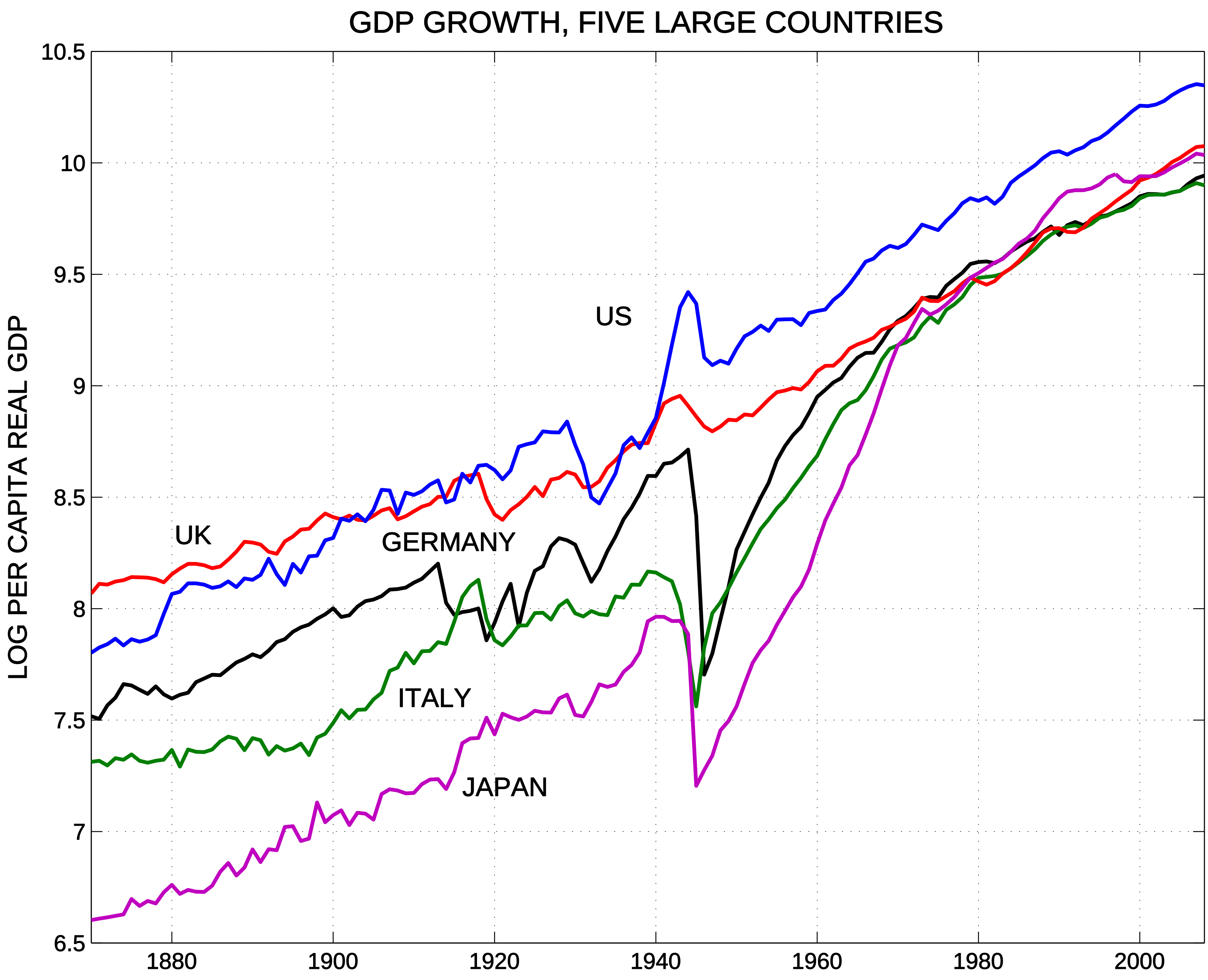
- Cole and Ohanian (2004) focus on distortions due to misguided real policies

- Government interventions, designed to speed recovery; in fact retarded it

- Believe we are repeating this mistake now. Details?

- First, some cautionary slides


GDP GROWTH IN THE US AND THE UK
LOG PER CAPITA REAL GDP
10.5
10
9.5
9
8.5
8
7.5
1880
1900
1920
1940
1960
1980
2000
UNITED STATES
UNITED KINGDOM



GDP GROWTH, FIVE LARGE COUNTRIES
LOG PER CAPITA REAL GDP
10.5
10
9.5
9
8.5
8
7.5
7
6.5
1880
1900
1920
1940
1960
1980
2000
US
UK
GERMANY
ITALY
JAPAN

- Prescott (2002, 2004) showed that 30% GDP gap between US and W. Europe can be attributed to differences in employment, due to higher taxes, other penalties to work [Not so for US/Japan gap]

- Apply same argument to 15% GDP gap between 2006 US and 3013 US? To 7% employment gap?

- Prescott estimates compare GDP levels along balanced growth paths under different, constant tax regimes

- Turn next to estimated effects of changing tax regime over course of current recession

- Source for this is new book: Casey Mulligan, *The Redistribution Recession: How Labor Market Distortions Contracted the Economy*. Oxford, 2012

- Thesis is that expansion of “safety net” from 2009 on reduced work incentives

- Main changes involved

  – unemployment insurance (both duration and replacement rates)

  – food stamps

  – means-tested loan forgiveness

- All of these policies reduce the pain of income loss, which is to say they reduce the gain from employment: a kind of tax

- Mulligan documents the growth of these “taxes”, the marginal tax rates (MTR), from 2007 through 2011

- Also documents conventional taxes on employers

- Then applies economic theory to simulate the effects of these policies on employment

- These depend on labor supply elasticities: Mulligan offers three

Figure 5.6a. Labor per Capita from Three MTR Scenarios, Elasticity = 1.1

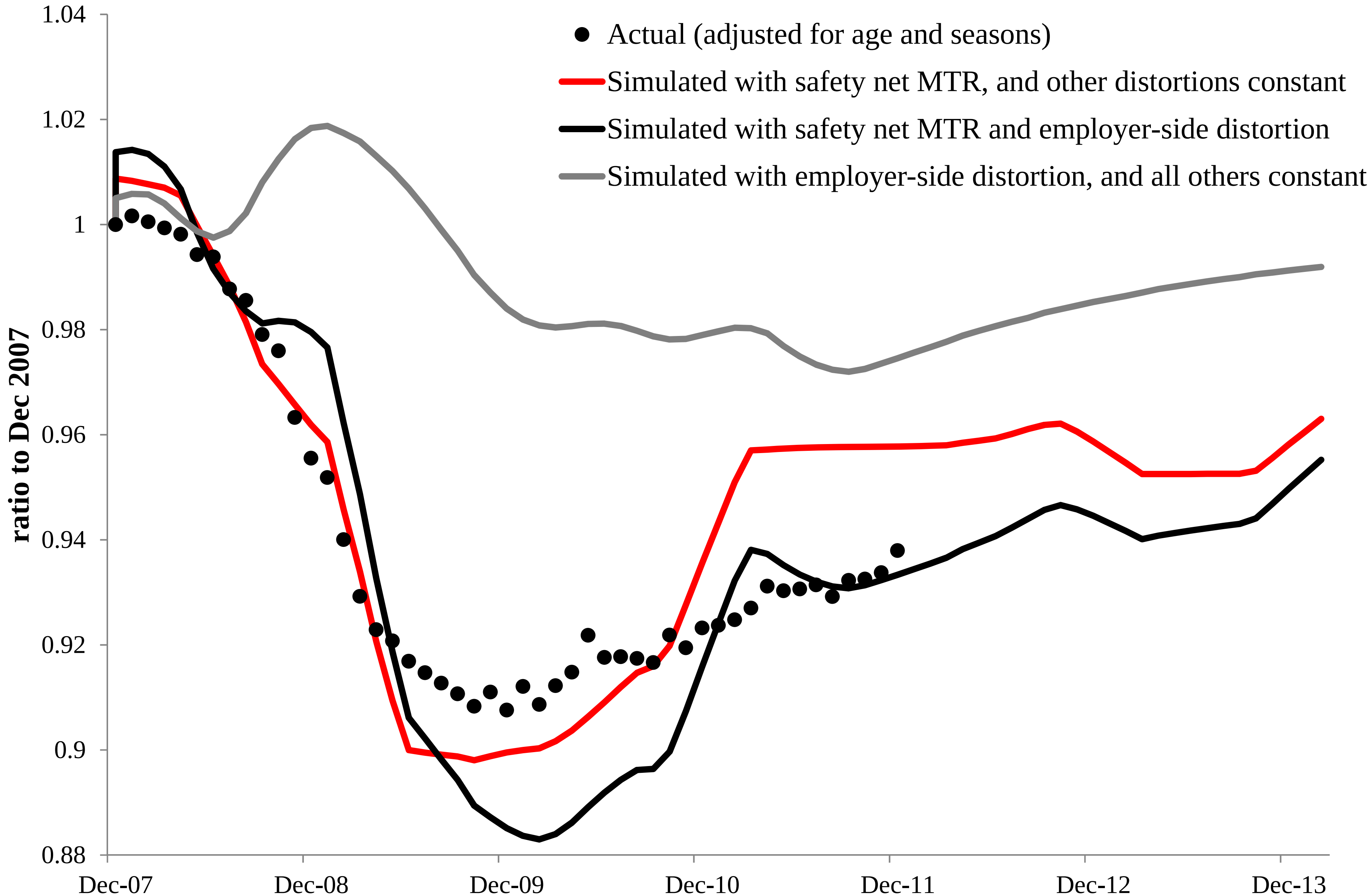


Figure 5.6b. Labor per Capita from Three MTR Scenarios, Elasticity = 0.75

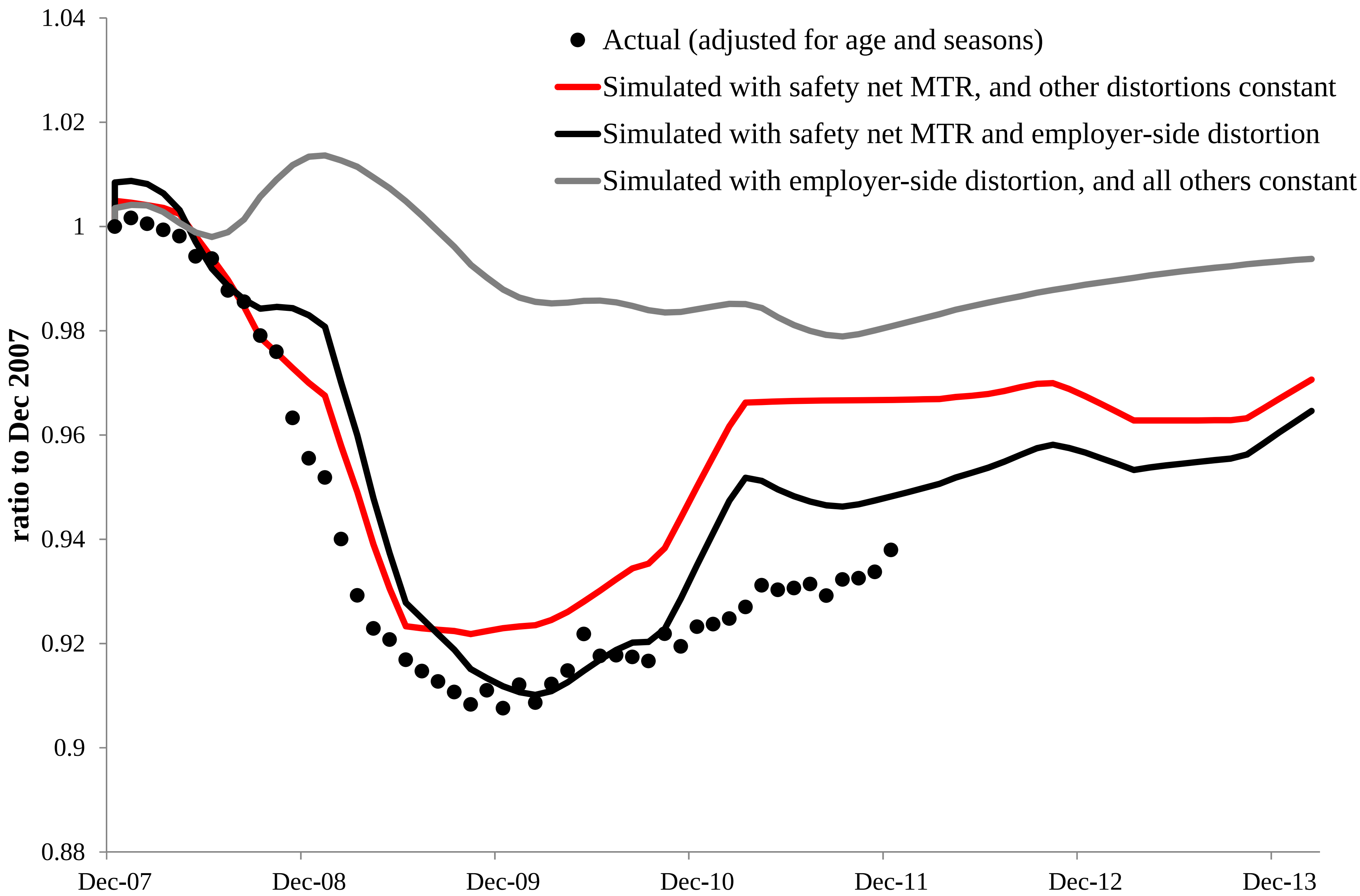
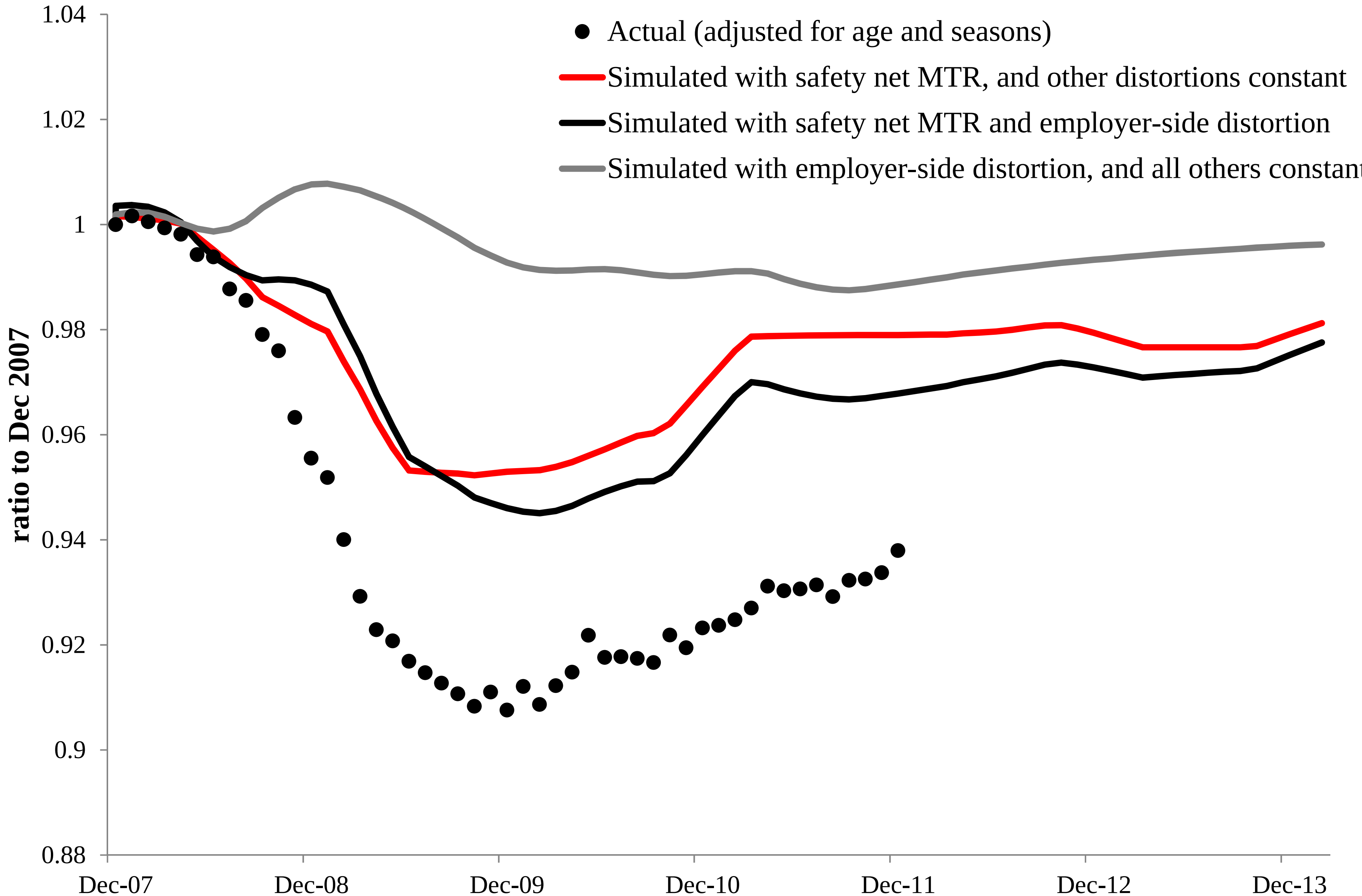


Figure 5.6c. Labor per Capita from Three MTR Scenarios, Elasticity = 0.4



- These studies do not imply that safety nets are bad policy

- But safety comes at a price and economic theory can be used to estimate this price

- Prescott worked out the long-run consequences for GDP under European as compared to US tax/welfare policies

- Now Mulligan has provided the transition dynamics in going from one regime to the other

- If they are right, this is a course we have chosen that will not be undone by any monetary magic