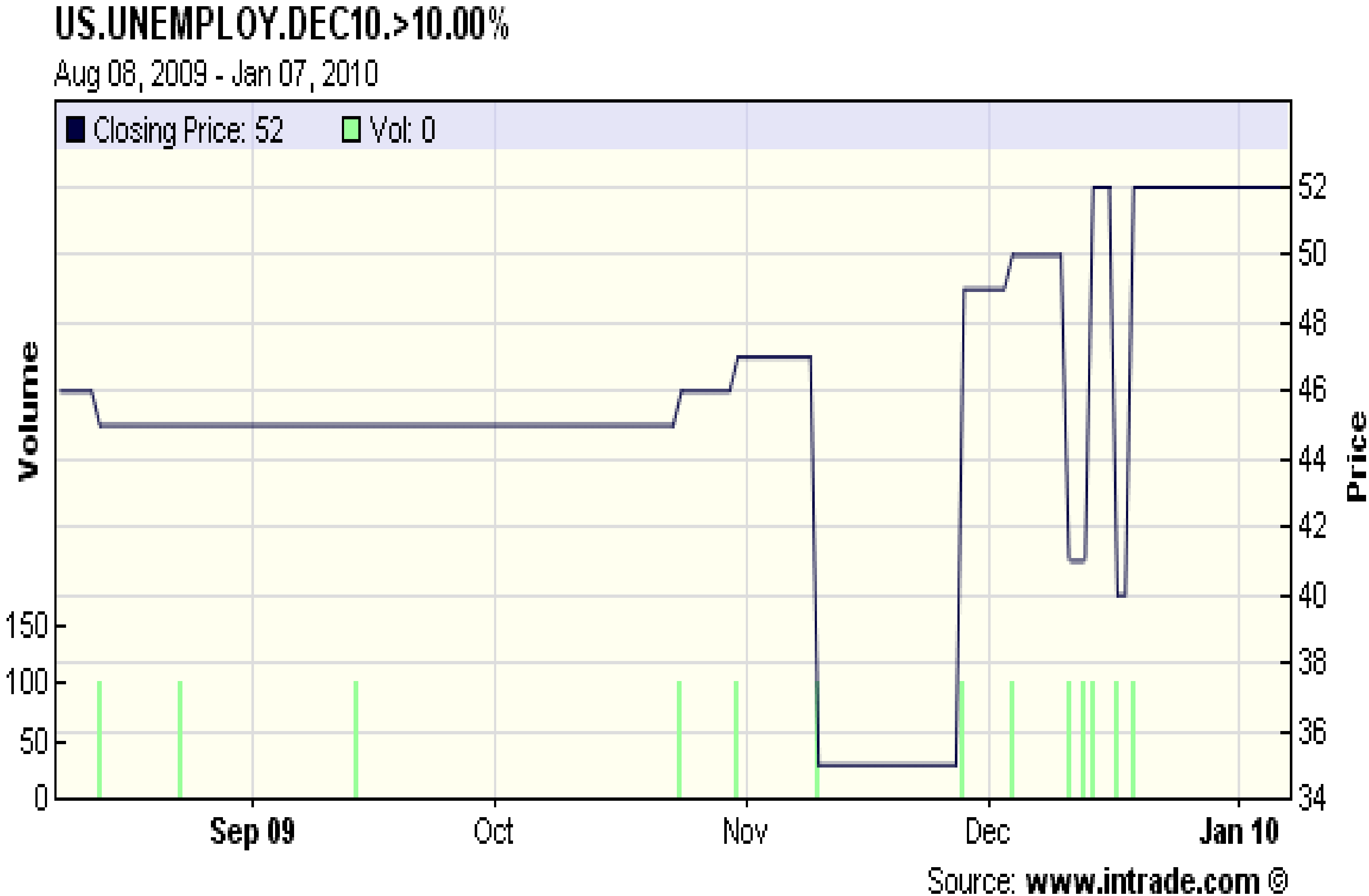
Creative Ways for Economic Recovery and Sustainable Growth

It may not bring back jobs or produce sustainable growth or pay our mortgage but sacrificing economists to the Invisible Hand raises our utility.

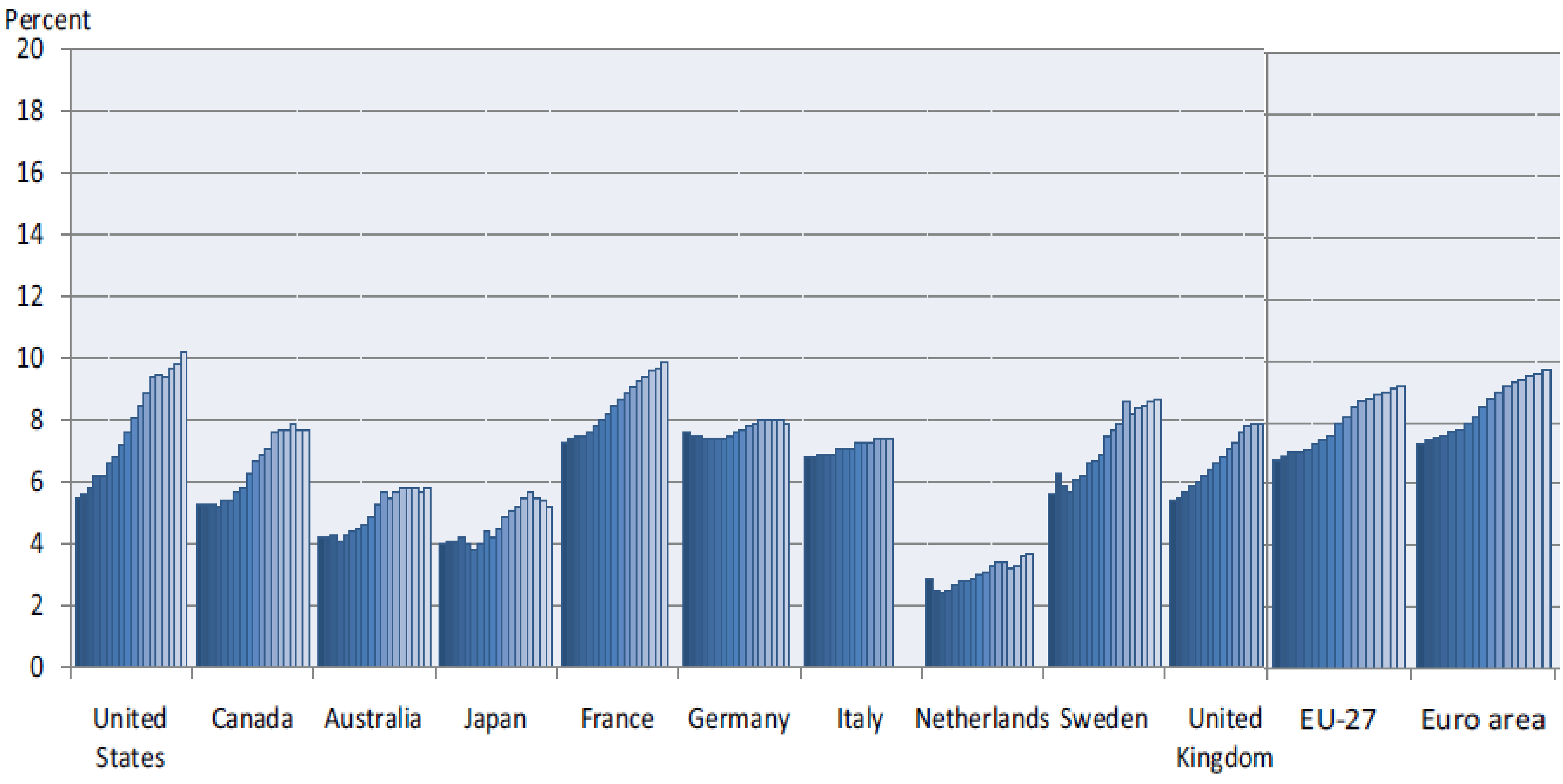
Richard B. Freeman, Harvard, NBER; CEP, LSE
NASI 22nd Annual Conference Session II
January 21, 2010

1) US unemployment high and likely to remain high for long time

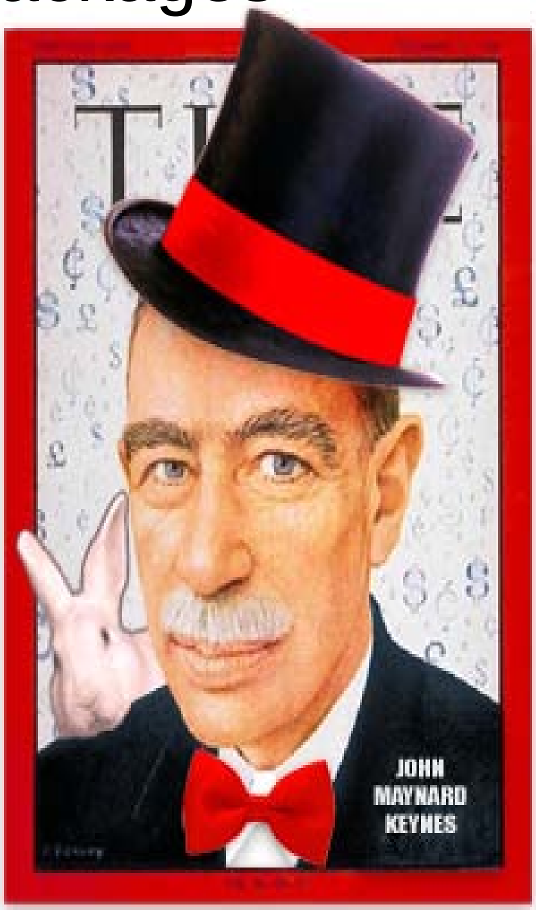


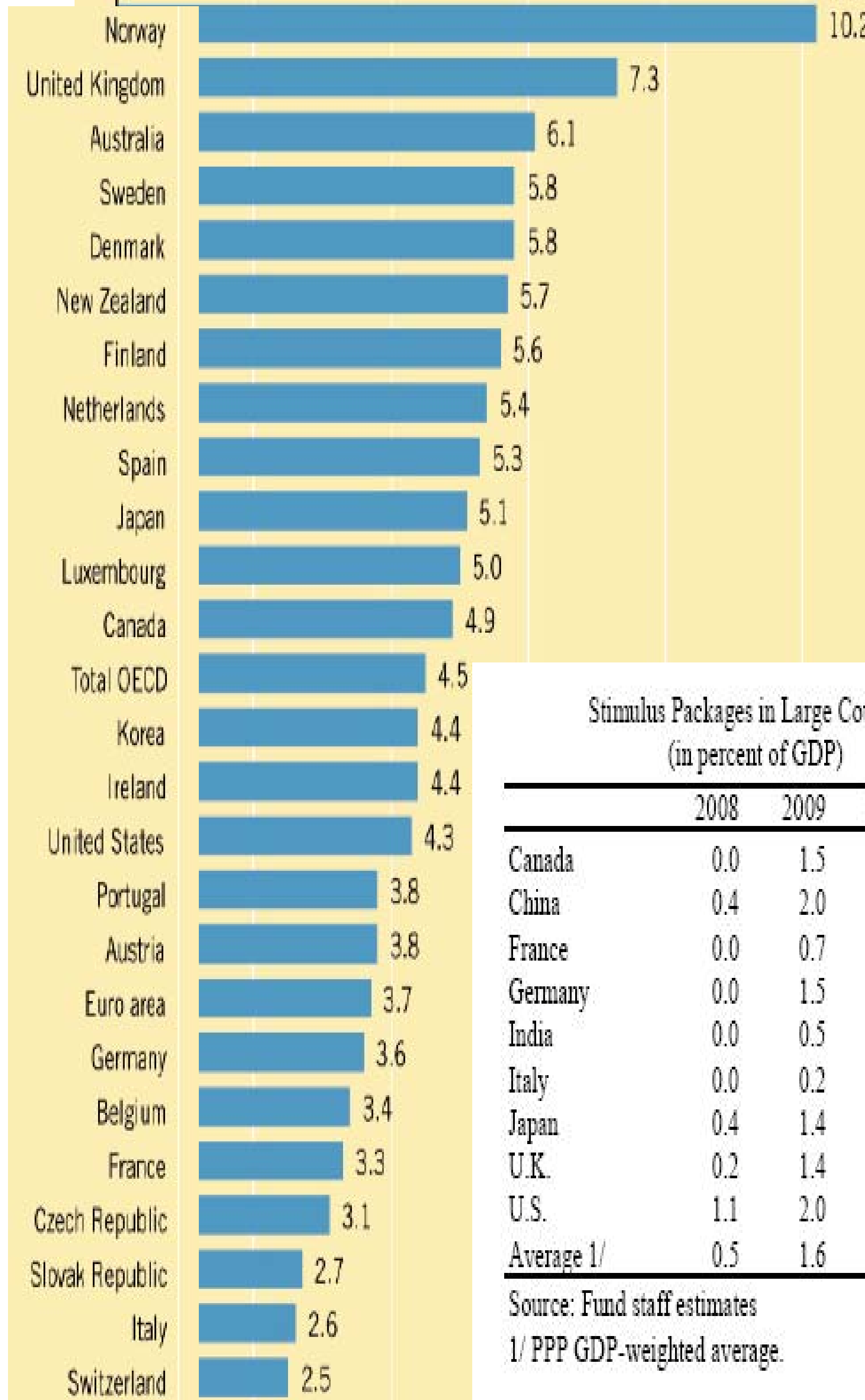
US job loss has created higher unemployment rate than in EU

CHART 1. Monthly unemployment rates adjusted to U.S. concepts, 10 countries, seasonally adjusted, Ma
2008–October 2009



2) Return of Keynesianism to prevent Great Depression II: fiscal deficits and stimulus packages





Stimulus Packages in Large Countries
(in percent of GDP)

	2008	2009	2010	Total
Canada	0.0	1.5	1.3	2.7
China	0.4	2.0	2.0	4.4
France	0.0	0.7	0.7	1.3
Germany	0.0	1.5	2.0	3.4
India	0.0	0.5	…	0.5
Italy	0.0	0.2	0.1	0.3
Japan	0.4	1.4	0.4	2.2
U.K.	0.2	1.4	-0.1	1.5
U.S.	1.1	2.0	1.8	4.8
Average 1/	0.5	1.6	1.3	3.4

Source: Fund staff estimates
1/ PPP GDP-weighted average.

Why fewer jobs lost in EU with smaller stimulus?

1) Bigger automatic stabilizers so deficits rose more than US without special packages

2) Decline in productivity per worker due to return of work-sharing -- part of EU drop in productivity is fewer hours per worker; rise in part-time share of employment, BUT hours productivity also goes negative in 2009 for EU15

3)The growth of “labor hoarding” as EU seeks to keep unemployed at workplace Some policy-caused: governments encourage firms to keep unemployed at workplace, some with training programs, Some employer-motivated

Rationale for Keeping Unemployed At Workplaces

Positives: Increases/maintains skills
Keeps people attached to market
Raises well-being of unemployed
Raises output by lower marginal cost of labor

Uncertain; cost of support of unemployed
Effect on other workers

Negatives: less job search/mobility to new areas
Props up less productive firms by lower mc of l
Concentrates "open unemployment" on young
Firms/workers could game system

The US Stimulus – too small/slow for job?

Jobs Created/Saved as Reported by Recipients 640,329 (reported by US government recovery website as of 10/30/2009)

Jobs Lost from Dec 07 to Dec 09: 8,542,000 (BLS employment situation)

But as of 12/31/09 only 257 billion of 787 billion funds were paid out. Obligated/funds paid out does not mean spent immediately. So bulk of stimulus moneys have yet to have their impact

Areas of Strength vs Areas of Weakness

\$20 billion spent on science stimulus → long term improvement in technology if end of ARRA RD boost does not have huge negative effect
Infrastructure on green economy; retrofitting
Most money will be spent 2010-2011

No effort to cure banking and finance CANCER on real economy bcs bailing out banks enabled them to marshal resources to derail major reforms.
Pressures for reduced federal deficits before recovery is self-sustained.
Reduced investment in education
State, local govt budget deficits → contraction

Bandage Policies are not long term strategy for sustainable recovery from Wall Street's mucking up economy

IMF analysis shows that banking induced crises are longer to cure than others

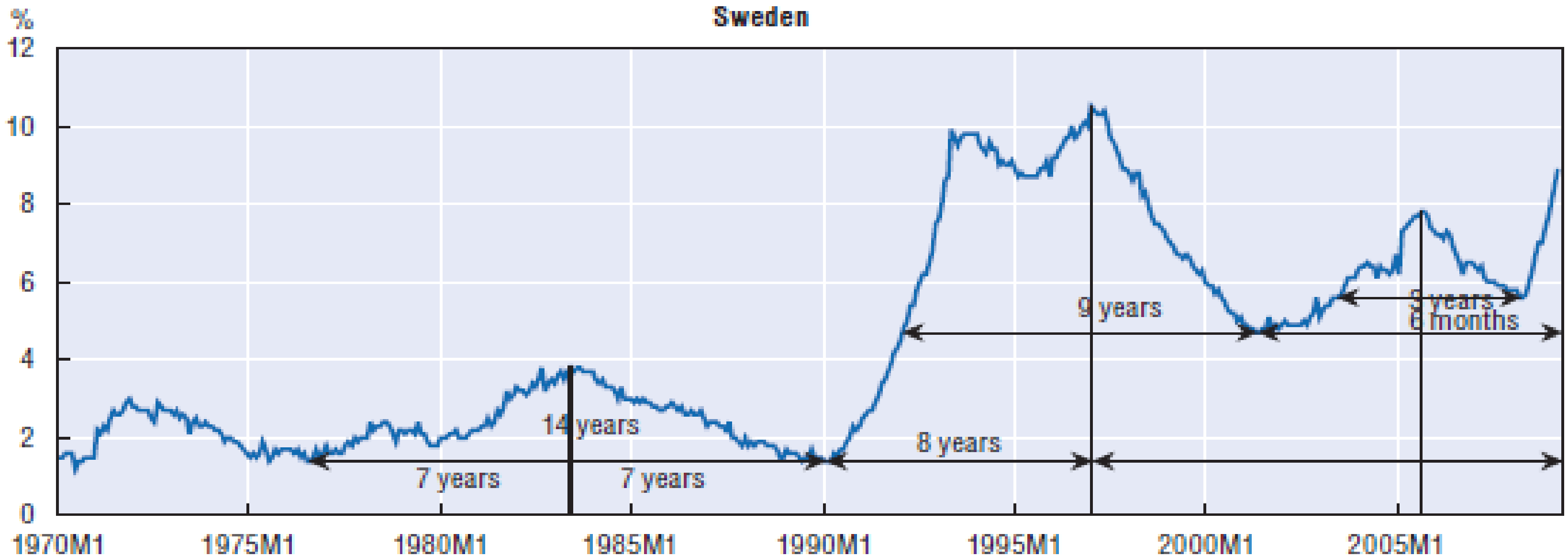
Lost decade of Japan shows danger of stagnation

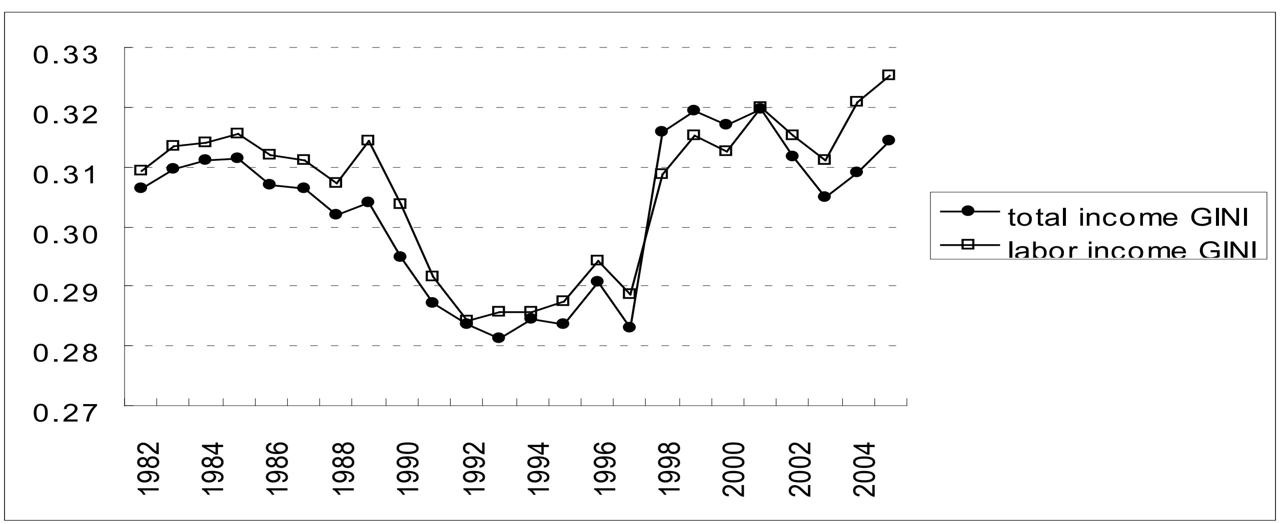
US recession has INCREASED wage and income inequality, increased poverty, so the problems of "shared prosperity" for all WORSE today

Recent recessions → long period for job recovery;greater inequality; loss of lifetime income for many

Figure 1.7. **Severe recessions generate sharp increases in unemployment which are long-lasting and often not reversed completely in recoveries** (cont.)

Evolutions of monthly harmonised unemployment rates[a] in selected countries, January 1970-June 2009





Korean growth built on low levels of inequality. The 1997 Asian flu crisis raised inequality so Korea is now second to US among OECD countries. Employment picked up through informal irregular jobs, not through growth of permanent jobs.

The nightmare scenario: US cannot attain sustainable growth with existing economic disparity and cannot address disparity with existing economic structure

1) Stagnant wages and rising inequality → middle-class debt for consumption spending. Finance provided “bubble” loans (that smart big banks bet against) and rest of world allowed US to consume beyond our means. In future consumers will not spend without wage increases while unemployment prevents wage increases; and will not go on debt-spending spree.

2) Sluggish growth → finance to make riskier short term bets because of huge inequality related incentives; use lobbying power and money to weaken/stop reforms of finance, which maintains danger of another nuclear bomb leverage collapse.