Debate: Stiglitz vs. Summers on Secular Stagnation

During the slow recovery after the 2008 financial crisis, Larry Summers, the Director of President Barack Obama's National Economic Council, argued that the US economy was in the grips of "secular stagnation": neither full employment nor strong growth could be achieved under stable financial conditions.

In this *BigPicture* debate, **Joseph E. Stiglitz** argues that Summers's theory has been invalidated by the effectiveness of today's fiscal stimulus policies – and that the Obama administration should have doubled down on them when it had the chance.

Summers responds that Stiglitz has mistakenly framed his theory as a passive justification of the *status quo*, rather than as a call to arms for precisely the type of intervention Stiglitz himself advocates. **Stiglitz** counters that the shape and size of the intervention matters as much as the decision to go through with it, and hopes that the right lessons will have been heeded by the next downturn. And **Summers** offers his final thoughts on the matter, noting that the Obama-era stimulus package did indeed fall within the range Stiglitz had prescribed at the time.

And in a commentary following the debate, **Roger E.A. Farmer** weighs in to argue that both Summers and Stiglitz would still need a new economic model to justify a fiscal expansion as the default response to the next recession.

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The Myth of Secular Stagnation

Aug 28, 2018 | **JOSEPH E. STIGLITZ**

NEW YORK – In the aftermath of the 2008 financial crisis, some economists argued that the United States, and perhaps the global economy, was suffering from "secular stagnation," an idea first conceived in the aftermath of the Great Depression. Economies had always recovered from downturns. But the Great Depression had lasted an unprecedented length of time. Many believed that the economy recovered only because of government spending on World War II, and many feared that with the end of the war, the economy would return to its doldrums.

Something, it was believed, had happened, such that even with low or zero interest rates, the economy would languish. For reasons now well understood, these dire predictions fortunately turned out to be wrong.

Those responsible for managing the 2008 recovery (the same individuals bearing culpability for the under-regulation of the economy in its pre-crisis days, to whom President Barack Obama inexplicably turned to fix what they had helped break) found the idea of secular stagnation attractive, because it explained their failures to achieve a quick, robust recovery. So, as the economy languished, the idea was revived: Don't blame us, its promoters implied, we're doing what we can.

The events of the past year have put the lie to this idea, which never seemed very plausible. The sudden increase in the US deficit, from around 3% to almost 6% of GDP, owing to a poorly designed regressive tax bill and a bipartisan expenditure increase, has boosted growth to around 4% and brought unemployment down to a 18-year low. These measures may be ill-conceived, but they show that with enough fiscal support, full employment can be attained, even as interest rates rise well above zero.

The Obama administration made a crucial mistake in 2009 in not pursuing a larger, longer, better-structured, and more flexible fiscal stimulus. Had it done so, the economy's rebound would have been stronger, and there would have been no talk of secular stagnation. As it was, only those in the top 1% saw their incomes grow during the first three years of the so-called recovery.

Some of us warned at the time that the downturn was likely to be deep and long, and that what was needed was stronger and different from what Obama proposed. I suspect that the main obstacle was the belief that the economy had just experienced a little "bump," from which it would quickly recover. Put the banks in the hospital, give them loving care (in other words, hold none of the bankers accountable or even scold them, but rather boost their morale by inviting them to consult on the way forward), and, most important, shower them with money, and soon all would be well.

But the economy's travails were deeper than this diagnosis suggested. The fallout from the financial crisis was more severe, and massive redistribution of income and wealth toward the top had weakened aggregate demand. The economy was experiencing a transition from manufacturing to services, and market economies don't manage such transitions well on their own.

What was needed was more than a massive bank bailout. The US needed a fundamental reform of its financial system. The 2010 Dodd-Frank legislation went some way, though not far enough, in preventing banks from doing harm to the rest of us; but it did little to ensure that the banks actually do what they are supposed to do, focusing more, for example, on lending to small and medium-size enterprises.

More government spending was necessary, but so, too, were more active redistribution and pre-distribution programs – addressing the weakening of workers' bargaining power, the agglomeration of market power by large corporations, and corporate and financial abuses. Likewise, active labor-market and industrial policies might have helped those areas suffering from the consequences of deindustrialization.

Instead, policymakers failed to do enough even to prevent poor households from losing their homes. The political consequences of these economic failures were predictable and predicted: it was clear that there was a risk that those who were so badly treated would turn to a demagogue. No one could have predicted that the US would get one as bad as Donald Trump: a racist misogynist bent on destroying the rule of law, both at home and abroad, and discrediting America's truth-telling and assessing institutions, including the media.

A fiscal stimulus as large as that of December 2017 and January 2018 (and which the economy didn't really need at the time) would have been all the more powerful a decade earlier when unemployment was so high. The weak recovery was thus not the result of "secular stagnation"; the problem was inadequate government policies.

Here, a central question arises: Will growth rates in coming years be as strong as they were in the past? That, of course, depends on the pace of technological change. Investments in research and development, especially in basic research, are an important determinant, though with long lags; cutbacks proposed by the Trump administration do not bode well.

But even then, there is a lot of uncertainty. Growth rates *per capita* have varied greatly over the past 50 years, from between 2 and 3% a year in the decade(s) after World War II to 0.7% in the last decade. But perhaps there's been too much growth fetishism – especially when we think of the environmental costs, and even more so if that growth fails to bring much benefit to the vast majority of citizens.

There are many lessons to be learned as we reflect on the 2008 crisis, but the most important is that the challenge was – and remains – political, not economic: there is nothing that inherently prevents our economy from being run in a way that ensures full employment and shared prosperity. Secular stagnation was just an excuse for flawed economic policies. Unless and until the selfishness and myopia that define our politics – especially in the US under Trump and his Republican enablers – is overcome, an economy that serves the many, rather than the few, will remain an impossible dream. Even if GDP increases, the incomes of the majority of citizens will stagnate.

Setting the Record Straight on Secular Stagnation

Sep 3, 2018 | **LAWRENCE H. SUMMERS**

CAMBRIDGE – Joseph Stiglitz recently dismissed the relevance of secular stagnation to the American economy, and in the process attacked (without naming me) my work in the administrations of Presidents Bill Clinton and Barack Obama. I am not a disinterested observer, but this is not the first time that I find Stiglitz's policy commentary as weak as his academic theoretical work is strong.

Stiglitz echoes conservatives like John Taylor in suggesting that secular stagnation was a fatalistic doctrine invented to provide an excuse for poor economic performance during the Obama years. This is simply not right. The theory of secular stagnation, as advanced by Alvin Hansen and echoed by me, holds that, left to its own devices, the private economy may not find its way back to full employment following a sharp contraction, which makes public policy essential. I think this is what Stiglitz believes, so I don't understand his attacks.

In all of my accounts of secular stagnation, I stressed that it was an argument not for any kind of fatalism, but rather for policies to promote demand, especially through fiscal expansion. In 2012, Brad DeLong and I argued that fiscal expansion would likely pay for itself. I also highlighted the role of rising inequality in increasing saving and the role of structural changes toward the demassification of the economy in reducing demand.

What about the policy record? Stiglitz condemns the Obama administration's failure to implement a larger fiscal stimulus policy and suggests that this reflects a failure of economic understanding. He was a signatory to a November 19, 2008 letter also signed by noted progressives James K. Galbraith, Dean Baker, and Larry Mishel calling for a stimulus of $300-$400 billion – less than half of what the Obama administration proposed. So matters were less clear in prospect than in retrospect.

We on the Obama economic team believed that a stimulus of at least $800 billion – and likely more – was desirable, given the gravity of the economic situation. We were told by those on the new president's political team to generate as much validation as possible for a large stimulus because big numbers approaching $1 trillion would generate "sticker shock" in the political system. So we worked to encourage a variety of economists, including Stiglitz, to offer larger estimates of what was appropriate, as reflected in the briefing memo I prepared for Obama.

Despite the incoming president's popularity and an all-out political effort, the Recovery Act passed by the thinnest of margins, with doubts about its ultimate passage lingering until the last moment. I cannot see the basis for the argument that a substantially larger fiscal stimulus was feasible. And the effort to seek a much larger one certainly would have meant more delay at a time when the economy was collapsing – and could have led to the defeat of fiscal expansion. While I wish the political climate had been different, I think Obama made the right choices in approaching fiscal stimulus. It is of course also highly regrettable that after the initial Recovery Act, Congress refused to support a variety of Obama's proposals for infrastructure and targeted tax credits.

Unrelated to the topic of secular stagnation, Stiglitz takes a swipe at me by saying that Obama turned to "the same individuals bearing culpability for the under-regulation of the economy in its pre-crisis days" and expected them "to fix what they had helped break." I find this a bit rich. Under the auspices of the government-sponsored enterprise (GSE) Fannie Mae, Stiglitz published a paper in 2002 arguing that the chance that the mortgage lender's capital would be depleted was less than one in 500,000, and in 2009 he called for nationalization of the US banking system. So I would expect Stiglitz to be well aware that hindsight is clearer than foresight.

What about the Clinton administration record on financial regulation? With hindsight, it clearly would have been better if we had foreseen the need for legislation like the 2010 Dodd-Frank reforms and had a way to enact it with a Republican-controlled Congress. And certainly we did not foresee the financial crisis that came eight years after we left office. Nor did we anticipate the ways in which credit default swaps would mushroom after 2000. We did, however, advocate for GSE reform and for measures to rein in predatory lending, which, if enacted by Congress, would have done much to forestall the accumulation of risks before 2008.

I have not seen a convincing causal argument linking the repeal of the Glass-Steagall Act and the financial crisis. The observation that most of the institutions involved – Bear Stearns, Lehman Brothers, Fannie Mae, the GSE Freddie Mac, AIG, WaMu, and Wachovia – were not covered by Glass-Steagall calls into question its centrality. Yes, Citi and Bank of America were centrally involved, but the activities that generated major losses were fully permissible under Glass-Steagall. And, in important respects, the repeal of Glass-Steagall actually enabled the resolution of the crisis, by permitting the merger of Bear and JPMorgan Chase and by allowing the US Federal Reserve to open its discount window for Morgan Stanley and Goldman when they otherwise could have been sources of systemic risk.

The other principal attack on the Clinton administration's record targets the deregulation of derivatives in 2000. With the benefit of hindsight, I wish we had not supported this legislation. But, given the extreme deregulatory approach of President George W. Bush's administration, it defies belief to suggest that it would have created major new rules regarding derivatives but for the 2000 act; so I am not sure how consequential our decisions were. It is also important to recall that we pursued the 2000 legislation not because we wanted to deregulate for its own sake, but rather to remove what the career lawyers at the US Treasury, the Fed, and the Securities and Exchange Commission saw as systemic risk arising from legal uncertainty surrounding derivatives contracts.

More important than litigating the past is thinking about the future. Even if we disagree about past political judgements and about the use of the term "secular stagnation," I am glad that an eminent theorist like Stiglitz agrees with what I intended to emphasize in resurrecting that theory: We cannot rely on interest-rate policies to ensure full employment. We must think hard about fiscal policies and structural measures to support sustained and adequate aggregate demand.

Beyond Secular Stagnation

Sep 5, 2018 | **JOSEPH E. STIGLITZ**

NEW YORK – As Larry Summers rightly points out, the term "secular stagnation" became popular as World War II was drawing to a close. Alvin Hansen (and many others) worried that, without the stimulation provided by the war, the economy would return to recession or depression. There was, it seemed, a fundamental malady.

But it didn't happen. How did Hansen and others get it so wrong? Like some modern-day secular stagnation advocates, there were deep flaws in the underlying micro- and macroeconomic analysis – most importantly, in the analysis of the causes of the Great Depression itself.

As Bruce Greenwald and I (with our co-authors) have argued, high growth in agricultural productivity (combined with high global production) drove down crop prices – in some cases by 75% – in the first three years of the Depression alone. Incomes in the country's major economic sector plummeted by around half. The crisis in agriculture led to a decrease in demand for urban goods and thus to an economy-wide downturn.

WWII, however, provided more than just a fiscal stimulus; it brought about a structural transformation, as the war effort moved large numbers of people from rural areas to urban centers and retrained them with the skills needed for a manufacturing economy, a process which continued with the GI bill. Moreover, the way the war was funded left households with strong balance sheets and pent-up demand once peace returned.

An analogous structural transformation, this time not from agriculture to manufacturing, but from manufacturing-led growth to services-led growth, compounded by the need to adjust to globalization, marked the economy in the years before the 2008 crisis. But this time, mismanagement of the financial sector had loaded huge debts onto households. This time, unlike the end of the WWII, there was cause for worry.

As Summers well knows, I published a widely cited commentary in *The New York Times* on November 29, 2008, entitled "A $1 Trillion Answer." In it, I called for a much stronger stimulus package than the one President Barack Obama eventually proposed. And that was in November.

By January and February 2009, it was clear that the downturn was greater and a larger stimulus was needed. In that *Times* commentary, and later more extensively in my book *Freefall*, I pointed out that the size of the stimulus that was needed would depend both on its design and economic conditions. If the banks couldn't be induced to restore lending, or if states cut back their own spending, more would be required.

Indeed, I publicly advocated linking stimulus spending to such contingencies – creating an automatic stabilizer. As it turned out, the banks weren't forced to expand lending to small and medium-size businesses; they cut it drastically. States, too, slashed spending. Obviously, an even larger stimulus in dollar terms would be needed if it was poorly designed, with large parts frittered away in less cost-effective tax cuts, which is what happened.

It should be clear, though, that there is nothing natural or inevitable about secular stagnation in the level of aggregate demand at zero interest rates. In 2008, demand was also depressed by the huge increases in inequality that had occurred over the preceding quarter-century. Mismanaged globalization and financialization, as well as tax cuts for the rich – including the cut in capital-gains tax (overwhelmingly benefiting those at the very top) during the Clinton and Bush administrations – were major causes of accelerating concentration of income and wealth.

Inadequate financial regulation left Americans vulnerable to predatory banking behavior and saddled with enormous debts. There were thus other ways of increasing aggregate demand besides fiscal stimulus: doing more to induce lending, to help homeowners, to restructure mortgage debt, and to redress existing inequalities.

Policies are always conceived and enacted under uncertainty. But some things are more predictable than others. As Summers again knows full well, when Peter Orszag, the head of the Office of Management and Budget at the beginning of Obama's first administration, and I analyzed the risks of mortgage lender Fannie Mae in 2002, we said that its lending practices *at that time* were safe. We did not say that no matter what it did, there was no risk.

And what Fannie Mae did later in the decade mattered very much. It changed its lending practices to resemble more closely those of the private sector, with predictable consequences. (Even then, notwithstanding the right-wing canard blaming Fannie Mae and the other government-sponsored lender, Freddie Mac, it was private-sector lending, especially by the big banks, that underlay the financial crisis.)

But what was predictable and predicted was the manner in which under-regulated derivatives could inflame the crisis. The Financial Crisis Inquiry Commission put the blame squarely on the derivatives market as one of the three central factors driving the events of late 2008 and 2009. Earlier in President Bill Clinton's administration, we had discussed the dangers of these fast-multiplying and risky financial products. They should have been reined in, but the Commodity Futures Modernization Act of 2000 prevented the regulation of derivatives.

There is no reason economists should agree about what is politically possible. What they can and should agree about is what would have happened if…

Here are the essentials: We would have had a stronger recovery if we had had a bigger and better-designed stimulus. We would have had stronger aggregate demand if we had done more to address inequality, and if we had not pursued policies that increased it. And we would have had a more stable financial sector if we had regulated it better.

These are the lessons that we should keep in mind as we prepare for the next economic downturn.

Final Thoughts on Secular Stagnation

Sep 6, 2018 | **LAWRENCE H. SUMMERS**

CAMBRIDGE – Joseph Stiglitz, Roger Farmer, and I are now and have long been in agreement on what are probably the most important points. The "New Keynesian" paradigm that sees business cycles as arising from temporary rigidities in wages and prices is insufficient to account for events like the Great Depression and the Great Recession. Too little was done in the aftermath of the financial crisis a decade ago to stimulate aggregate demand. A more equal income distribution operates to increase aggregate demand. Substantially stronger financial regulation than was in place before 2008 needs to be adopted to minimize the risks of future crises.

I continue to have disagreements with Stiglitz on the record of policy advice, and with both Stiglitz and Farmer on some points of theory regarding secular stagnation.

Starting with the policy record, Stiglitz is right to assert that economists should not be expected to agree on issues of political feasibility. They should, however, be able to agree on what texts say. *The New York Times* commentary that Stiglitz proudly cites calls for a stimulus of "at least $600 billion to $1 trillion over two years." The Obama administration called for and received stimulus totaling some $800 billion, a figure well within Stiglitz's range, despite being politically constrained by the necessity of Congressional approval. So I'm not sure what he is claiming.

Stiglitz asserts that the study Fannie Mae hired him to write in 2002 said only that its lending practices at that time were safe. That is not how I read it. It speaks to ten-year default probabilities of less than one in 500,000; notes that even if the analysis is off by an order of magnitude, any risks to government are very modest; and appeals to the regulatory system in place at the time to minimize that their model missed risks. He makes arguments against the Congressional Budget Office, the Department of the Treasury, and the Federal Reserve, all of which had suggested – based on the same information available to Stiglitz when he wrote his paper – that implicit guarantees to Fannie Mae were potentially costly.

I am not sure what point Joe is making with respect to derivatives. I was clear in my article to which he is responding that I wish we had not supported the 2000 legislation. But I also noted that there is no reason to think that, in the absence of the legislation, the Commodity Futures Trading Commission under the Bush administration would have asserted sweeping new authority over derivatives and pointed to the legal certainty problem that career lawyers thought was important to address.

What about secular stagnation theory? Stiglitz and I agree that Alvin Hansen's prediction was not borne out after World War II because of a combination of expansionary policy and structural changes in the economy. This was my point five years ago in renewing the idea of secular stagnation – to suggest that the economy as it was in 2013 required some combination of fiscal expansion and structural change to sustain full employment. My discussions of secular stagnation have all emphasized a variety of structural factors, including inequality, high profit shares, changes in relative prices, and global saving patterns. Where does Stiglitz disagree?

Farmer, in his thoughtful commentary, argues that models of the type he has pioneered in recent years are the right way to think about chronically excessive unemployment and that, with the right microfoundations, one can conclude that fiscal policies are ineffective. I think his modeling approach may well prove very fruitful, and I wish I understood it better. But, for now, I find the empirical evidence, international comparisons, time-series studies, and studies of local variation within the United States compelling in suggesting that fiscal policy works. I do think, however, that Farmer's views on the use of monetary policy to stabilize asset prices deserve serious consideration.

Finally, I hope Stiglitz will respond positively to my repeated suggestions that we debate these matters in person at Columbia or Harvard or some other suitable venue. We can all agree that the stakes in a better understanding of the lessons of macroeconomic history, and in avoiding future events like those of the last decade, are very high.

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JOSEPH E. STIGLITZ

Joseph E. Stiglitz, a Nobel laureate in economics and University Professor at Columbia University, is a former chief economist of the World Bank (1997-2000) and chair of the US President's Council of Economic Advisers, was lead author of the 1995 IPCC Climate Assessment, and co-chaired the international High-Level Commission on Carbon Prices.

LAWRENCE H. SUMMERS

Lawrence H. Summers, US Secretary of the Treasury (1999-2001) and Director of the US National Economic Council (2009-2010), is a former president of Harvard University, where he is currently University Professor.

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