Ahead of the midterm elections, Steve Fazzari explores the current state of the economy and explains why widely cited unemployment and growth numbers don’t give a full picture.

Transcript:
Claire Gauen (host): Thanks for listening to Hold That Thought. I’m Claire Gauen.
Midterm elections are right around the corner. This election cycle, there are many issues that voters care deeply about – one of which is, of course, the economy. According to most news outlets in recent days, the economy is doing well. But how good is the US economy, really? To answer that question, I turned to economist Steve Fazzari.

Steve Fazzari (guest): I am Steve Fazzari, a professor of economics, chair of the Department of Sociology, associate director of the Weidenbaum center.

CG: The Weidenbaum Center at WashU supports research related to the economy, government, and public policy. Fazzari recently gave a talk for the center that inspired this episode. So let’s start with the basics. When most of us think about the health of the economy, we’re really thinking about jobs and employment. What’s the story with jobs right now?

SF: If you look at the unemployment rate, it is now at the lowest level it has been since the 1960s.

CG: As of September, that’s 3.7%. Historically speaking, a really good number.

SF: Most economists say that this number, below 4 percent, is a very good number. I think the expectation is that it’s not going to go a whole lot lower than that. Maybe it will, but if it didn’t, I think people still think this is an economy that would be operating roughly at full employment.

CG: So far, so good. So, let’s zoom out to the bigger picture. What about GDP? How quickly is the economy growing?

SF: Those numbers have been good. The second quarter number of 2018, which is the most recent one we have now, was 4.2%. So it actually grew by a little over 1 percent, but we’ve basically multiplied by four to get the annualized rate.

CG: Again, so far so good!

SF: It looks pretty good by those by those measures.

CG: So what does all this have to do with politics? Ahead of the upcoming election, Republican candidates and their supporters have been pointing to these numbers as signs of a job well done by the current administration. President Trump himself often makes this claim.
SF: The president is claiming that the economy is maybe the best it’s ever been, and that his policies deserve credit.

CG: These claims are not entirely accurate, Fazzari says, but they’re also not super surprising.

SF: Presidents always take credit for good economic news, whether their actual policies are responsible for this or not. My own opinion is that, overall, presidents take more credit than they deserve and are saddled with more blame than they deserve for economic performance.

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CG: Still, for the most part, there seems to be a general consensus out there that the economy is doing well and that the current administration is at least in part responsible.

SF: Saying that, well, the economy was on a pretty good path before the president took office, and it’s continued on that path, but the president deserves credit for the recent good economic news.

CG: So, with more or less enthusiasm, everyone seems to be generally on the same page. So, does the conversation stop there? Not quite. According to Fazzari, this accepted narrative misses something. Something important.

SF: What this perspective misses is that we lost a lot in the Great Recession.

CG: The great recession. It’s been more than 10 years since the beginning of the financial crisis, but according to Fazzari, no current economic picture is complete without that context. The great recession was historic, the biggest downturn in the US economy since
the 1930s. What happened beginning in 2007 was simply not like other economic downturns the country has experienced.

SF: So usually, or at least when looking at past experience in recent decades, you'd think, 'OK this is bad, but we should snap back. We should pop back to the trend we were on, or close to it, before.' That's basically what has happened in the last few recessions. It has not happened in the aftermath of the Great Recession.

CG: Imagine the US economy is a car. It’s a sort of silly analogy, but bear with me for a minute. Before 2007, we were cruising along, feeling good, the wind in our hair. During the financial crisis, the car screeched to a halt. Right now it feels like we’re cruising again, but we still haven’t caught up to where we would have been without that unexpected stop.

SF: By various measures, you could say that we are seeing an economy that's operating 10 to maybe even close to 15 percent below the trend that had been established before the Great Recession. So in that sense, the economy has never fully recovered. That was certainly true in the Obama years - most of that time was when Obama was president - but nothing much has changed in the Trump years, as well. So this idea of somehow the greatest economy ever? Well, the numbers are good in terms of current unemployment and current growth rates, but we still lost that trend.

CG: Ten to fifteen percent of the US economy seems like a sort of nebulous idea, but in real dollars and cents, it's enormous.

SF: This is a lot. I mean this is probably approaching, depending on your estimates, two trillion dollars. 10 percent of a 20 trillion-dollar economy. This is thousands and thousands of dollars for the average American household. So this a big deal.

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CG: So here we are, trillions of dollars behind where we would have been had the recession not happened. The question now becomes, is it even possible to catch up?

SF: I think it is, but not instantaneously.

CG: But how? Well, in order to fix a problem, you need to understand what caused the problem. So let's go back in time. What happened? What caused the great recession? That may seem like a huge question in itself to tackle, but according to Fazzari, there's actually a pretty quick way to sum it up.

SF: Well, I think there's a pretty obvious answer. Households were borrowing like crazy prior to the recession. Really, going from my point of view back to the late 1970s - certainly by the mid 1980s - household borrowing and debt-to-income ratio started to rise. It got extreme in the late 1990s and the early 2000s. When the financial crisis hit, they lost that. The borrowing was shut down almost immediately, and there was a massive "deleveraging," we say, of the household sector, with defaults and borrowing dropping dramatically. So if people can't borrow as much money, they can't spend as much money. That to me is the obvious direct cause of the Great Recession.

CG: To this day, Fazzari argues, household spending hasn't recovered. He's looked into this in his own work.

SF: Our research is measuring what we call household demand, where we're trying to really focus in on the actual cash spending of the household sector. That's anything that a household will basically write a check for or use a credit card to pay for.

CG: Everything from new house construction to, well, everything.

SF: Cars, and washing machines, and meals out, and buying the kid's school supplies, and just everything, in that sense. It's that broad measure that is way below the trend that was established before the Great Recession.

CG: By this broad measure, US households simply don't spend what they used to. The result, Fazzari says, is an economy that is in reality more stagnant than it appears.

SF: Household spending - the demand from the household sector, which is by far the biggest part of the economy - is still way below the trend that it was following prior to the Great Recession. So we've lost that demand. I think we could stimulate our economy more if we if we were able to regain some of that trend of household spending.
CG: But how? How do you get more people to buy more things? And, how might a government help make this happen?

SF: A large tax cut could help do that. But the tax cut would have to be targeted towards the middle-income and lower-income households who actually recycle most of that back into spending. Higher income households probably still would spend some, but in some ways the least effective tax cut from that point of view is a corporate tax cut.

CG: Here’s where we get back to the policy and politics side of the discussion. Earlier this year, President Trump and his republican colleagues passed sweeping tax cuts in an effort, they claimed, to further stimulate the economy. But according to Fazzari, those cuts were skewed to mostly benefit corporations. Corporations are an important part of the economy, but they don’t directly affect household demand.

SF: Corporations are not likely to go to the grocery store.

CG: Instead of creating demand, Fazzari explains, Trump’s tax policy focuses more on stimulating the supply side of the economy.

SF: The idea is that they would use this extra money, or take this incentive, as a way to say, ‘Well now if we invest in new plants and equipment, the profits from those activities will be taxed at a lower rate. So this gives us more incentive to expand our productive capacity, to increase the supply side of the economy.’

CG: President Trump claims that the economy is booming, and that his policies, in particular the tax cut, deserve credit. But think about the supply-side process that Fazzari just explained, and also the fact that these tax cuts have been in place for less than a year. Something doesn’t add up.

SF: So how long does it take from the time that these tax cuts are passed for businesses to plan this new plant and equipment spending, to actually make the orders, to get the get the new material - it might even be mean building new factories - incorporate that into their productive processes, get their employees trained on the new equipment, and then start to see him get higher output. Well, it’s probably more than a couple of months.

CG: In other words, if the tax cuts work as they were designed to work, we wouldn’t see the effects yet.

SF: It really is too soon to see those supply-side factors. Many economists, including me, are somewhat skeptical that this effect is going to be all that large. But the jury has to be out on that for a few years before we can start to really try to assess the independent effect
of these tax cuts on business investment - which let me tell you it was a difficult thing to do, anyway. Certainly very difficult to do in just a few months.

CG: All that said, according to Fazzari it is possible that these tax cuts are already affecting the economy. While the majority of the benefits go to corporations, middle-class Americans have seen a slight reduction in their taxes. And unlike a corporation, if a person has a little more money in their paycheck, they might go spend that money that week. You can see the effects almost immediately.

SF: You're seeing middle-income families on average getting probably 500 to 1000 dollars at an annual rate in these tax cuts. So, you could get some kick to consumption from this. The interesting thing, though, is that if that happens it's likely temporary. It's also not the argument that was used to pass the tax cuts. In fact if you wanted to stimulate consumer spending, you would have had a very different structure of tax cuts - one that would be much more weighted towards lower- and middle-income people who are going to spend much more of this.

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CG: We started this episode out with a question: How good is the US economy, really? So, are we any closer to answering that question?

SF: My summary of how good the U.S. economy is doing, really, is a little bit nuanced, which makes it a little harder to get across in terms of the typical sound bite. So in a narrow sense - this month, this quarter - it's doing pretty well. About as well as it was
doing two years ago. What is also more of the same, though, is that is that we haven’t regained that trend that we lost in the Great Recession. So despite the fact that today’s economy looks pretty good by standard measures, if you look over a somewhat longer horizon to put this more in historical context, I think you see a stagnation that helps explain the actual frustration that has led to some of the political upheavals we've seen in the last years.

CG: So, the answer to “How Good is the US Economy” seems to be something along the lines of: It’s doing well, but not as well as you think, and not for the reasons you might expect. It’s an imprecise and sort of dissatisfying answer, but an important one to understand – especially as you head into the voting booth.

SF: To me the biggest political message to take away from this whole analysis of the last 10 years plus is that the claim that somehow the economy is doing dramatically better, and that’s a reason to support the direction of the Trump administration - there’s really no support for that. If people were making the argument that Trump has ruined the economy, I would push back against that as well. We're basically looking at the same old thing. Like I said, 2016 versus 2018 looks looks very similar, in terms of the economy. To the extent that the big problem of the last decade was the lost trend from the Great Recession that we never got back to, there's nothing in the cards that suggests that the Trump policies are going to do very much along those lines.

CG: Thank you to Steve Fazzari for joining Hold That Thought. For many more ideas to explore, you can find us at holdthatthought.wustl.edu, apple podcasts, Stitcher, PRX, and more. On the off chance that this talk of elections is making you feel nostalgic, be sure to revisit our 2016 election episodes, including “The Hidden History of Trumpism” and “How to Forecast an Election.” Don’t forget to vote on November 6th, and as always, thank you for listening.

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