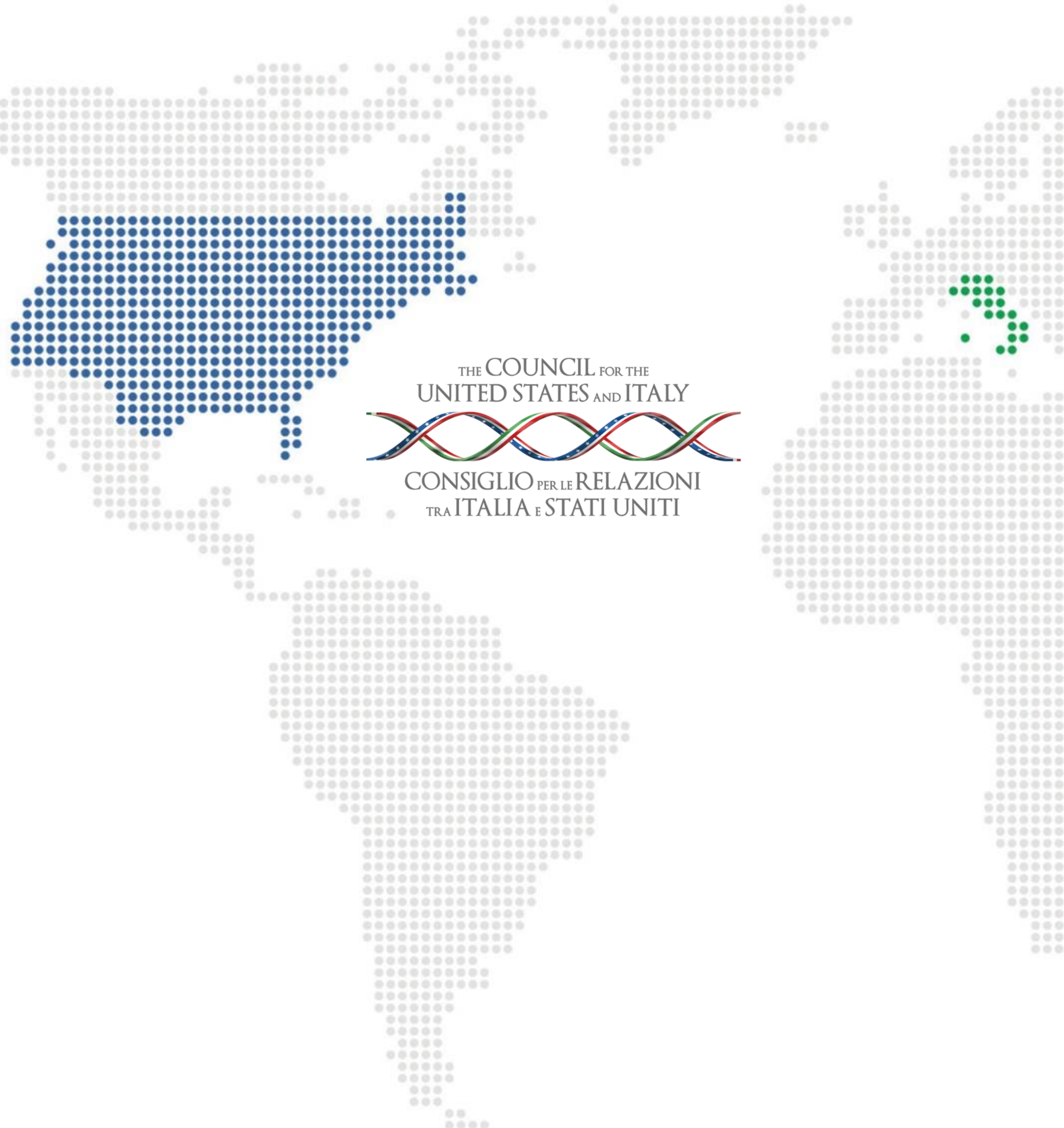
August 2020 - II



THE COUNCIL FOR THE UNITED STATES AND ITALY

CONSIGLIO PER LE RELAZIONI TRA ITALIA E STATI UNITI

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"Poverty as Injustice?"

(Project Syndicate, August 28, 2020)

Edmund S. Phelps, *Edmund S. Phelps, the 2006 Nobel laureate in economics and Director of the Center on Capitalism and Society at Columbia University, is author of Mass Flourishing and co-author of Dynamism.*

Across Western advanced economies, a widespread sense of malaise has given rise to a debate about what the state can and should do to ensure economic justice, particularly for those at the bottom of the income ladder. As always, the fundamental question is whether public policies would help or hamper growth and dynamism.

NEW YORK – In much of the world, there is concern over abysmal wages for the less advantaged and the many victims of racial and gender discrimination. Though tax credits for low-income single mothers provide support and contribute to the development of their children, there are still signs of poverty among working people: malnourishment, poor health, and substance abuse.

Less appreciated is that many low-wage workers often must pass up meaningful work because it pays too little. And without a "good job," these workers cannot have "the good life." Such outcomes, particularly in advanced economies, are grim signs that something is wrong: the problem is not "inequality," but a high degree of injustice.

Wide swaths of society are deeply frustrated with the downward trend in the rewards of work and enterprise. Since the 1970s, there has been a general decline in job satisfaction and a virtual cessation of real-wage growth in the United States, and later in the United Kingdom, France, and perhaps parts of Germany and some other countries. Moreover, real interest rates have sunk nearly to the vanishing point. Underlying this is a decline in innovation. Clearly, some fault in the mechanism of human satisfaction has not been adequately addressed.

While Western societies work to ensure economic justice, it is essential that they restore and preserve a widespread experience of the good life. That means providing for meaningful work such as that in enterprise capitalism, in which participants allocate their accumulated wealth and developed abilities to establish various industries and invest in various projects. To do this, countries have raised and educated people who can exercise their creativity by conceiving new commercial methods and products – and also people who are wise and brave enough to take a chance on backing innovation.

At the same time, a debate about economic justice is emerging. Voices in the Democratic Party, including presidential nominee Joe Biden, have raised expectations that, if elected, they will address the injustices decried at their recent convention. In contrast, Republicans – as far back as Ronald Reagan and, on occasion, Donald Trump – have argued that measures aimed at reducing inequality come at the price of economic growth.

They have in mind the large-scale US programs to raise incomes among the working poor over the past several decades, beginning with the "Great Society," launched by Lyndon Johnson's administration in the 1960s, and the Earned Income Tax Credit in the 1970s. Also, as recently noted, Democrats legislated "Medicare, food stamps, Head Start, and a host of other programs that helped whites and minorities alike." Has all this slowed growth?

It does appear that productivity growth – more precisely, total factor productivity, and ultimately labor productivity – slowed just after this legislation was enacted, and, apart from the peak years of the Internet revolution, remained subdued. Yet, as the old saying goes, "correlation is not causation."

My contrary thesis, which has been argued at length and now tested extensively, is that the great productivity slowdown was really caused by a major loss of people still keen on devising new commercial products and methods, and not by the Great Society. Certainly, it is implausible that those helped by the Great Society are to blame. In any case, there do not appear to be any econometric studies showing that countries that aid the disadvantaged more have less growth.

There is also a worry on another score: call it the "fiscal capacity charge." Some economists and businesspeople fear that boosting already high tax rates in the hope of raising the money needed for substantial poverty reduction would fail to collect much more revenue. Revenue might even be lost as taxpayers cut back their supply of labor and companies lose interest in increasing their efficiency. Yet there is not a shred of academic evidence showing that Western economies – and certainly not the low-tax US economy – have reached the limits of their fiscal capacity.

The US (and other Western governments to varying degrees) therefore has enough room to attack economic injustice. To bring low-paid workers' wages to an acceptable level, the state will want to institute a schedule of subsidies to pull up most strongly the wage rates of those at the bottom. The schedule would then set progressively lower subsidies for each ascending wage bracket.

Much of the attention now paid to economic injustice derives from A Theory of Justice, philosopher John Rawls's landmark work of nearly 50 years ago. Remarkably, Rawls argued that justice requires pulling up the pay of the lowest paid to the maximum – which would entail taxing to capacity. (I soon thereafter built a model of Rawlsian taxation in a 1974 paper.) Of course, a theory abstracts from much, and Rawls focused on poverty from all sources. My hope today is to work for an economy that is both inclusive and just.

While it is important to know the way out of poverty, it is equally important to know the way not to go. We must oppose a universal basic income – a lamentable use of public revenue that would be better directed toward increasing low-wage workers' income to a level enabling them to support themselves, which is essential for self-esteem. But a UBI would also draw (or keep) people and their children away from work, which is for many the only available avenue to personal fulfillment and to satisfying involvement in the world.

"AMERICA'S COMING DOUBLE DIP"

(Project Syndicate, Aug 25, 2020)

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Soaring financial markets are blithely indifferent to lingering vulnerabilities in the US economy. But the impact of consumers' fear of COVID-19 on pandemic-sensitive services are unlikely to subside, undermining the case for the uninterrupted recovery that investors seem to expect.

NEW HAVEN – The double dip is not a dance. It is the time-honored tendency of the US economy to relapse into recession after a temporary recovery. Over the years, it has happened far more often than not. Notwithstanding frothy financial markets, which currently are discounting the nirvana of an uninterrupted V-shaped recovery, there is a compelling case for another double dip in the aftermath of America's devastating COVID-19 shock.

The daunting history of the US business cycle warns against complacency. Double dips – defined simply as a decline in quarterly real GDP following a temporary rebound – have occurred in eight of the 11 recessions since the end of World War II. The only exceptions were the recessions of 1953-54, the brief contraction of 1980, and the mild downturn of 1990-91. All the others contained double dips, and two featured triple dips – two false starts followed by relapses.

The double-dip does not, of course, come out of thin air. It reflects the combination of lingering vulnerability in the underlying economy and aftershocks from the initial recessionary blow. As a general rule, the more severe the downturn, the greater the damage, the longer the healing, and the higher the likelihood of a double dip. That was the case in the sharp recessions of 1957-58, 1973-75, and 1981-82, as well as in the major contraction that accompanied the 2008-09 global financial crisis.

The current recession is a classic set-up for a double dip. Lingering vulnerability is hardly a question in the aftermath of the 32.9% annualized plunge in the second quarter of 2020 – by far the sharpest quarterly decline on record. Damaged as never before by the unprecedented lockdown to combat the initial outbreak of COVID-19, the economy has barely begun to heal. A sharp rebound in the current quarter is simple arithmetic –and virtually guaranteed by the partial re-opening of shuttered businesses. But will it stick, or will there be a relapse?

Financial markets aren't the least bit worried about a relapse, owing largely to unprecedented monetary easing, which has evoked the time-honored maxim: "don't fight the Fed." Added comfort comes from equally unprecedented fiscal relief aimed at mitigating the pandemic-related shock to businesses and households.

This could be wishful thinking. The basic problem is the virus, not the need for Fed-induced liquidity injections or the temporary support of a fiscal package. Monetary and fiscal measures can temper financial markets' distress, but they can do little, if anything, to resolve the underlying health security issues weighing on the real economy.

With the US remaining in the grips of the pandemic, the case for sustainable recovery looks tenuous. While rebounds in production and employment underscore significant progress on the supply side of the economy, these gains are far from complete. Through July, nonfarm employment has recouped only 42% of what was lost in February and March, and the unemployment rate, at 10.2%, is still nearly triple the pre-COVID level of 3.5%. Similarly, industrial production in July remained 8% below its February high.

Healing has been even more tentative on the demand side. That is especially the case for key components of discretionary consumption – notably, retail shopping, as well as spending on restaurants, travel, and leisure. Full participation in these activities – all of which entail face-to-face human contact – implies health risks that most of the population is unwilling to take, especially given elevated infections, the lack of robust therapeutics, and the absence of a vaccine.

To put the pandemic's impact in perspective, consider that transportation, recreation, restaurants, and accommodations – the most COVID-sensitive segments of consumer demand – accounted for 21% of total household expenditures on services in the first quarter of 2020, before the pandemic hit full force. Combined spending on these categories plunged at an 86% annual rate in real (inflation-adjusted) terms in the second quarter.

The monthly data through June underscore the lingering headwinds from these important segments of discretionary consumption. While combined consumer spending on durables and nondurables bounced back to 4.6% above pre-pandemic levels (in real terms), household spending on total services – by far, the largest component of total consumption – has recouped only 43% of its lockdown-induced losses.

On balance, this points to what can be called an asynchronous normalization – a partial recovery that is drawing greater support from the supply side than from the demand side. The US is hardly unique in this respect. Similar outcomes are evident in other economies – even China, whose state-directed system is much more effective at command and control of the supply side than it is in influencing the behavioral norms shaping pandemic-sensitive household consumption on the demand side.

But the asynchronous normalization of the US economy is very different in one key respect: America's abysmal failure at containing the virus not only underscores the lingering fears of infection, but also raises the distinct possibility of a new wave of COVID-19 itself. While there has been a reduction in the incidence of new cases over the past month, the daily infection count of nearly 48,000 in the week ending August 20 is more than double the pace recorded in May and June.

Together with a death rate that has averaged a little more than 1,000 per day since late July – and projected to remain at that level for the rest of the year – this elevated pace of infection takes on even greater importance as a predictor of what lies ahead. Consumer fears – and their impact on pandemic-sensitive services – are unlikely to subside in such a climate and could well intensify if a new wave hits.

Therein lies the case for a double dip. Partial and asynchronous normalization in the aftermath of the worst economic shock on record signals lingering vulnerability in the US economy. And failure to contain the virus underscores the distinct possibility of aftershocks. This is precisely the combination that has led to previous double dips. Yet frothy financial markets are wedded to the narrative of a classic V-shaped recovery. The rhymes of history suggest a very different outcome.

ABOUT THE COUNCIL FOR THE UNITED STATES AND ITALY

The Council for the United States and Italy is a private non-profit organization, founded in Venice in 1983 by Gianni Agnelli and David Rockefeller, who served as honorary presidents until 2003. Marco Tronchetti Provera followed them as Chairman, then Sergio Marchionne until 2018. Domenico Siniscalco is the current Chairman, Gianni Riotta Executive Vice Chairman. The Council for the United States and Italy promotes and creates economic relations between Italy and the United States, linking them to Europe, Asia and Africa through knowledge and free trade. Its members are leaders in the economy, industry, finance, technology, services, consulting, law and culture - a team in which economic growth is viewed as promoting humanity and wealth as a cultural value to be shared.