

Econ 113: April 7, 2015

Reposted version with updated graphs

- About the Term Paper
- Post-World War II Macro
 - Trends
 - Policy
- 20th/21st Century Inequality Patterns
- Activity: Connecting Inequality & Macro

*Term Paper due Thursday April 16
Last Class is Thursday April 30*

Government Growth Deficits and Debt Social Security & Medicare

Term Paper: Article Databases

- Start from [Econ 113 homepage](#)
 - Go to Librarian Jim Church's [page for Economics](#)
 - Then to 'articles & working papers' tab
 - Or his page for [Economic History](#)
 - Section labeled 'Organizations, Search Engines, and Reference Sources'
 - Go to [EconLit](#)
- Search tips
 - Often want to check box: Peer-Reviewed
 - Make use of subject codes in subsequent searches
 - Sometimes 'cited by' links are helpful (also in google scholar)

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Post-World War II Macro

- Overview
 - What has happened in the macroeconomy since ~1950?
 - Mix of expenditure: C I G EX IM
 - Mix: goods vs services
 - Business cycles: Recessions & recoveries
 - Macro policy since ~1950
 - Fiscal and Monetary Policy
 - Successes, Challenges, Failures, Conundrums

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Thinking About Macro Theory

- Macro traditionally, "the economy as a whole"
 - Very much dictated by Keynesian approach
- Any theory (model) must be true to what is (facts)
- Hold in your mind that tension between theory and facts

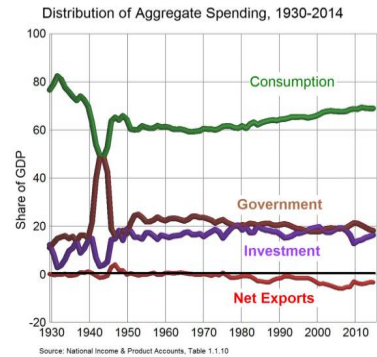
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How describe US macroeconomy ~1930?

- Mix of C, I, G, NX
- Mix of goods & services
- Policy making institutions
 - Monetary policy
 - Fiscal policy

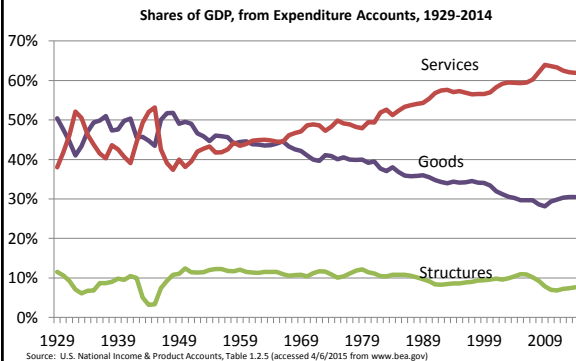
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Mix of expenditure



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Mix of goods & services



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Policy Making Institutions, c. 1930

- Monetary policy
 - Each Fed Bank conducted independent policy
 - NY Fed was strong leader in 1920s
 - (That's a bad pun...NY Fed President was named Benjamin Strong)
 - Federal Open Market Committee (FOMC) created in 1933, strengthened in 1935, amended in 1942 to current structure
 - 12 voting members: the 7 Federal Reserve Board members, the NY Fed President, and 4 of the other Fed Bank Presidents in 1-year rotations
 - Today the Board's mission includes the macroeconomy, but in 1930 it did not
 - Today: "The mission of the Board is to foster the stability, integrity, and efficiency of the nation's monetary, financial, and payment systems so as to *promote optimal macroeconomic performance.*"

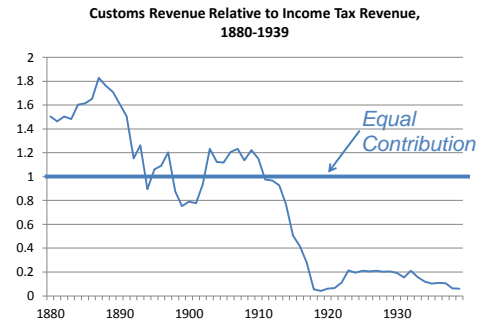
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Fiscal Policy

- Fiscal policy ~1930
 - Federal government did not see its role as saving economy
- Before 1913
 - Tariffs primary revenue source
 - 1913: Constitutional Amendment allowing federal income tax
 - Tension between federal and state rights & power
 - Land grants for colleges & universities
 - Land grants for railroad development
 - No central bank 1836 – 1913

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1913 Income Tax Makes a Difference



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New perception of government role

- After Great Depression
 - New Deal Regulations
 - Unregulated economy pre-1929 seemed to run amuck
 - Social Security Act
 - Tax assessed starting 1937; benefits paid starting 1942
 - Full Employment Act of 1946
 - Congress gives itself responsibility for ensuring high employment

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Important Differences Between the Bill and the Act

The following summarizes some of the more important differences between the Full Employment Bill as reported by the Banking and Currency Com-

mittee and the Employment Act of 1946 that was approved on February 20, 1946. Italics are added to emphasize deletions or changes in wording.

The 1945 Bill

Section 1
"This Act may be cited as the *Full Employment Act of 1945.*"

Section 2

- b) "All Americans ... *are entitled to an opportunity for useful, remunerative, regular, and full-time employment.*"
 c) "In order to assure the free exercise of the right to an opportunity for employment ... *the Federal Government has the responsibility to assure continuing full employment, that is, the existence at all times of sufficient employment opportunities for all Americans.*"
 d) "To that end the Federal Government shall, ... *provide such volume of Federal investment and expenditure as may be needed, ... to assure continuing full employment.*"

Section 3

"The President shall transmit to Congress ... a general program, pursuant to section 2, *for assuring continuing full employment.*"

The 1946 Act

Section 1
"This Act may be cited as the *Employment Act of 1946.*"

Section 2

"The Congress hereby declares that it is the continuing *policy* and responsibility of the Federal Government ... *to promote maximum employment, production, and purchasing power.*"

Section 3

"The President shall transmit to the Congress ... a program for carrying out the policy declared in section 2."

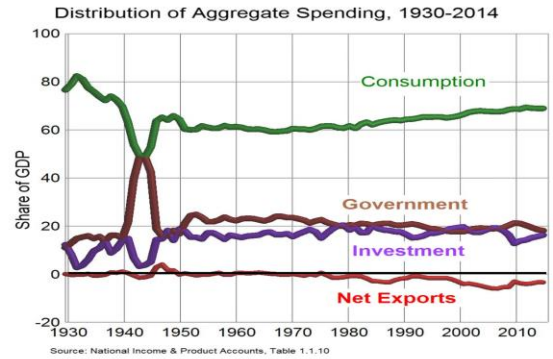
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“Policy” begins after WWII

- There was no “federal monetary policy” before 1935 or so
- There was no “federal fiscal policy” before 1933
- There was no consensus that policy was called for until after WWII
- There arose a debate over “which” policy was “best” and “should be used”
 - Implicit assumption: a lack of coordination between fiscal & monetary policies
- Macro theory evolved with policy efforts, policy mistakes, and actual events

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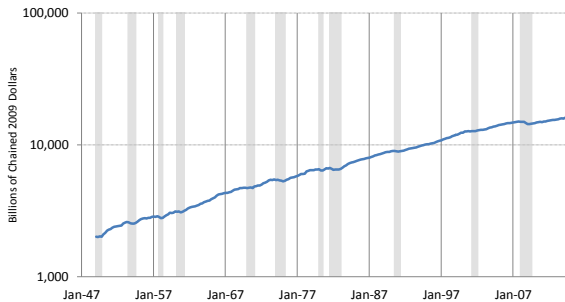
Mix of expenditure



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Post-WWII Macro Trends

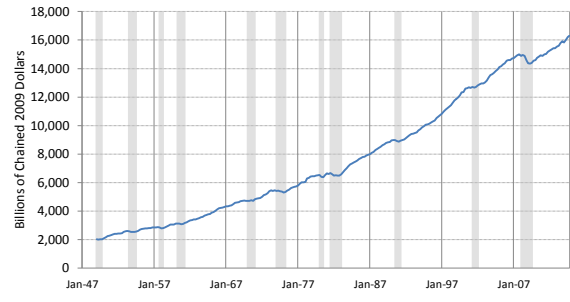
Real Gross Domestic Product, 1949-2015



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Linear (non-log) scale

Real Gross Domestic Product, 1949-2015



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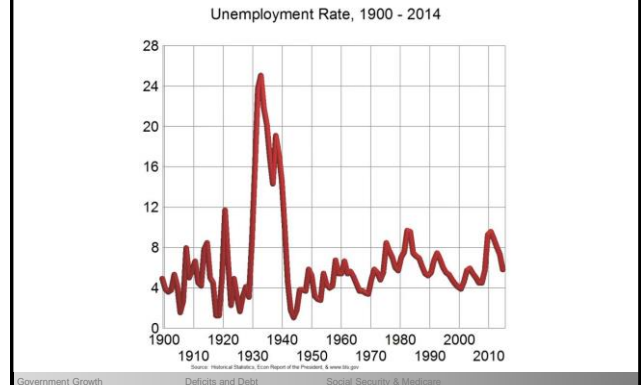
Recessions, 10 or 11 since 1949

www.nber.org/cycles/cyclemain.html

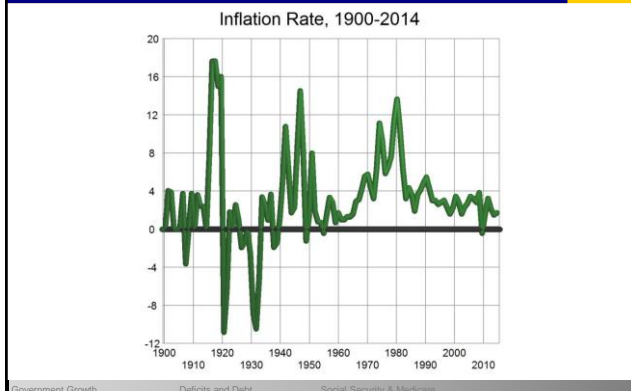
| Peak | Trough | Contraction | Expansion | Cycle | |
|------------------------------------|--------------------|----------------|------------------------------|-----------------------------|-------------------------|
| Quarterly dates are in parentheses | | | | | |
| | | Peak to Trough | Previous trough to this peak | Trough from Previous Trough | Peak from Previous Peak |
| November 1948(IV) | October 1949 (IV) | 11 | 37 | 48 | 45 |
| July 1953(II) | May 1954 (II) | 10 | 45 | 55 | 56 |
| August 1957(III) | April 1958 (II) | 8 | 39 | 47 | 49 |
| April 1960(II) | February 1961 (I) | 10 | 24 | 34 | 32 |
| December 1969(IV) | November 1970 (IV) | 11 | 106 | 117 | 116 |
| November 1973(IV) | March 1975 (I) | 16 | 36 | 52 | 47 |
| January 1980(I) | July 1980 (III) | 6 | 58 | 64 | 74 |
| July 1981(III) | November 1982 (IV) | 16 | 12 | 28 | 18 |
| July 1990(III) | March 1991(I) | 8 | 92 | 100 | 108 |
| March 2001(I) | November 2001 (IV) | 8 | 120 | 128 | 128 |
| December 2007 (IV) | June 2009 (II) | 18 | 73 | 91 | 81 |

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Unemployment Rate



Inflation Rate



“What Kind of Economist Are You?”

- It was a sensible question in the 1960s
 - Not so much today
 - The question was about how to fight recession
 - Monetarist
 - Adherent of Milton Friedman
 - Believed $MV = PQ$ (or $MV = PY$) was best model
 - Advocated active use of monetary policy (esp Lender Last Resort)
 - Keynesian
 - Adherent of John Maynard Keynes
 - Believed $GDP = C + I + G + NX$ was best model
 - Advocated active use of fiscal policy
 - Lots of literature estimating money vs. fiscal multipliers
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A Bit of Macro

- One approach: AD & AS Model
 - Developed late 1970s / early 1980s
 - Aggregate Demand (AD): Demand for output, $C + I + G + NX$, given either price level (P) or inflation rate ($\% \Delta P$)
 - Multiplier effects caught in slope of AD
 - Exogenous policy effects caught in shifts of AD
 - Aggregate Supply (AS): Potential output given either P or $\% \Delta P$
 - Changes in A caught in shifts of AS
 - Exogenous changes in K, L, T caught in shifts of AS
 - Ability of economy to move toward or beyond PPF caught in slope of AS

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AS/AD Model

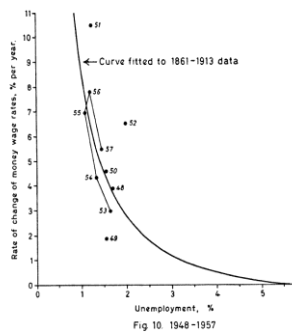
How model policy?



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Alternative Approach: Phillips Curve

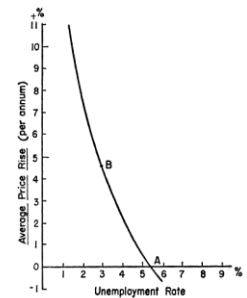
- A.W. Phillips used U.K. data for 1861-1957
- Found:
 - tradeoff between unemployment and wage inflation
- Story:
 - Bargaining power



Fed & Inflation Phillips Curve Shifts of Phillips Curve

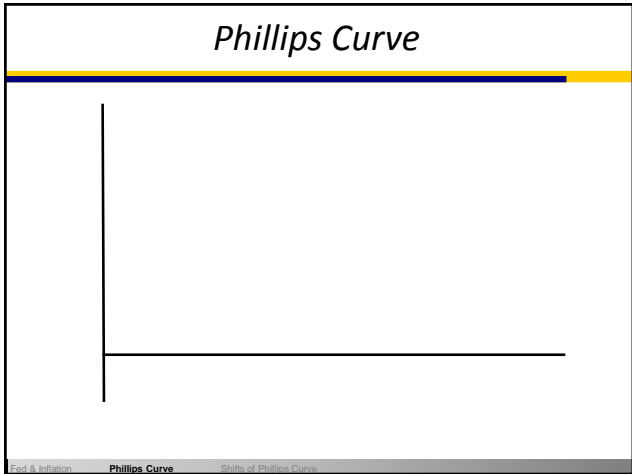
Phillips Curve (U.S. version)

- Tradeoff between unemployment and *price* inflation
- “This shows the menu of choice...”

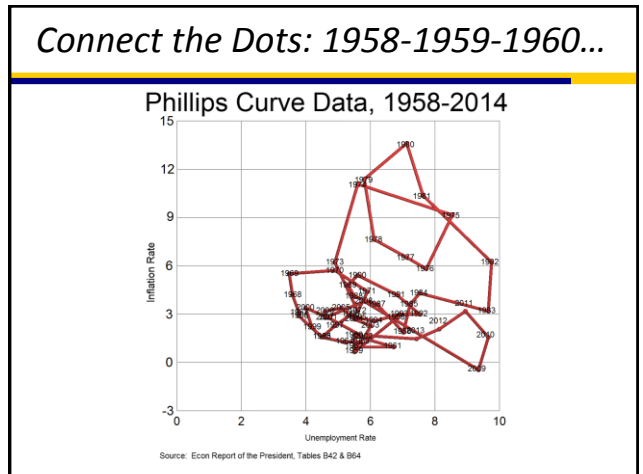
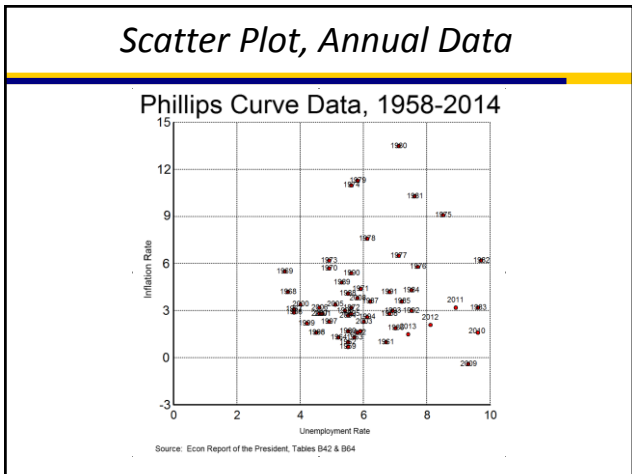


This shows the menu of choice between different degrees of unemployment and price stability as roughly estimated from last twenty-five years of American data.

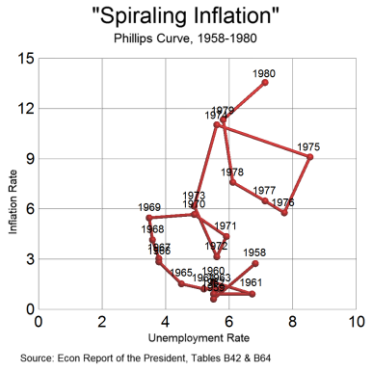
Fed & Inflation Phillips Curve Shifts of Phillips Curve



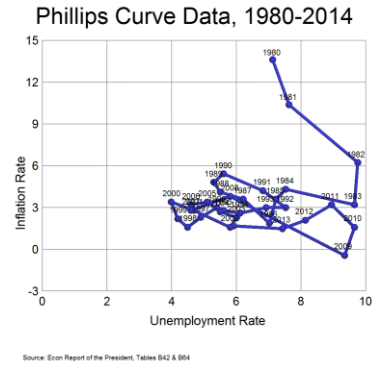
- ### Movements Along vs. Shifts of PC
- If aggregate demand changes, *move along* Phillips Curve
 - If prices change for some reason other than “change in AD,” *shift of* Phillips Curve
 1. Change in inflationary expectations
 2. Cost shocks (i.e., “supply shocks”)
 3. Change in labor productivity growth
- Econ & Inflation Phillips Curve Shifts of Phillips Curve



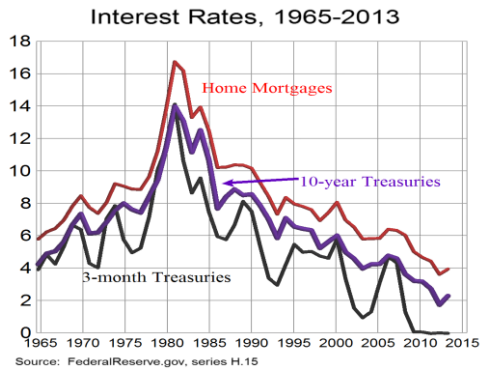
1970s: Things spun out of control



And then PC shifted back in...many times



Interest Rate Policy

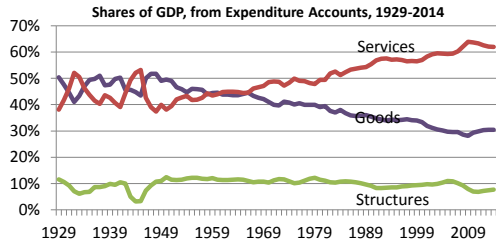


Policy Summary

- 1950s & 1960s: "fine tune" the economy, mostly fiscal policy options
 - Remember Treasury-Fed Accord through 1951
- 1970s: "oh c**p" experiences
 - Vietnam War, higher inflationary expectations, OPEC oil crisis
- 1980s: Rhetoric didn't match policy; policy worked
 - Rhetoric "supply-side"; Policy "raise interest rates" to lower AD
 - Theorists "let's assume always at full employment"
- 1990s: Divergence of theory & policy
 - The Great Moderation, a whole lot of luck
- 2000s: And then it all came crashing down. . .

What's missing from policy?

1. Consideration of mix of goods vs. services (April 9 topic)



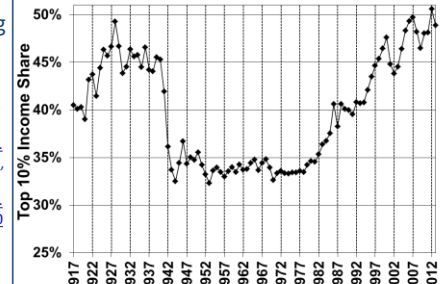
Source: U.S. National Income & Product Accounts, Table 1.2.5 (accessed 4/6/2015 from www.bea.gov)

2. Consideration of effect of inequality

Income Distribution Worsens

Share of income going to top 10%

Top 10% Pre-tax Income Share in the US, 1917-2013

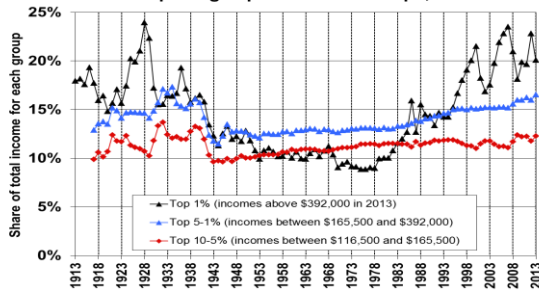


Source: Prof. Saez's website, <http://eml.berkeley.edu/~saez/#income>, specifically <http://eml.berkeley.edu/~saez/TabFig2013prel.xls>

Source: Piketty and Saez, 2003 updated to 2013. Series based on pre-tax cash market income including realized capital gains and excluding government transfers.

Top 1, 5, and 10 % Income Groups

Decomposing Top 10% into 3 Groups, 1913-2013



Source: Prof. Saez's website, <http://eml.berkeley.edu/~saez/TabFig2013prel.xls>

Gini coefficient, U.S., 1937-2004

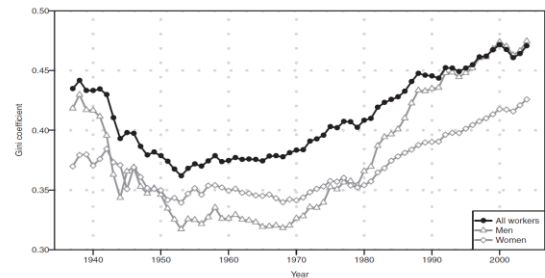
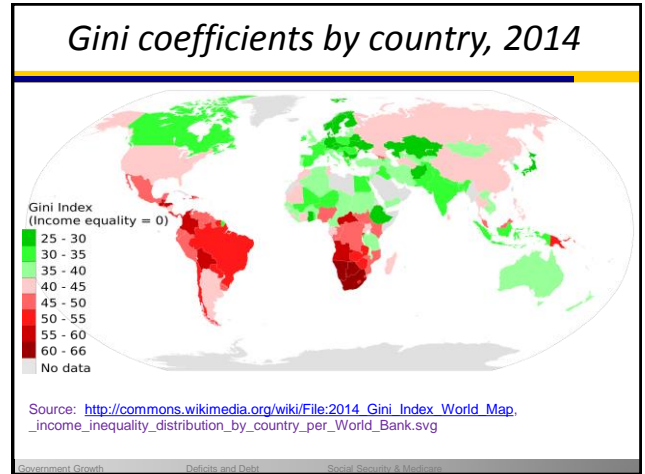
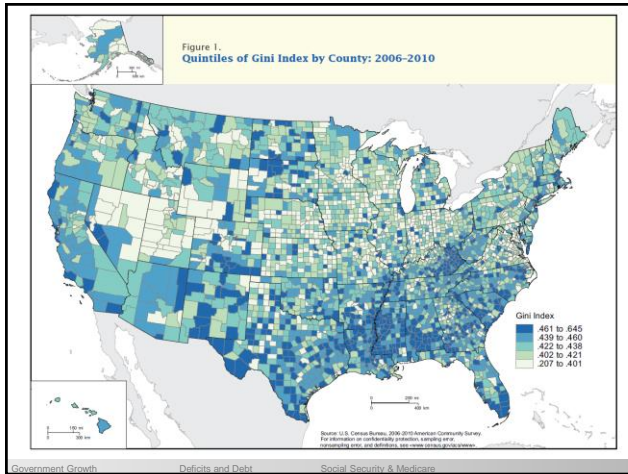


FIGURE I Annual Gini Coefficients

Source: Kopczuk, Saez, and Song, "Earnings and Inequality & Mobility in the U.S.: Evidence from Social Security Data Since 1937," QJE (Feb 2010).



Who are the top 1%

- 1920s, top 1% were wealthy class, (capital income)
- 2000s, top 1% are very highly paid (labor income)
 - Not due to aggregate change in $\frac{\text{labor income}}{\text{total income}}$
- In a study based on 1979-2005 tax returns
 - Non-financial execs, managers, supervisors
 - Medical professionals
 - Financial professionals
 - Lawyers

Why the rise in income for top 1%

- Increased labor income
 - “Superstars” reach wider audiences due to technological changes in mass media
 - Very large pay increases for CEOs
 - Exercised stock options counts as “labor” income
 - In finance, deregulation and compensation for IPO risk

Why the rise in income for top 1%

- Increased labor income
- Changes in government taxes and transfers
 - Overall, taxes and transfers lower Gini coefficient
 - But today, less equalizing than 30 years ago
 - Transfers through Medicare (health care, age 65+) benefit all
 - Less generous transfers to low-income households
 - Taxes have become less progressive
 - Shift from income to payroll taxes

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Average Tax Rates for Top 0.1%

Figure 1. Average Tax Rates for the Highest-Income Taxpayers, 1945-2009

Source: CRS calculations using Internal Revenue Service (IRS) Statistics of Income (SOI) information.
Note: The vertical axis is the average tax rate.

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Activity: Connecting Inequality & Macro

- 1930s and 2000s, high Gini coefficient
- 1950s - 1970s and early 1980s, low(er) Gini coefficient

Discussion questions

1. (Think theory): what are ways that including inequality might change our macro models?
2. (Think history and theory): what are ways that including inequality might change our explanations of past recessions and/or recoveries?
 - a) Be sure you remember that Gini was low in 1950s - 1970s

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