RIGHTING THE UPSIDE-DOWN ECONOMY:
CREATING A SUSTAINABLE RECOVERY
Transcript
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James Galbraith:
Let me say first that it is a privilege and pleasure to be here as the guest of Center for American Progress, one of the most important new forces on the American scene.

Our general economic condition is presently one of moderate expansion, following a long stagnation, propelled in part by provisional factors and endangered by hidden obstacles. Recovery is far from complete. It would take four years of job growth at the March-April rates to return us to the full employment prosperity of 1999-2000. And one of the most important factors which has been supporting growth of spending so far, that is to say low interest rates on new debt, is in the process of being attenuated as we speak. For this and other reasons, some of which I will touch on in the next few minutes, the prospect of going all the way with current policies is very low.

It is important; it seems to me, in thinking about this issue, not to be mesmerized by a metaphor – or at least to use metaphorical language properly. In this case, we have a plethora of potential metaphors. But the most common one is a medical metaphor, that of illness, followed by recovery, and return to health.

Now, doctors and hospitals like the start of recoveries because it means that their job is mostly done. The patient is not getting worse and organic recuperative powers can usually be relied upon to kick in. Patients, on the other hand, count the days until they are actually out of the hospital and fully back to normal. If the convalescence is prolonged and the continuing treatment is lousy, the patient is unhappy and rightly so. What we see in most discussions of the economy is the perspective of the doctor and the hospital and not the perspective of the patient.

Moreover the economy is not actually a biological process and recovery mechanisms are not automatic. Sustaining the Reagan expansion of the nineteen eighties required complex fiscal and monetary maneuvers, including large take backs of the original tax reductions in 1982 and 1984, interest rate reductions, and a major devaluation of the dollar beginning in 1985. Sustaining the Clinton expansion in the 1990s required fiscal adjustment in the beginning, low and stable interest rates thereafter, and the careful cultivation of the eventual technology boom that brought us to full employment at the end. Sustaining the present expansion will also require major policy adjustments -- some of them similar to the ones I've just described, some of them quite different -- of which there is absolutely no sign so far.

This expansion is different from past expansions, partly in that job creation has been very delayed and compensation growth has been slow, while corporate profits have soared, particularly in recent months. I am however, not inclined to blame corporations for their rising profits. Total profits are up, but from very low levels a couple of years ago. And a 40 percent profit growth has therefore only returned total corporate profits to the share of total income that they had back in 1996, which was a pretty good year.

What has been rising steadily over time in this process is the share of proprietors' income in total income. It was 7.1 percent in 1994 up to eight percent in 2000, 8.6 percent now. Proprietors are basically those who report themselves as self-employed – neither corporations earning profits nor compensated employees. Is this a good or a bad thing? I think the answer to that is: it depends.

To have more prosperous professionals, more merchants, more entrepreneurs, would be fine. More-down-at-the-heels housekeepers, gardeners, out-of-work academics posing as consultants is not such a good thing. So it depends on the numbers and the income. And what you find when you look at the numbers is that the rising share of proprietors' income in the late nineties was in fact mainly rising income. But in recent years, it is mainly rising numbers. This is not a good sign, and I would judge that it is mainly due to the unavailability and poor quality of regular jobs, which Eileen Appelbaum has already described. And this is not surprising, considering the total number hours of compensated employment are still less than they were in 2000. Real compensation per hour is up only a little more than four percent over that entire time compared to a 15 percent gain in total productivity.

Is this situation sustainable? I think Bob Manning has raised some important questions about the sustainability of the debt process, a process that has been fueling consumer spending for a long period of time. And I have been raising those questions myself for quite a few years. There is the old Herbert Stein adage, that when a trend cannot continue it will stop. The only question is exactly when – and that of course you don't know.

The phenomenon of rising proprietors' income may well go on for a long time. The problem is that it isn't a symptom of real recovery. The patient won't die, but he will go on feeling miserable for quite a few years into the future. And this is not something that we should be happy with.

What is to be done? Some of the strategies have already been mentioned by the previous speakers and I don't see a need to elaborate on them in depth. We need a comprehensive set of policies to improve the wages and the benefits of those who are employed; to move health care costs away from private business so that they don't have that major barrier to adding employment; to support public employment, particularly in states and localities. I have long been an advocate of a revenue sharing initiative, so that states and localities can keep up the level of vital public services and don't continue to add a downward drag on the economy by cutting spending and raising middle class taxes at a time when the full growth of the economy is not assured. I saw this morning the particularly deplorable story of the downward spiral of the Washington Metro – raising prices and cutting services to the point that people will go back to clogging the streets with cars. This is *exactly* what you do not want to happen as a result of deteriorating economic conditions.

We need also to shift the tax burden more generally away from the working poor and away from middle class families, that is to say to take the pressure off of states and localities to raise those taxes, to take control and put some of the burden back on to what the New York Times reporter, David Cay Johnston in his book *Perfectly Legal*, calls the political contributor class. But my brief has been the macro level and let me close with just a few remarks about what we should be about at that level.

We should, it seems to me, clearly be driving to make labor scarce again. Work should be well paid *and* profitable. But we can't get there if the Federal Reserve continues to commit medical malpractice and if the administration simply doesn't care about the issue. If there is no national leadership on the pressing issues – for example, of energy security – very closely tied to the whole question of national economic security and national security generally speaking – then we'll be in trouble. Global economic management will also have to be improved if we are to open up vistas for private profitability in a fashion similar, but not the same as, we were able to do in the late 1990s.

We should be aiming for full recovery, for a return to a situation where the private economy is producing good jobs, at good wages, and in great numbers. For that, though, we may well need both new doctors and new ideas about medical best practice.

Thank you very much.