Available online at www.sciencedirect.com
ScienceDirect
Journal of Policy Modeling 32 (2010) 632–636
Journal of Policy Modeling
www.elsevier.com/locate/jpm

Robust growth or anemic recovery in the U.S. and the global economy

Joseph E. Stiglitz *

Department of Economics, International Affairs Building, Columbia University, 116th Street, New York, NY 10027, USA

Available online 1 August 2010

Keywords: Growth; Recovery; Global economy

1. Introduction

It is a real pleasure to be here to share some of my views. I am going to focus my remarks mostly on the short- to medium-term and on the demand side. Most of this panel has demonstrated why economics is often referred to as the "dismal science" – and this crisis has given us every right to be dismal. In the competition among the panel, I am going to try to out-distance the other panelists and be a little more dismal than they are about the short- to medium-term. I want to begin by putting the problem in context by thinking about the world as it was before the crisis. What sustained the American economy and, to a large extent, the global economy was America's housing bubble (and bubbles in a number of other countries), and that housing bubble allowed a consumption boom. As already mentioned by several speakers, this is what kept the U.S. economy going. It fueled high levels of consumption and a household savings rate that was close to zero. It was clear to almost everyone that this was not sustainable, which has been said many times in this session. Herb Stein once said, "That which is not sustainable will not be sustained." And it was not. As we *officially* emerge from the recession – the NBER has not confirmed it yet, but there has certainly been growth – the question really is, what will replace the sources of demand that existed prior to the crisis?

I think that there will be a real shortage of national as well as global aggregate demand. It will probably take a number of years to solve the problem. The long-term prognosis

* Tel.: +1 212 854 0334; fax: +1 212 662-8474.
E-mail addresses: jestiglitz@gmail.com, Jb2632@columbia.edu.

0161-8938/$ – see front matter
doi:10.1016/j.jpolmod.2010.07.005

is that we are setting ourselves up for another crisis before we fully recover if we do not do something about the regulatory framework (that I outline more fully in my book *Freefall*).

2. Slow recovery and the legacy of debt

This is the first time that real incomes have not recovered to the levels where they were before a crisis; we now have a potential of going into the next crisis, whenever it might be, before we fully recover from the current one. Every crisis obviously leaves a legacy; one of the legacies that we are dealing with now is the legacy of debt, which affects both the public and the private sector, both households and firms. In the past, there were a number of ways that countries have dealt with an overhang of debt of the kind that American firms and households now face. The easiest way, of course, is inflation, but as that no longer has the approval of most parties, it is unlikely that we will inflate away the debt. Some foreign holders of dollars look at the U.S. economy and are afraid that we will go down that road. (Moreover, with so much of the debt being short-term, it is not so easy to inflate it away.)

Another way of dealing with an overhang of debt is restructuring. About one-quarter to one-third of all mortgages are "underwater," that is to say, the value of the mortgage exceeds the value of the house. Even if housing prices stabilized, they will not rise very rapidly, which means that these mortgages are likely to remain underwater for a very long time. The obvious solution is to try to restructure these mortgages. However, that has not really happened to any significant extent under the current administration's programs, which have combined small amounts of assistance with payments that are stretched out to allow individuals to stay in their homes; but the values of the mortgages have not been written down. Thus the number of mortgages remaining underwater has remained high, and the burden of the debt persists.

The third strategy, which is the one that the U.S. seems to be opting for, is called "prayer," where you hope or pray somehow to grow out of the problem. (It is also sometimes called muddling through.) Of course, it is not easy to grow out of debt if there is no growth, and the problem is that it is unlikely we will have robust growth anytime soon, especially if we do not deal with this issue.

3. Inadequate U.S. aggregate demand

Let me look more closely at each of the components of aggregate demand, to explain why I am somewhat pessimistic that we will return to robust growth anytime soon. Obviously the place to begin is consumption.

3.1. The savings rate

The savings rate has already increased substantially, and if we return to our historical average of around 7% of GDP, there will be a big gap in aggregate demand arising from this source, relative to what we had before the crisis, which has to be filled. One of the important things to realize is that when you have had a shock of the kind that we have had, averages hide a lot of what goes on. Many of the people who have lost a lot are facing a number of constraints. Older people have lost a large fraction of their wealth in the form of home equity, since for most Americans their most important asset is their home; if their homes are underwater, that means they have negative home equity.