Rebuilding the Economy Will Require Joe Biden to Think Very Differently Than 2009

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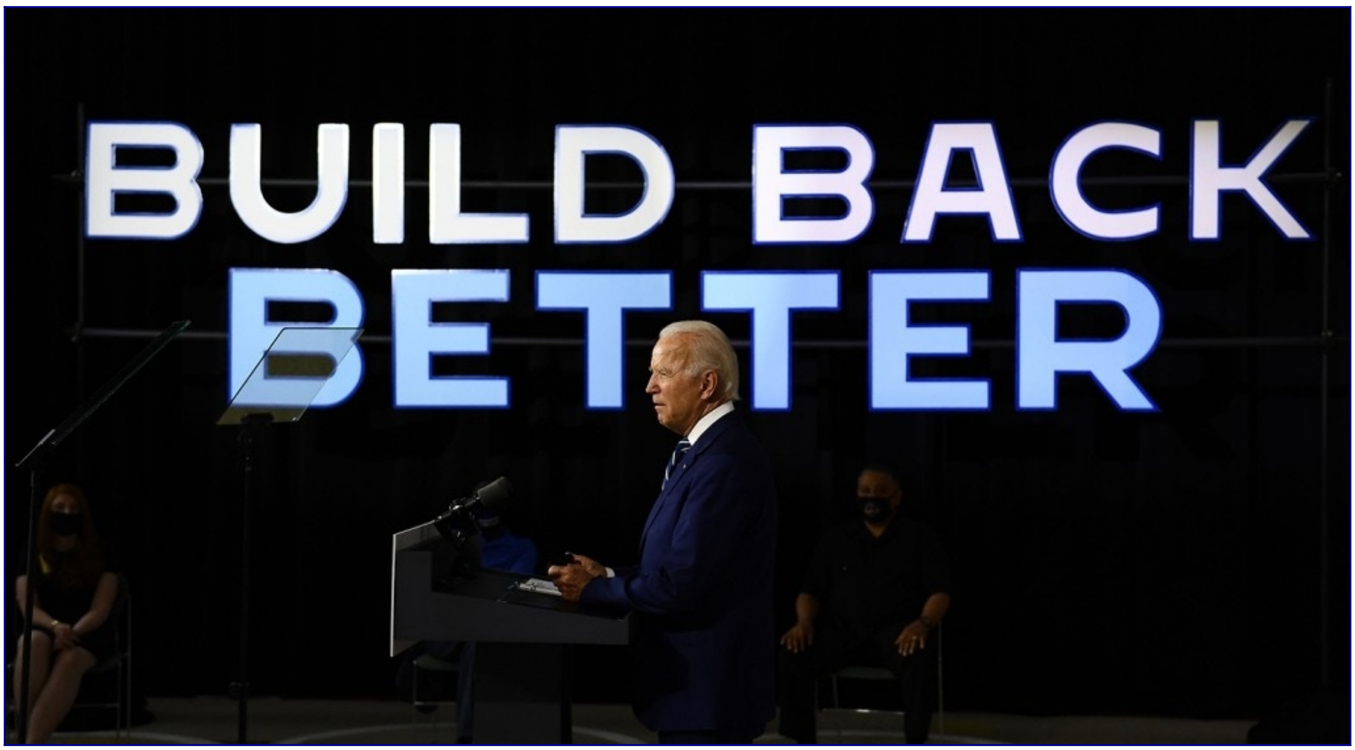
September 1 2020, 7:00 a.m.



Democratic presidential candidate Joe Biden speaks on the third plank of his “Build Back Better” economic recovery plan for working families, on July 21, 2020, in New Castle, Del.

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Joe Biden’s invocation of Franklin Roosevelt’s New Deal, in the opening words of his convention acceptance speech, offered a flash of hope that, in broad terms, the Democratic nominee has grasped the scale of the Covid-19 crisis. Yet before Biden even spoke, the head of his transition team, former Sen. Ted Kaufman, undercut that hope, telling the Wall Street Journal that, in effect, Biden didn’t mean it. “When we get in, the pantry is going to be bare,” Kaufman said. “When you see what Trump’s done to the deficit … forget about Covid-19, all the deficits that he built with the incredible tax cuts. So we're going to be limited." After being called out by David Sirota, the Biden campaign split the difference: There will be "stimulus" in the short run, retrenchment later.

The reassurance is not reassuring. For, like the Biden-Sanders Unity Task Force report on which the Democratic platform is based, it confirms that economic thinking on Team Biden, even among its most progressive elements, is essentially the same as that behind the Obama-Biden strategy for the previous economic crisis, from 2008 to 2009. But the underlying situation now is in many ways much more serious and intractable.

The 2008 crisis was, at its core, a *financial* one. It stemmed from a rash of financial frauds, which generated a simulacrum of economic growth through mortgage loans that would never be honored in full — and that were designed, and targeted, to ensure that they *could* never be honored in full. When the frauds were exposed and the housing market collapsed, millions lost their jobs; millions more lost their homes. Still, overall and over time, the crisis was amenable to the conventional "Keynesian" fix: a large injection of money. The residual arguments over the Obama-Biden program in 2009 are merely over whether the injection was large enough, and whether a larger one might have averted the political backlash that hit the administration in 2010.

Remarkably, although the recovery was slow and neither the labor force nor homeownership ever returned to pre-crisis levels, the United States was able to sustain an economic expansion after 2010. The position of the country was helped by an unexpected surge in low-cost natural gas and high-cost oil production. The expansion was continued, in the first three years of Donald Trump's term, by large tax cuts weighted to the wealthy and a booming stock market — the "everything bubble" as it is sometimes called. The jobs created, it is true, were mainly at relatively low wages. Nevertheless, they were created. The U.S. returned to full employment, conventionally defined, by around 2018. This fact — a slow-motion success story — no doubt bolsters the confidence now of those who set the policy back then.

The long expansion relied very heavily on the consumer. While personal consumption had been the source of the pre-crisis boom, and fell sharply in the slump, its share of gross domestic product recovered after early 2015 and remained throughout well above levels of any previous post-war epoch. Total business investment, on the other hand, never returned to pre-crisis levels as a share of GDP and was at the peak in 2015 almost 2 percentage points below the previous peak in 2005, in part because the digital revolution reduced the cost of capital equipment and cut into the brick-and-mortar needs of the business sector. Government spending rose sharply in the slump and remained historically high, but as a share of GDP it declined continuously from the start of the expansion until 2020. Thus, consumer spending was the main sustaining factor for the five final years, until the pandemic hit.

There are three reasons why the experience of the last expansion will not be repeated now.

First, the pandemic has obliterated the global market for many advanced capital goods in which America excels. Aircraft are a major example. The civil aviation industry depends on worldwide demand, not U.S. demand, and world demand is dead so long as more airworthy planes are parked on the ground than are in the air. In a slightly different vein, the U.S. oil business turns on a world price. It is doomed so long as the selling price is half the cost of getting fracked oil from the ground in West Texas. Construction of offices and retail malls: also dead and done as a substantial share of clerical work shifts to the home office and of shopping to online distributors. The sale of automobiles will slow as commuting and shopping demand fewer miles of travel, and cars therefore last longer. In many other sectors, cheap digital equipment will replace expensive facilities and human labor. Overall, the next recovery will not be kickstarted by exports, by business investment, or by the purchases of durable consumer goods. There is nothing that Keynesian stimulus can do about that.

When we come to the consumer, there is an even bigger problem. It is that the largest share of increased spending in the last recovery — and the secret of American success at job creation — was not in the purchase of goods, but in the production and consumption of services. The U.S. economy after the crisis saw a vast growth in jobs in bars, restaurants, coffeehouses, hotels, resorts, spas and casinos, gyms, ride-shares, massage and tattoo parlors, hair and nail salons, boutique shops, and high-end grocery stores, as well as in child care, education, cultural events, and elective medical procedures — the entire panoply of services with which a wealthy society tends to pamper itself. In effect, the U.S. economy became a gigantic carnival of doing each other's washing and scratching each other's backs.

The pandemic has washed much of that away. Direct personal contact, crowded spaces, and mixing are the essence of many services and have been suppressed, necessarily, for health reasons — and will remain. There is an assumption, in many quarters, that if and when the pandemic recedes, these will simply return, and things will start up where they left off. This is neither a safe assumption nor even a reasonable one.

Back when most spending, at the margin, was for goods produced in American factories, the simple provision of money could flip the switch that got things going. Customers placed orders, businesses hired workers, and the engine started up. In an economy in which domestic spending is overwhelmingly directed at services, the jobs will not return until the customers, collectively, are willing to buy the services that they, themselves, collectively provide. But they will not be willing until they have the jobs, which depend on the prior presence of customers. This is a classic catch-22. It is precisely the dynamic — the virtuous circle — of self-reinforcing demand that the pandemic has obstructed and will continue to obstruct.

Even when the threat of the virus recedes — if it does recede — these services will not return easily for a more basic reason. They are generally not *essential*. They are add-ons that grew up with our wealth, and most Americans can, by and large, do without them. American households in the middle class and up live in houses, the byproduct of postwar policies of suburbanization and homeownership. If they have to, people who live in houses can cook, clean, and entertain themselves at home. In recent years, the economy grew by persuading them to *leave* home: to go out, to buy food, get exercise, and have fun on the market. The economy can and will retreat along the same lines, as families with incomes decide to spend less and save more, while those without incomes cut back on everything because they have to. It will retreat along those lines at least until the uncertainties of the pandemic start to recede. But the uncertainties can't recede, so long as people who provide all those services do not first experience a sustained improvement in their prospect for jobs — and there, once again, is the catch.

The firms that provide the jobs cannot survive these conditions indefinitely. Service businesses generally operate with fixed costs, including rent and interest, that demand a high level of customer pass-through. Bars must be packed, restaurants full and noisy on the weekends, concerts sold out, or the businesses behind them cannot be sustained. The combination of public health restrictions on their capacity with high household savings and low patronage driven by economic insecurity is lethal to their prospects. A New York Times survey shows a falloff in August of almost 25 percent in visits to businesses compared to 2019, even though incomes have been kept up by relief programs. How long businesses can hold out is anyone's guess. But many have given up already and many more will follow. And once a commercial strip or mall or neighborhood begins to go dark, blight weighs on the survivors. This is something we can see all around us right now.

Third, as the pandemic lingers and people cannot work, arrears for rent, mortgages, and utility bills are piling up. According to one survey, about a third of households failed to make their full rent or mortgage payment in July — for the fourth month in a row. Landlords have begun again to file for evictions — understandably from their point of view but disastrously for the economy as a whole. As the fear of eviction or foreclosure returns, households will save even more, and spend even less, hoping to have enough in reserve, in case of bad luck or sustained joblessness, to keep the bailiff from the door.

The Covid-19 pandemic has changed our economy *for the long term*. The changes are due to our advanced technology, not our backwardness; to our wealth, not our poverty; to our past access to credit and therefore, to our fixed commitments in relation to current incomes; to our houses and suburbs and cars; and to the fact that we have had, and still have, an affluent society. The decision, by millions of anxious Americans each acting in their own best interest — to eat and play at home, to save more and spend less, to protect their health and to hang on for as long as possible — creates an economic problem that cannot be palliated by money alone. This is not the postwar America of competitive consumerism and pent-up demand on which the magic of Maynard Keynes worked so well.

The point of all the measures taken in April — the CARES Act, with extended unemployment benefits, payroll protection, small business loans, and direct payments to tax filers; and the Federal Reserve's moves — was to buy time for social distancing and other measures to bring Covid-19 under control. The assumption was that the economy would then recover on its own. Even though the public health measures did not work, the funds did buy time for American households to pay rent, mortgages, utility bills, and (as it turned out) to put something aside for the summer and fall. They kept the country from falling apart as the pandemic spread. A new round of income supports can, of course, buy more time and is indeed urgent right now. But it will not, by itself, set the economy on a path toward renewed growth and high employment. Something else must be done, going far beyond mere money. Or else, it's depression all the way down.

The outlines of that something else are only just coming into view. Some of the basic elements are the following:

1. The sectors producing advanced capital goods for world markets, energy for domestic use, weapons, and the construction sector must be mobilized, as if in a wartime effort, to a new set of purposes. These should aim at sustainable energy, mitigation of climate change, public health, and the reconstruction of life itself around safe and sustainable patterns of activity. Renewed infrastructure of all types, new transportation systems, new amenities, natural conservation, and cultural investments are all parts of

this challenge. The Green New Deal is now doubly necessary, not only to transform the energy basis of the economy, but also to ensure that there is an economy to be transformed.

2. For the many millions who cannot find jobs in the private sector, there must be a job guarantee for all seeking to work, at a modest living wage, in the public sector. The pandemic has cut not only services jobs, but also office jobs and construction, so that nearly 40 million American workers have been displaced. Many will not be called back even if their employers survive. Yet there is work enough for everyone: in teaching, in caring, in public health, in parks and libraries, in art and culture, in maintaining our communities, and in providing food and housing and other basic services to those in need, and if the jobs are made available, people will sign up for them by the millions.

3. Service providers must be restructured so they can be sustained at reduced volumes. They must get loans on easy terms to reconfigure their physical layout to protect both customers and workers. But they also need assistance in meeting their costs. Cooperative private-public ownership and partial municipalization of service firms, with local government getting support from the federal government, is one promising path. In Germany, small businesses got a share of their costs covered by their localities, and so can survive, whereas in the U.S. they are failing.

4. Manufacturing capacity sufficient to meet the basic requirements of public health and sustenance must be rebuilt on domestic soil, so as to be immune from the disruptions to trade associated with the pandemic or other threats to global supply chains. We cannot be caught again, as we were this spring and summer, unable to provide basic protective equipment to health care workers and indeed to the whole population. For this purpose, a new structure of financing will be required, a Health Finance Corporation along the lines of the Reconstruction Finance Corporation that operated from 1932 to 1956.

5. Public health must be reconstructed, accessible to all at no out-of-pocket cost. This call goes beyond the conventional discussion of public options and single-payer schemes to recognize that Covid-19 has created a financial crisis for America's health care sector. Like everything else in America, health care is a business. And as the economy has fallen, reducing accidents and other infectious diseases, and as elective procedures have been postponed, providers are seeing fewer people, so that — like every other form of business — many hospitals and clinics cannot cover their costs. The solution is to make the health care sector cooperative, to assure that appropriate services are available to all. Indeed Spain and Ireland nationalized all health care services in the pandemic; America could do the same or find a less drastic solution.

6. For the duration and beyond, renters and mortgage holders must be shielded from evictions, foreclosures, and utility stoppages, consistent with good behavior supervised by local authorities, and there must be reasonable facilities to write down unpayable debts, along with reasonable compensation to small landlords. Student debt and medical debt are also good candidates for general relief.

7. Ultimately, since these debts are also the assets of those who lent the money, the reality is that a successful economy after Covid-19 requires a redistribution of financial wealth. If the pandemic is to be defeated, and if a viable social order is to emerge in the aftermath, the balance sheets of American households will have to be rewritten to carry a burden of debt that is manageable, given less market activity and lower market incomes. This means that the assets of the wealthy, as well as the debts of the

overburdened, will have to be written down. There must be a general redistribution from creditors to debtors, reversing the trend of the past 40 years. The redistribution, by the way, *will occur.* It can be done through a decade of depression, as in the 1930s, or two decades of inflation, as in the 1960s, or it can be done by sensible restructuring and debt relief, as was done in the immediate aftermath of World War II.

8.Finally, with a widespread write-down of debts and assets, the financial sector must be restructured, since that sector holds many of the assets that will lose value. The ultimate financial consequences of this pandemic are not yet clear, and where the weak points of the financial system will emerge is still somewhat obscure. But it is certain that those weak points exist and when they are exposed, they will prove profound. The big banks that cannot make it can be taken over and run as public utilities; this can be done under present law. Necessary payments, savings, and credit functions can be sustained by providing public options, through postal banking and a public electronic payments system, managed by the Fed. Over time, regional and local banks can be supported to build a new economy in place of the one that Wall Street distorted and, ultimately, helped to destroy.

No spirit of radicalism animates these ideas. They are not driven by ideology nor by any past commitment to any agenda. They follow as matters of logic and fact from an understanding of the situation. The previous structure of the American economy was highly efficient in some ways. It supported, although unequally, a high living standard for a very large part of the population. But circumstances have changed in ways that cannot be controlled or reversed, and that will not evaporate on their own, whatever happens to the virus and the pandemic.

It is therefore a delusion to think that markets will restore us to well-being on their own. It is a delusion to think that the mere injection of money, however great and generous and however needed for the short run, will bring back the happy mix of jobs and incomes we've just lost. It is a delusion to think that the easy methods of the postwar economists, whose ideas have dominated liberal thought and response to economic crises for 70 years now, will work in the face of the Covid-19 challenge. The path forward requires planning and action on a far larger scale. It requires skills, imagination, local knowledge, commitment, and mobilization that resemble — but actually surpass — those brought to bear in the New Deal.

The only good news is that other unprecedented crises have happened before. In most cases, the result has been disaster. But there are a few moments in American history when the country rallied to do what was necessary, overcoming the odds, the powers, the old ideas, and the bad actors who stood in the way. It did so in 1861, in 1933, and in 1942. And here we are again.

Biden was right to invoke Roosevelt and the New Deal. America needs for him to mean it.