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Non-Capacity Generating Semi-Autonomous Expenditures, Effective Demand, and Business Cycles

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Wage-led vs profit-led demand

• Empirical debate
  – The omission of overhead labour costs (supervisory workers) biases opinion towards profit led conclusion

• Theoretical debate

• Domestic demand cannot be profit-led
  – Gestation lag between investment decision and investment realization (Mott/Slattery 1994, Laski 2004)
  – Non-capacity creating autonomous demand
Non-capacity creating autonomous demand

- Revival of the arguments put forth by Serrano (1995) and Bortis (1997) – the Sraffian supermultiplier
- Residential investment, consumer expenditures financed by debt, government expenditure, exports
Alternative explanations of business cycles

• Changes in the non-capacity creating semi-autonomous expenditures (NCCSAE), notably residential investment
  – Leamer 2009, Sherman 2010

• Changes in corporate investment, the Goodwin cycle (profit-led and profit squeeze regime)
What component is the most volatile?

**Table 1: Annual Growth Rate of U.S. Output Components (in per cent), 1955-2015**

<table>
<thead>
<tr>
<th>Component</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Max</th>
<th>Min</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross domestic product</td>
<td>3.1</td>
<td>2.2</td>
<td>7.3</td>
<td>-2.8</td>
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<tr>
<td>Personal consumption expenditures</td>
<td>3.3</td>
<td>1.9</td>
<td>7.4</td>
<td>-1.6</td>
</tr>
<tr>
<td>Gross private domestic investment</td>
<td>4.3</td>
<td>9.0</td>
<td>27.3</td>
<td>-21.6</td>
</tr>
<tr>
<td>Fixed investment*</td>
<td>3.4</td>
<td>6.4</td>
<td>15.1</td>
<td>-18.2</td>
</tr>
<tr>
<td>Non-residential*</td>
<td>3.7</td>
<td>6.2</td>
<td>15.9</td>
<td>-16.5</td>
</tr>
<tr>
<td>Residential*</td>
<td>3.1</td>
<td>13.2</td>
<td>39.9</td>
<td>-26.5</td>
</tr>
<tr>
<td>Exports</td>
<td>6.0</td>
<td>6.1</td>
<td>18.9</td>
<td>-13.5</td>
</tr>
<tr>
<td>Imports</td>
<td>6.0</td>
<td>6.5</td>
<td>24.4</td>
<td>-13.7</td>
</tr>
<tr>
<td>Government consumption and investment</td>
<td>1.9</td>
<td>2.5</td>
<td>8.7</td>
<td>-3.2</td>
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</table>

* Adjusted for inflation using a deflator calculated from Tables 1.1.5 and 1.1.6. Source: U.S. Bureau of Economic Analysis, NIPA, Tables 1.1.5 and 1.1.6.
Fall in NCCSAE/GDP precedes recessions

Figure 2: U.S. Household Fixed Investment and Consumer Credit per cent Output, 1952(I)-2015(II)

Sources: St. Louis Federal Reserve, FRED. Freddie Mac, Cash-Out Refinance Report.

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<table>
<thead>
<tr>
<th>Lag</th>
<th>H-GFI</th>
<th>H-SAE</th>
<th>C-GFI</th>
<th>P-RFI</th>
<th>P-NRFI</th>
<th>C-P</th>
<th>Profits</th>
<th>Y</th>
<th>GDP</th>
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<tbody>
<tr>
<td></td>
<td>0.48</td>
<td>0.39</td>
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<td>-0.23</td>
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<td>0.65</td>
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<td>0.61</td>
<td>0.62</td>
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<td>0.66</td>
<td>0.11</td>
<td>0.11</td>
<td>0.01</td>
<td>0.01</td>
</tr>
</tbody>
</table>

^ Inflation-adjusted annualised quarter over previous year quarter growth rates. Sources: St. Louis Federal Reserve, FRED. U.S. BEA, NIPA, Tables 1.1.5, 1.1.6 & 1.14.

- H-GFI: real household gross fixed investment
- H-SAE: real H-GFI + change in consumer credit
- C-GFI: real corporate gross fixed investment
- P-RFI: real private residential fixed investment
- P-NRFI: real private non-residential fixed investment
Quarterly annualised real growth rates: NCCSAE leads and is more volatile
The Goodwin profit share/economic activity cycle

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Corporate profits, household residential investment, and corporate investment vs utilization rate

Source: Fiebiger 2016

Corporate profits

Household residential investment

Corporate investment
The Goodwin cycle view

- Why is there crisis and stagnation in the Goodwinian limit-cycle models?
- The answer is the rate of employment is too high, real wage rates are too high and the profit share is too low.
- The crucial puzzle from the standpoint of an outsider to this approach is the following: why would firms expand productive capacity at troughs when they are bulging in idle capacity?
- There is a second puzzle within this storyline. Unless firms are able to raise costing margins in a downturn, when taking fixed overhead costs into consideration, low rates of capacity utilisation and low rates of employment should be associated with low profit shares and low profits. Why low profitability should encourage firms to speed up investment is beyond us.
Rejecting the Goodwin view I

- Those who endorse this answer also ask us to imagine that all expenditures on current output originate within the firm sector (so consumption is only possible via payments of wages, dividends and interest payments) and to disregard the role of external markets and finance to influence growth and cycles.

- Goodwin-inspired models have no financial stocks (and no channel for interest rates), no public sector (and no channel for proportional taxes), no foreign sector, no inventory dynamics, no dwelling investment, no debt-financed consumption, no overhead labour and an investment function that reduces decisions on output and accumulation down to a negative relation with the rate of employment.

- It would be remarkable if such a model did have strong empirical support, given its abstraction from the world of complexity.
Alternatives to the Goodwin prey-predator

- The existence of a pro-cyclical profit share seems insufficient evidence to claim the relevance of Goodwinian predator-prey mechanisms.
- An alternative explanation is provided by Stockhammer and Michell (2016), who present a formal model where pseudo-Goodwin cycles are generated by financial fragility in the firm sector.
- We focus on the role of household fixed investment and semi-autonomous expenditures.
- As Leamer (2009) says, ‘housing is the business cycle’!
Conclusion

• A supermultiplier mechanism is capable of giving insight into the effects of secular trends in dwelling investment or in other semi-autonomous expenditure on the secular growth rate.

• There is however also an unstable cyclical dimension to dwelling investment that appears to be an overlooked factor in generating Keynesian unemployment (at least in the US).

• All of this underlines the pragmatic point that the merit of any set of modelling and behavioural assumptions are contingent on the analytical task under investigation.