

Death and Transfiguration

Jesús Fernández-Villaverde¹

November 17, 2023

¹University of Pennsylvania

The end of the thirty glorious years

- The great years of post-war II growth in the advanced economies end up around 1973.
- Period 1973-2023 experiences much lower per capita growth.
- Large political and social consequences.
- Think about basic discounting:

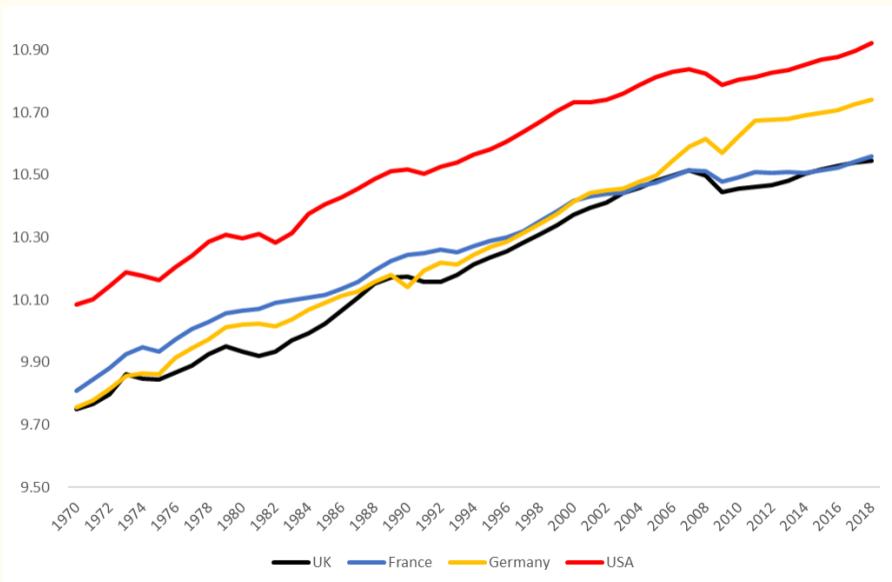
$$wealth = \frac{output}{r - g} + k$$

- Then:

$$\frac{\partial wealth}{\partial g} = \frac{output}{(r - g)^2}$$

- Why did growth slow down?

Real GDP per capita PPP, 1970-2018 (2017=100)

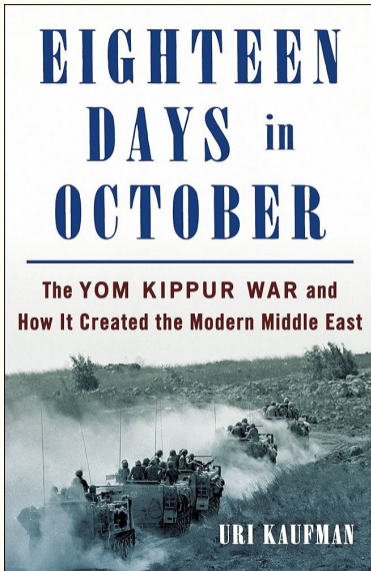
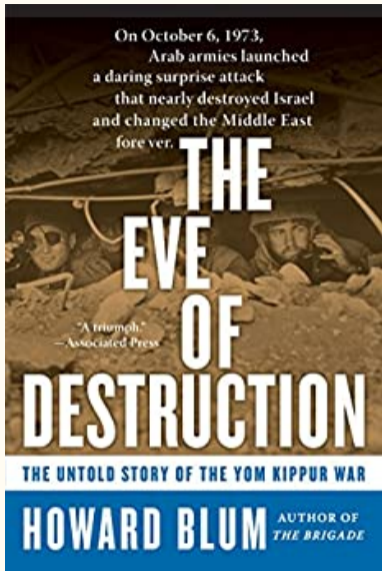


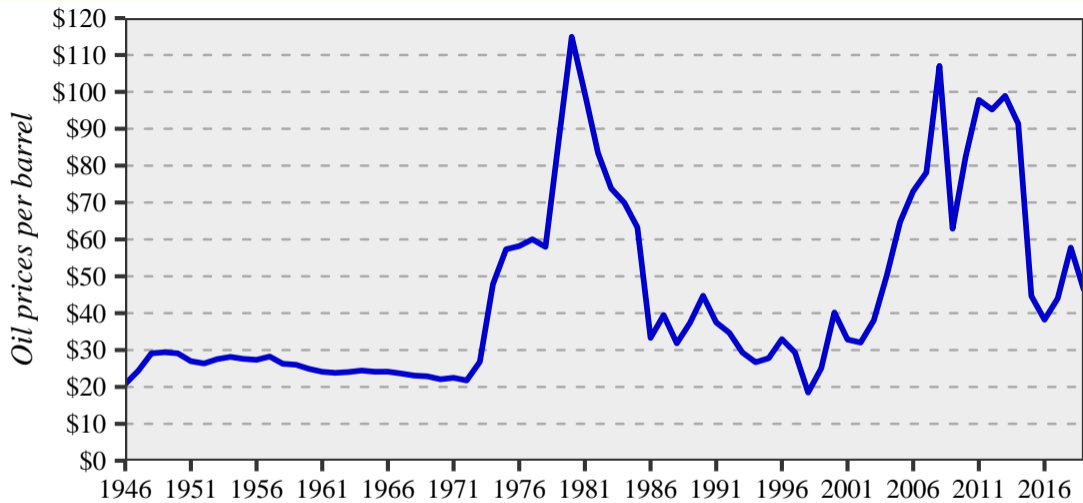
The 1973 oil shock, I

- Oil shock of 1973 after the Yom Kippur War (October 6-25, 1973):
 1. Sadat wants to recover the Sinai Peninsula.
 2. Israel is caught unprepared.
 3. It needs the massive military help of the U.S. and other European countries to turn war around.
- Arab countries respond with an oil embargo against the U.S., the Netherlands, Rhodesia, South Africa, and Portugal and increasing oil prices to everyone else.









The 1973 oil shock, II

- However, inflation had been brewing before (we will return to this point later).
- Also, there is no extra capacity in world oil production.
- Role of the OPEC: complex mix of interests (nationalism, revolutionary, maximizing rents...).
- Policy responses within advanced economies are often misguided: price controls, rationing, subsidies.



"SPELLBINDING . . . IRRESISTIBLE . . . MONUMENTAL . . .
must be read to understand the first thing about the role of
oil in modern history." —THE NEW YORK TIMES

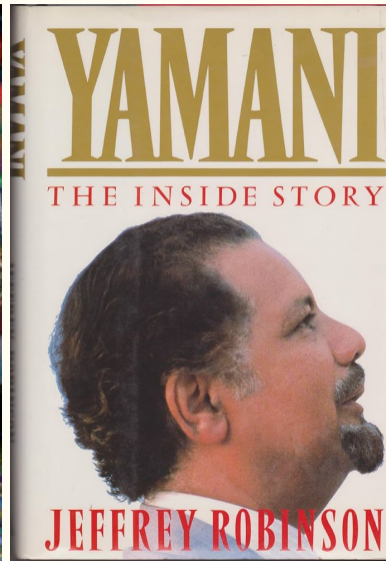
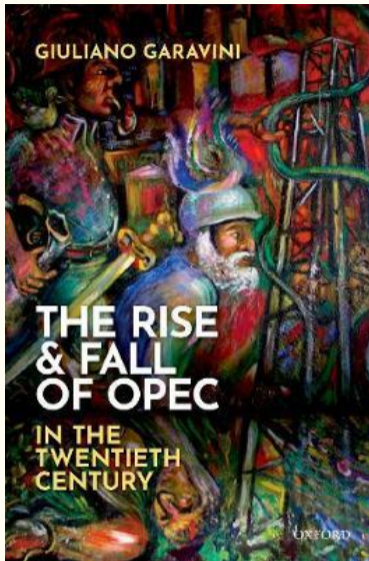
THE PRIZE

THE
EPIC QUEST
FOR
OIL,
MONEY &
POWER



WITH A NEW EPILOGUE

DANIEL YERGIN



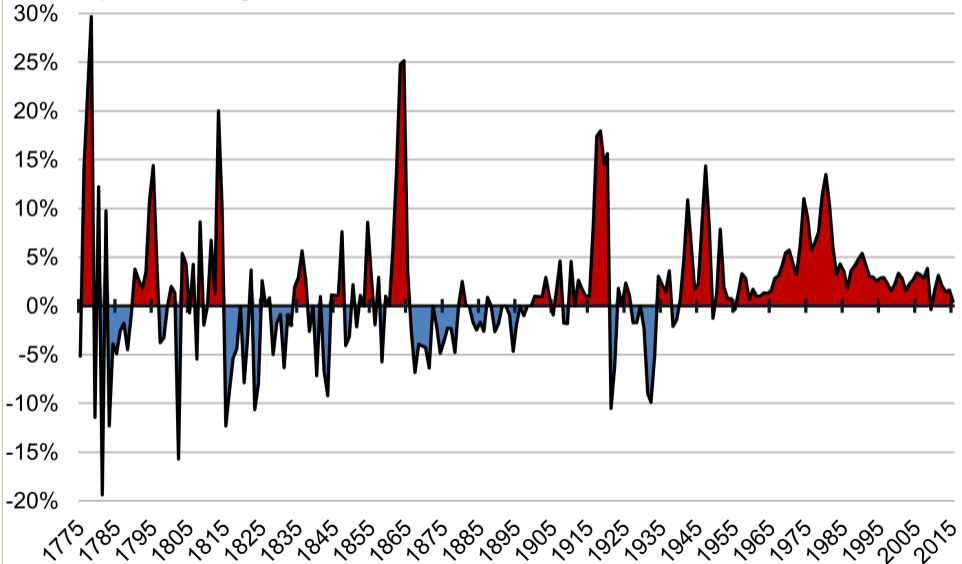


More background

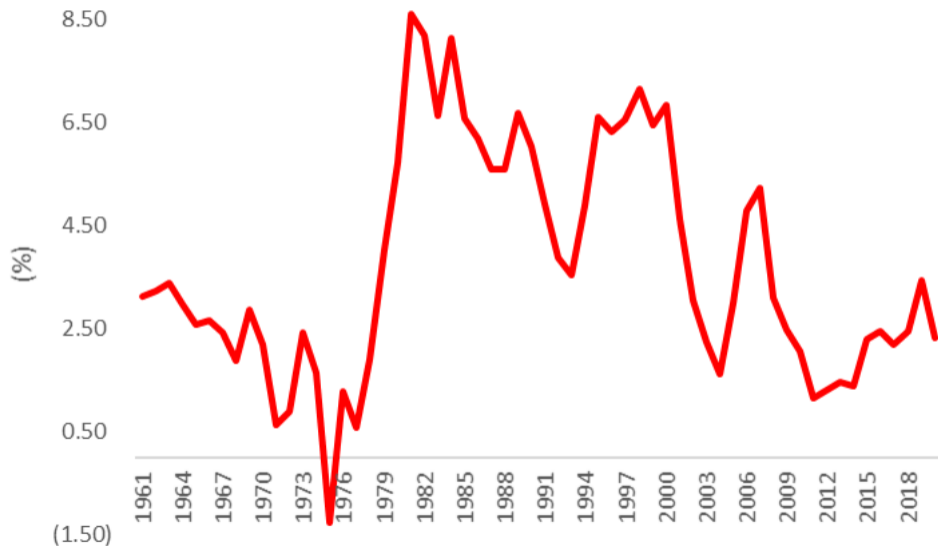
- Period of monetary instability: only peacetime inflation in U.S. history.
 - Recall the collapse of Bretton Woods.
 - Loss of effective independence of the Fed.
- Fiscal problems: growing public debt.
 - Growing welfare state with worsening demographics.
- Increase of structural unemployment in Europe.
- Growing social unrest since the mid-1960s (May 1968).
- Second oil shock in 1979, after the Islamic Revolution in Iran.

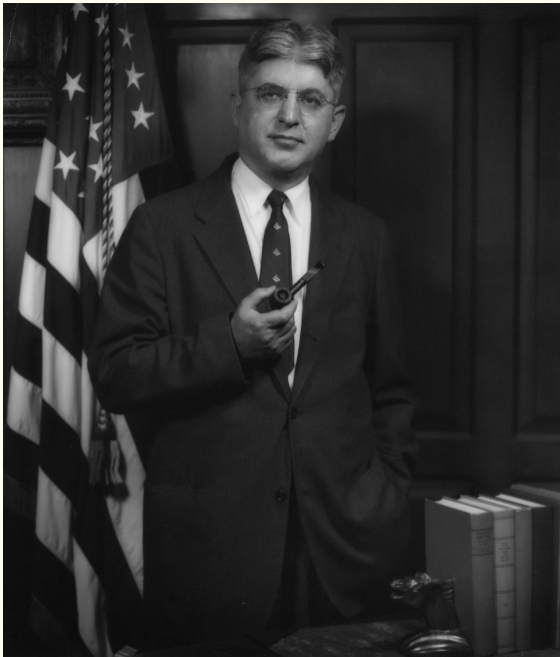
U.S. Inflation from 1775 to Present

Annual percent change in overall U.S. consumer-price index

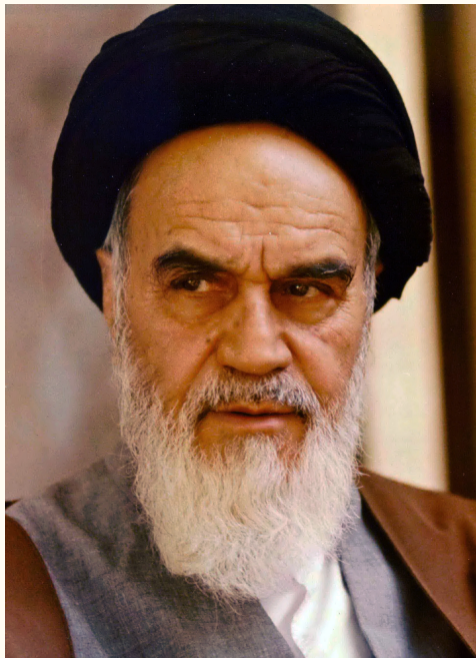


Real interest rate (%), 1961-2020









The age of reform

- Deep reforms in many countries in the 1980s.
- Most famous: Margaret Thatcher in the U.K. after 1979.
- U.K. suffers from deficiencies in:
 1. Business management.
 2. Industrial relations.
 3. Human capital formation.
 4. Design of supply side policies.
- Winter of discontent of 1978-79: Jim Callaghan's labour government collapses on March 28, 1979.



b) Tariff rates for UK and West German manufacturing (%)

	<i>UK</i>	<i>West Germany</i>
Chemicals	15	8
Leather	16	12
Rubber	21	10
Wood	15	7
Paper	13	8
Textiles	23	11
Non-Metallic Minerals	17	6
Iron & Steel	14	7
Non-Electrical Machinery	17	5
Electrical Machinery	23	6
Transport Equipment	25	12
Clothing	26	13
Instruments	27	8



LABOUR ISN'T WORKING.

UNEMPLOYMENT
OFFICE

A large crowd of people, representing the unemployed, is shown standing in a long line that curves across the bottom half of the image. The people are dressed in a variety of styles, suggesting a diverse group. The background is a plain, light color, making the crowd stand out.

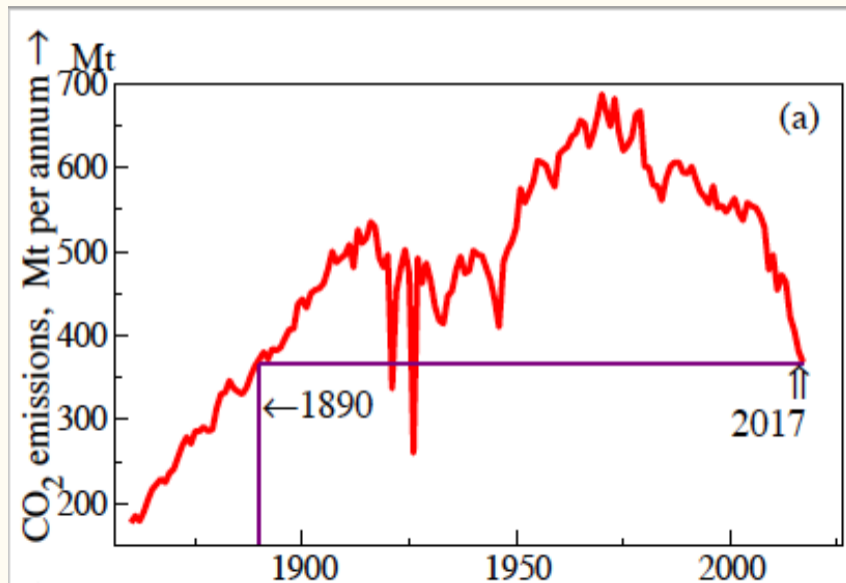
BRITAIN'S BETTER OFF WITH THE CONSERVATIVES.

Thatcher's program

- Main focus:
 1. Fight against inflation.
 2. Fight against trade unions: coal miners' strike (1984-85). Paradoxically, Thatcher's closing of coal mines made the U.K. a leader in CO2 emissions reduction in the 21st century.
 3. Privatization of most government-owned firms and council housing.
 4. Lowering of marginal income taxes.
 5. Deregulation.
 6. More assertive foreign policy (Falklands War in 1982).
- Quite controversial in the U.K. (although, surprisingly, supported by a majority of workers).



U.K. CO₂ emissions in millions of tonnes (Mt), 1860-2017



Privatizations



Table 9. Product market regulation, competition policy, and price-cost margins

a) PMR

	1975	1990	1998a	1998b	2003	2008
France	6.0	5.2	4.3	2.52	1.75	1.45
Germany	5.2	4.6	2.8	2.06	1.60	1.33
UK	4.8	3.0	1.4	1.07	0.82	0.84
USA	3.7	2.3	1.6	1.28	1.01	0.84

One unhappy artist

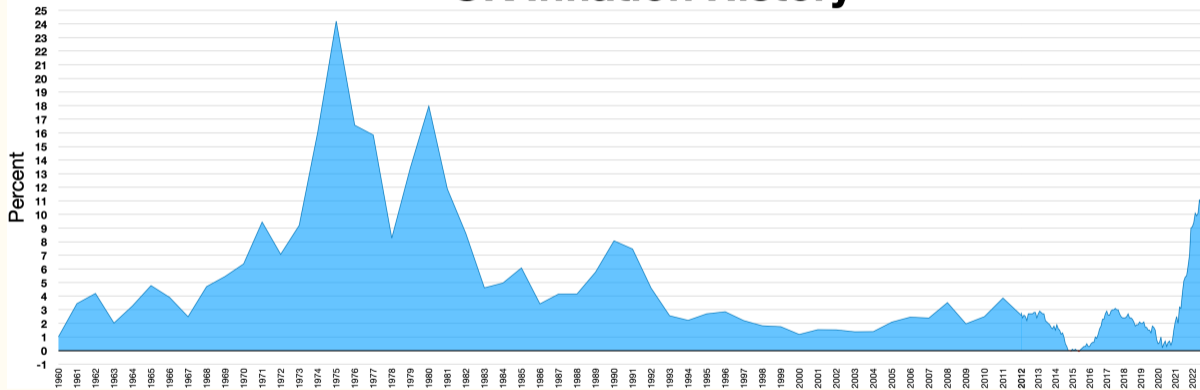
Merry Christmas Maggie Thatcher, by Elton John

So Merry Christmas Maggie Thatcher
May God's love be with you
We all sing together in one breath
Merry Christmas Maggie Thatcher
We all celebrate today
'Cause it's one day closer to your death

The economic legacy of Mrs. Thatcher

- Inflation comes down.
- Number of strikes is dramatically reduced.
- Relative success in per capita GDP terms: U.K. economic decline reversed, but not totally.
- Conservatives can never quite figure out what to do with Europe.
- Lingering problems with education, low investment, and productivity in many sectors.
- Gini index increases by nine points.

UK Inflation History



MAKING A MODERN CENTRAL BANK

THE BANK OF ENGLAND 1979-2003

HAROLD JAMES



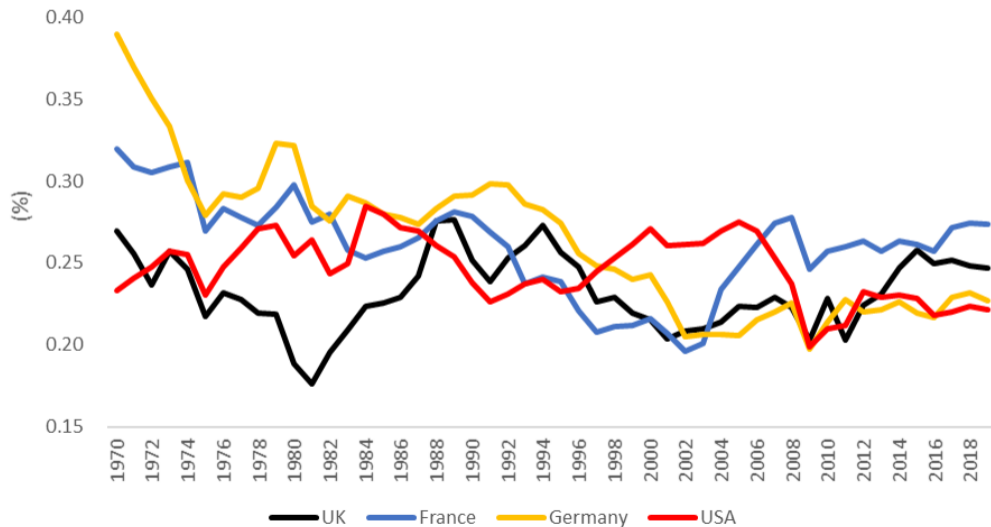
Table 1. Real GDP/head as percentage of other countries in each year

	<i>UK/USA</i>	<i>UK/West Germany</i>	<i>UK/France</i>
1870	130.5	173.5	170.0
1913	92.8	134.9	141.2
1929	79.8	135.8	116.8
1937	96.7	132.7	138.6
1950	72.6	162.1	133.8
1979	70.1	86.3	90.0
2007	75.4	101.4	106.1

Table 6. Levels of productivity in the market sector (UK = 100)

	<i>France</i>	<i>West Germany /Germany</i>	<i>USA</i>
Y/HW			
1973	95	132	160
1979	112	157	166
1991	123	161/143	156
1995	117	133	146
2007	109	119	147
TFP			
1973	87	112	127
1979	103	135	135
1991	110	133/123	128
1995	104	115	123
2007	101	110	125

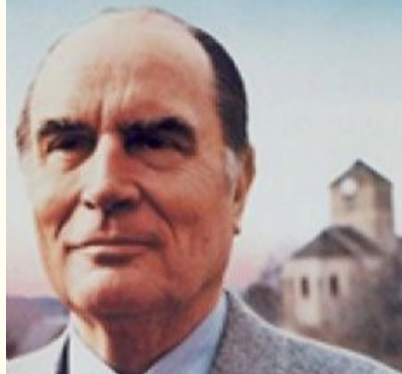
Share of gross capital formation on the GDP, 1970-2019



Reforms across Europe

- However, deep reforms in many other countries without the same level of political stress: New Zealand, Sweden, and the Netherlands.
- Even in France, Germany, and Spain (although less thoroughly).
- France is an interesting case.
- France tries to go in an opposite direction in 1981 after the election of François Mitterrand: new nationalizations and aggressively expansionary fiscal policy.
- Forced to abandon the program after two years (“tournant de la rigueur”).
- Focus on nuclear power.

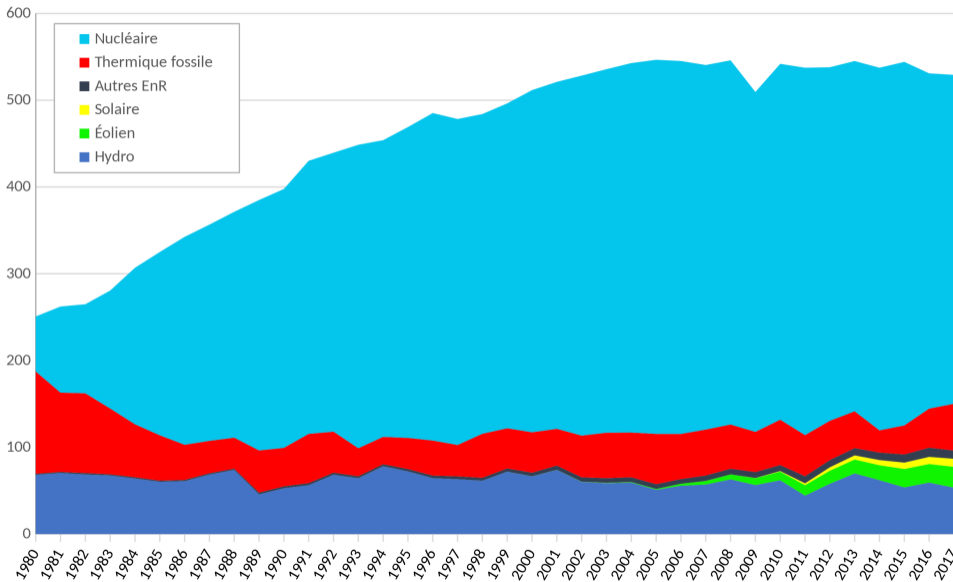
La force tranquille.



Mitterrand Président

TWh

Production nette d'électricité en France



- Germany takes the lead in Europe through its influence in the European Monetary System (the predecessor of the Euro).
- Countries engage in competitive disinflation.
- Landscape changes dramatically with the collapse of the Socialist block.
- German distress after unification and Europe's new round of economic integration.



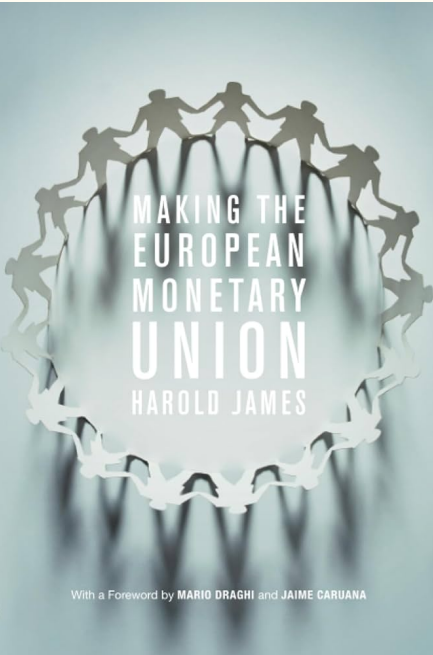




EUROPE SINCE 1989

a history

PHILIPP THER



MAKING THE EUROPEAN MONETARY UNION

HAROLD JAMES

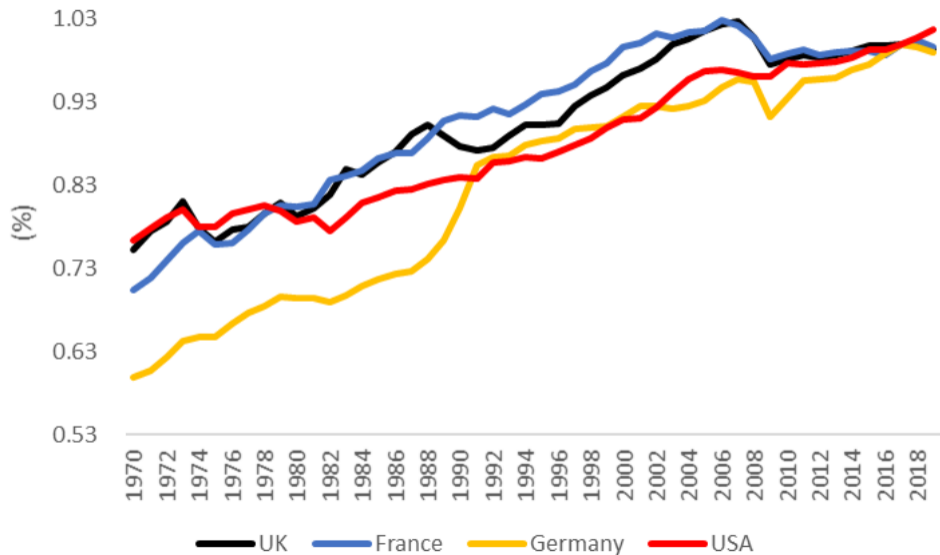
With a Foreword by MARIO DRAGHI and JAIME CARUANA

Productivity slowdown in the 1970s

Period	g_Y	$s_{K}g_K$	$s_{L}g_L$	TFP (g_A)
1929 – 1948	2.54	0.11	1.42	1.01
1948 – 1973	3.70	1.40	0.77	1.53
1973 – 1982	1.55	0.69	1.13	-0.27
1982 – 2004	2.75	0.80	0.96	0.99

- Data for the U.S., but most advanced economies look roughly the same (in fact, productivity slowdown in Europe is deeper).
- 1995-2004 look much better.
- 2005-2015: pretty bad.
- 2016-2020: much better again.
- After COVID?

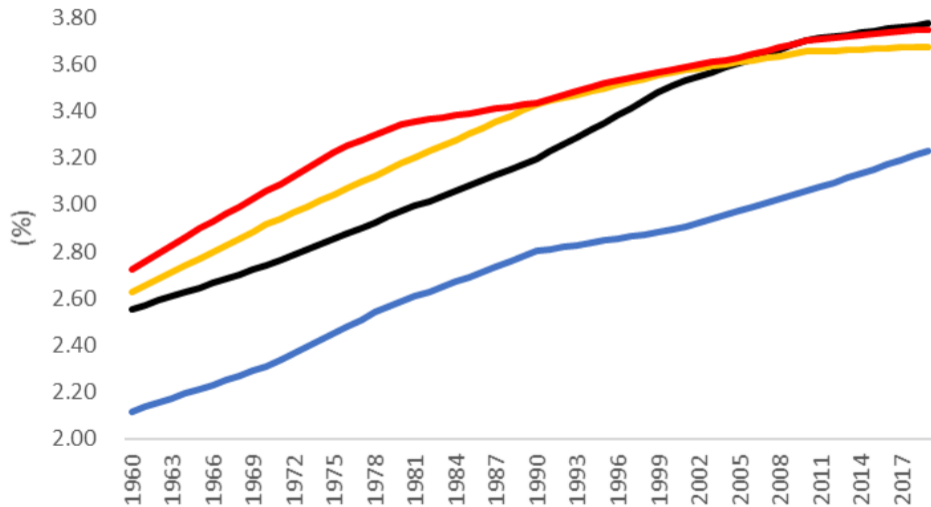
TFP index (2017=100)



Reasons for the productivity slowdown

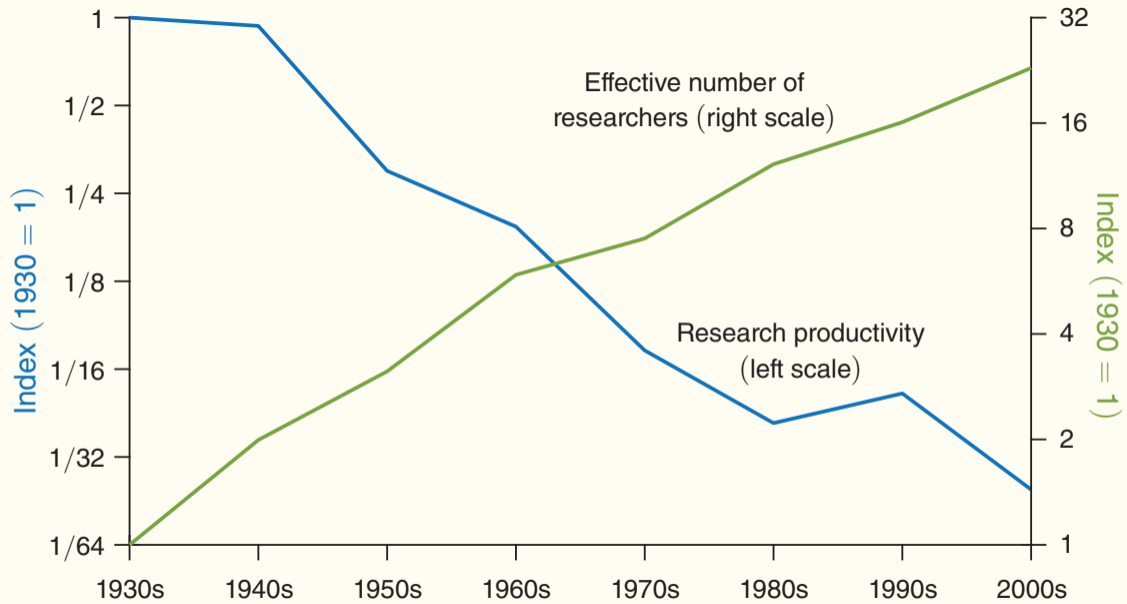
1. Sharp increases in the price of oil in the 1970s.
2. Structural changes: more services and fewer manufacturing goods produced.
3. Slowdown in resources spent on R&D in the late 1960s.
4. TFP was abnormally high in the 1950s and 1960s.
5. Information technology (IT) revolution in the 1970s.
6. Education increases are finishing.
7. We are running out of ideas.

Human Capital index, 1960-2019 (based on years of schooling and returns to education)









A NEW YORK TIMES BESTSELLER

ROBERT J. GORDON

THE RISE AND FALL OF AMERICAN GROWTH

WITH A NEW AFTERWORD BY THE AUTHOR

THE U.S.
STANDARD OF
LIVING SINCE
THE CIVIL
WAR

The book cover features a stylized illustration of several men in work clothes and hats engaged in manual labor. They are positioned around a large, dark, curved structure that resembles a ship's hull or a large piece of industrial machinery. The background is a light, hazy landscape. A prominent red circle is overlaid on the lower right portion of the cover, containing white text. The overall aesthetic is reminiscent of mid-20th-century industrial or maritime art.