Death and Transfiguration

Jesús Fernández-Villaverde\textsuperscript{1}
October 29, 2021

\textsuperscript{1}University of Pennsylvania
Real GDP per capita PPP, 1970-2018 (2017=100)

Source: Maddison dataset
Oil shocks

- Oil shocks of 1973 after the Yom Kippur War (October 6-25, 1973): Israel is caught unprepared and it needs the massive military help of the U.S. and other European countries to turn war around. Arab countries respond by increasing oil prices.

- However, inflation had been brewing before and there is no extra capacity in world oil production.

- Period of monetary instability: only peacetime inflation in U.S. history.

- Fiscal problems: growing public debt.

- Increase of structural unemployment in Europe.

- Growing social unrest since the mid-1960s (May 1968).

- Second oil shock in 1979, after the revolution in Iran.
On October 6, 1973, Arab armies launched a daring surprise attack that nearly destroyed Israel and changed the Middle East forever.
U.S. Inflation from 1775 to Present

Annual percent change in overall U.S. consumer-price index
The age of reform

- Deep reforms in many countries in the 1980s.

  
  1. Fight against inflation.
  
  
  3. Privatization of most government-owned firms and council housing.
  
  4. Lowering of marginal income taxes.
  
  5. More assertive foreign policy (Falklands War in 1982).

- Quite polemical in the U.K. (although supported by a majority of workers).

- Relative success: U.K. economic decline reversed, but not totally.
U.K. CO2 emissions in millions of tonnes (Mt), 1860-2017
Share of gross capital formation on the GDP, 1970-2019

Source: Maddison dataset
• However, deep reforms in many other countries without same level of political stress: New Zealand, Sweden, Netherlands. Even in France, Germany, and Spain (although less thoroughly).

• 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").

• Germany takes the lead in Europe through its influence in the European Monetary System (the predecessor of the Euro).

• Countries engage in competitive disinflation.
La force tranquille.

Mitterrand Président
Productivity slowdown in the 1970s

<table>
<thead>
<tr>
<th>Period</th>
<th>$g_Y$</th>
<th>$s_Kg_K$</th>
<th>$s_Lg_L$</th>
<th>TFP ($g_A$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1929 – 1948</td>
<td>2.54</td>
<td>0.11</td>
<td>1.42</td>
<td>1.01</td>
</tr>
<tr>
<td>1948 – 1973</td>
<td>3.70</td>
<td>1.40</td>
<td>0.77</td>
<td>1.53</td>
</tr>
<tr>
<td>1973 – 1982</td>
<td>1.55</td>
<td>0.69</td>
<td>1.13</td>
<td>−0.27</td>
</tr>
<tr>
<td>1982 – 2004</td>
<td>2.75</td>
<td>0.80</td>
<td>0.96</td>
<td>0.99</td>
</tr>
</tbody>
</table>

- 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.
- 2016-2020: much better again.
- After COVID?
TFP index (2017=100)

Source: Maddison dataset
Reasons for the productivity slowdown


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 1950's 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)

Source: Maddison dataset