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LARGE FISCAL STIMULUS PLANS NOT ENOUGH TO PREVENT RISING UNEMPLOYMENT OVER NEXT TWO YEARS, NEW LEVY STUDY SAYS

New Strategic Analysis Argues that Coordinated Effort to Address Imbalances in International Trade Is Necessary to Restore Sustained Growth and Full Employment

ANNANDALE-ON-HUDSON, N.Y.—With the U.S. economy mired in the worst financial crisis since the Great Depression, policymakers have been scrambling to design and enact fiscal and monetary policy that will restore confidence and growth. A new study from The Levy Economics Institute of Bard College agrees with the use of dramatic fiscal spending plans to bolster the economy, but argues that, even with low interest rates and a massive and sustained fiscal stimulus, unemployment will continue to rise over the next two years. In their Strategic Analysis, Prospects for the U.S. and the World: A Crisis That Conventional Remedies Cannot Resolve, the Levy Institute’s Macro Modeling Team—Distinguished Scholar Wynne Godley, President Dimitri B. Papadimitriou, and Research Scholar Gennaro Zezza—argue that restoring sustained growth and full employment will require a coordinated and unprecedented effort from global financial institutions to address imbalances in international trade.

The Levy scholars have for years contended that robust growth in the economy was being driven by unprecedented and unsustainable imbalances—chiefly in the balance of payments and private debt—that would eventually require both a large fiscal stimulus and a sustained rise in net exports. In their latest analysis, the Levy team draws attention to the dramatic fall in net lending to the private sector as a result of the credit crisis (with a projected drop in GDP of 14 percent between the first quarter of 2008 and the first quarter of 2009), and predicts that trend will continue. The implications for the economy, their model shows, is that GDP will fall about 12 percent below trend between now and

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2010, while unemployment will rise to about 10 percent. The central contention of their analysis is that “the virtual collapse of private spending will make it impossible for U.S. authorities to apply a fiscal and monetary stimulus large enough to return output and unemployment to tolerable levels within the next two years.” Indeed, they write, “even with the application of almost unbelievably large fiscal stimuli, output will not increase enough to prevent unemployment from continuing to rise” through 2010.

Godley, Papadimitriou, and Zezza maintain that fiscal policy alone cannot resolve the current crisis. They assert that “a large enough stimulus will help counter the drop in private expenditure, reducing unemployment, but it will bring back a large and growing external imbalance, which will keep world growth on an unsustainable path.” The Levy team concludes by arguing that expansionary fiscal and monetary policies by the United States and other countries will not be sufficient to restore balanced growth, and that a worldwide recovery of output must be accompanied by sustainable balances in international trade. In previous studies, the authors suggested that a dollar devaluation of 25 percent might do the trick, but they believe a much larger adjustment is now needed to dramatically expand U.S. exports on the order of 25 percent in the next three to four years. They conclude by saying that “it is inconceivable that such a large rebalancing could occur without a drastic change in the institutions responsible for running the world economy—a change that would involve placing far less than total reliance on market forces.”

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Strategic Analysis: Prospects for the U.S. and the World: A Crisis That Conventional Remedies Cannot Resolve

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