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FISCAL STIMULUS AND EXPORT GROWTH NEEDED FOR STRONG US RECOVERY, NEW LEVY ECONOMICS INSTITUTE STUDY SAYS

Budget-Cutting Efforts in Congress Will Likely Prove Counterproductive and Prolong Jobless Recovery, Scholars Say

ANNANDALE-ON-HUDSON, N.Y.—The US economy grew reasonably fast during the last quarter of 2010, and the general expectation seems to be that satisfactory growth will continue in 2011–12. A new report from the Levy Economics Institute of Bard College argues, however, that while the expansion may indeed continue through 2012 and perhaps for another quarter or so in 2013, growth in the medium term cannot be achieved without either a major, sustained increase in net export demand or significant further fiscal stimulus.

In their Strategic Analysis, *Jobless Recovery Is No Recovery: Prospects for the US Economy*, the Levy Institute’s Macro-Modeling Team—President Dimitri B. Papadimitriou and Research Scholars Greg Hannsgen and Gennaro Zezza—analyze trends and indicators in the US economy. They assert that the expansionary fiscal policy initiated by President Obama and reinforced by the aggressive monetary policy of the Fed have brought the Great Recession to an end, but stubbornly high levels of unemployment and underemployment prove that the recovery has not been robust. “More than 7.0 million jobs have been lost since the last peak of employment in November 2007, and, as of December of last year, about 19 million jobs need to be created to have employment returned to its prerecession trend, adjusted for increases in the current population,” they write.

Using a neutral set of assumptions for the government deficit, private spending, and the external balance, Papadimitriou, Hannsgen, and Zezza find that, as a result of the two-year extension of the Bush-era tax cuts, GDP grows to 3.8 percent by 2012 but slips, as the

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tax cuts expire, to just below 2 percent by 2015. The authors term this a “growth recession,” with unemployment declining to 8.6 percent by 2012 but then increasing and stabilizing at about 9.4 percent by 2015. Under this scenario, the private sector continues to reduce its debt and the external deficit disappears. Faster growth and a significant reduction in unemployment, the Levy team suggests, would require either a more substantial increase in the federal deficit than the CBO is projecting or an increase in exports brought about by a devaluation in the dollar—or, preferably, a coordinated realignment of currencies of surplus countries.

“Ideally, countries around the world with large surpluses should consider a focus on increasing their populations’ consumption levels,” the authors write. They note, however, that, in the absence of an internationally coordinated stimulus, aggressive domestic policy is crucial for countries that are running current account deficits. “Domestic monetary and fiscal stimulus measures have helped and continue to do so,” they write. “With the economy operating at far less than full employment, we think Americans will ultimately have to grit their teeth for some hair-raising deficit figures, but should take heart in recent data showing record-low ‘core’ CPI inflation.”

To conclude, the authors acknowledge that, in the next few months, “policymaking will be hampered by political rhetoric and realities in Washington, and hence deficits will probably remain far below the levels that would be needed to bring about a strong recovery. On the other hand, export-led growth has the potential to begin to reduce unemployment. Given the likely political tenor of the new Congress, we consider only a moderate fiscal stimulus in this analysis, finding that growth prospects are somewhat improved in a scenario combining this stimulus with a devaluation. Specifically, the unemployment rate declines to about 7 percent by the end of the simulation period.”

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Strategic Analysis: Jobless recovery is No Recovery: Prospects for the US Economy

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