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SIGNIFICANT INCREASE IN FISCAL STIMULUS NEEDED TO REDUCE UNEMPLOYMENT AND SPUR GROWTH, NEW LEVY STUDY SAYS

ANNANDALE-ON-HUDSON, N.Y.— With rising interest rates in Europe and faltering jobs growth in the United States, global policymakers are meeting with urgency to discuss ways to keep the fragile recovery from the financial crisis from unraveling. Broad measures indicate that 14.5 percent of the U.S. labor force is unemployed or underemployed. A new study from the Levy Economics Institute of Bard College contends that official projections for recovery in America rely on the same faulty economic models that failed to predict the crisis, and that a sustainable recovery in jobs and growth will require further fiscal stimulus.

In their Strategic Analysis *Back to Business as Usual? Or a Fiscal Boost?* the Levy Institute’s Macro-Modeling Team—President Dimitri B. Papadimitriou and Research Scholars Greg Hannsgen and Gennaro Zezza—estimate that in order to fill the gap between the current employment rate and the peak it reached prior to the 2001 recession, the United States would need to find jobs for about 6 percent of the working-age population, or roughly 15 million people, an outcome they argue is unlikely to occur without further fiscal stimulus. With economic uncertainty abroad limiting the potential for export growth, the scholars contend that the Congressional Budget Office’s (CBO) projections of a mild surge in job growth starting two years from now are unrealistic, unless private sector borrowing and indebtedness surge again as they did before the financial crisis.

Papadimitriou, Hannsgen, and Zezza argue that the CBO model is “still based on theoretical assumptions that have been proven wrong by the spectacular failure of

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mainstream models to predict the last recession: (1) that output is driven by supply-side forces, such as incentives in the tax code to supply labor; and (2) that a government deficit only crowds out private investment,” they write. Furthermore, they are critical of both sides in the economic debate for relying on a supply-side theory to substantially cut corporate tax rates to encourage business investment, despite the fact that “cash is now rather notoriously abundant on corporate balance sheets” and has largely been spent on buying back stock and funding acquisitions, and not on new investment or retaining employees.

To conclude, the Levy team recommends at least a modest application of fiscal stimulus. “A small, tax-financed increase in government investment could lower the unemployment rate significantly—by about one-half of 1 percent,” they write. Given the political realities, a stimulus package of this size might be within the realm of possibility. However, “it would take a much more substantial increase in fiscal stimulus to reduce unemployment to a level that most policymakers would regard as acceptable.” A good stimulus plan would include help for state and local governments, a renewal of the 2011 payroll tax cut, incentives for private sector job creation, an extension of unemployment benefits, and, with so many skilled people out of work and capital cheap, an investment in long-run initiatives such as infrastructure improvement.

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Strategic Analysis: Back to Business as Usual? Or a Fiscal Boost?

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