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ECONOMIC IMBALANCES LOOM OVER U.S. ECONOMY
WITH NO EASY REMEDY, LEVY INSTITUTE SCHOLAR SAYS

ANNANDALE-ON-HUDSON, N.Y.—In the first quarter of 2005, the U.S. trade deficit reached 5.7 percent of gross domestic product (GDP), with many economists expecting it to rise even further in the absence of major policy changes. In a new policy note from The Levy Economics Institute of Bard College, Levy Institute Distinguished Scholar Wynne Godley argues that the United States’s surging trade deficit poses a serious threat to the U.S. and global economies that is unlikely to be alleviated by a devaluation of the dollar or a rise in exports.

In his policy note, Some Unpleasant American Arithmetic, Godley examines the state of structural imbalances within the U.S. economy between the private sector, government, and current account. He contends that, if the current account deficit remains near 6 percent and the private sector balance moves back toward positive territory or to its long term average of plus 1.8 percent, the U.S. government deficit would have to rise to between 6 and 8 percent of GDP in order to maintain adequate growth. “Are either of these figures for the budget deficit credible, given the administration’s firm commitment to cut the federal deficit in half during the next four years?” Godley asks. “Yet without such renewed fiscal stimulus, the United States will at best encounter a prolonged growth recession” under even conservative assumptions regarding international trade and the private sector balance.

The current account problem, Godley says, would not necessarily be solved by a rise in exports, because that could simply be a manifestation of recession in the United States. “Sustained and balanced growth in the future requires that exports rise faster than full-employment imports,” he writes. “This is a necessary condition for achieving a reduction...continued...
in the budget and current account deficits simultaneously without recession." Still, he finds the obstacles to such a growth in exports daunting. He maintains that, using a range of assumptions regarding the value of the dollar, that a sustained rise in the volume of exports at a rate well in excess of 12 percent per annum—faster than during any previous four-year period—would be required to reduce the trade deficit to 3 percent. Beyond the likelihood of such a scenario, Godley has questions as to which countries would be buying these exports and whether or not the United States even has the capacity to manufacture them.

Godley mentions a few of the issues that could force the strategic issue of the U.S. imbalances, possibly a collapse in the housing market boom or the loss of manufacturing jobs, but ultimately contends that a global solution will be necessary to address an issue that surely has global consequences. “How is the rest of the world to manage should their main motor for growth—their growing trade surplus with the United States—turns negative?” he asks. “Are they collectively able and willing to generate adequate growth at home to compensate for the loss?”

Policy Note 2005/5, Some Unpleasant American Arithmetic

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