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LEVY INSTITUTE REPORT FINDS ECONOMIC UNDERPINNINGS OF THE 'GOLDILOCKS ECONOMY' ARE UNSUSTAINABLE

Author Contends There is No 'New Paradigm' and That Structural Imbalances Will Eventually Halt Economic Growth

ANNANDALE-ON-HUDSON, N.Y.--As the U.S. economy continues on its record-setting roll, many economists are seeking a new economic paradigm that can explain the expansion and its unusual combination of low unemployment and benign inflation. In a new report issued by the Jerome Levy Economics Institute, distinguished scholar Wynne Godley explores the underpinnings of the eight-year expansion and finds that the economic processes associated with what has come to be known as the "Goldilocks economy"-- neither too hot nor too cold--are clearly unsustainable.

He contends that there is no new paradigm to be found and that, while the U.S. economy could continue to expand as the result of such forces as rising consumer spending relative to debt for perhaps another year or two, the economy will eventually succumb. He also argues that when the economy does at last begin a downward turn, the result could be a deep and/or prolonged recession.

In his report, ***Seven Unsustainable Processes, Medium-Term Prospects and Policies for the United States and the World,*** just published by the Levy Institute, Godley cites the following as among the unsustainable forces associated with current U.S. economy:

- The fall in private saving into ever deeper negative territory
- The rise in the flow of net lending to the private sector
- The rise in asset prices at a rate that far exceeds the growth of profits (or of GDP)
- The rise in the budget surplus
- The rise in the current account deficit
- The increase in the United States's net foreign indebtedness relative to GDP

Godley analyzes these processes and determines that, in an era of increasingly tight fiscal policy and slowing net export demand, economic growth has been fueled entirely by an exceptional rise in private spending *relative to income.* This process cannot be sustained indefinitely, he says, adding that, while capital gains income has contributed to household wealth, these gains do not add to income and thus, as one-shot gains, cannot be counted on to fuel growth indefinitely.

"As the budget balance during the last seven years has changed by a larger amount than any since the early 1950s and has reached a record surplus, and as the current balance of payments has deteriorated rapidly," he says, "it comes as no surprise to find that the private sector balance has moved south as well, again by a record amount (reaching 5.5 percent of GDP in the second quarter of 1999). The descent of the private sector into financial deficit means the sector as a whole has become a net borrower on a record and growing scale."

"Given unchanged fiscal policy and accepting the consensus forecast for growth in the rest of the world, continued expansion of the U.S. economy requires that private expenditures continue to rise relative to income. While anything can happen over the next year or so, it seems *impossible that this source of growth can be forthcoming on a strategic time horizon,"* he writes.

Godley concludes that it will eventually become necessary *both* to relax fiscal policy and to increase exports relative to imports--not an easy task.. Getting the timing right is particularly important, he writes, noting that it would be wrong to relax fiscal policy immediately, just as the credit boom reaches its peak. Over the coming five to ten years is will be necessary not only to bring about a substantial relaxation in the currently restrictive fiscal stance in the United States, but also to ensure that there is a structural improvement in the United States's balance of payments.

Special Report, *Seven Unsustainable Processes, Medium-Term Prospects and Policies for the United States and the World*

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