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RESTORING GROWTH AND EMPLOYMENT SHOULD BE TOP POLICY PRIORITY, NOT CUTTING DEFICIT, NEW LEVY INSTITUTE STUDY SAYS

Budget Deficits Are Inevitable Result of Low Economic Growth and Lost Tax Revenues, and a Normal Part of Boom-Bust Cycle, Scholars Say

ANNANDALE-ON-HUDSON, N.Y.— As America heads toward midterm elections, policymakers and economists are debating how best to restore growth and jobs to the U.S. economy, with many calling for the government to rein in spending, citing fears about the impact of soaring budget deficits. Yet, a Labor Department report released at the start of Labor Day weekend offered little encouragement to those unemployed: 67,000 new private-sector jobs were created in August, more than expected but still far short of the number needed to keep up with the growth of the potential workforce. A new study from the Levy Economics Institute of Bard College argues that restoring growth and addressing unemployment should be the federal government's top priority, and that America's current fiscal stance is not the product of political whims but part and parcel of the recession and financial crisis. The Levy study contends that the dire economic situation demands very high deficits for at least a few more years.

In their new Public Policy Brief, *Debts, Deficits, Economic Recovery, and the U.S. Government*, Levy President Dimitri B. Papadimitriou and Research Scholar Greg Hannsgen evaluate the current path of fiscal deficits in the United States in the context of government debt and further spending, economic recovery, and unemployment. Papadimitriou and Hannsgen find that federal government and Federal Reserve liabilities, as a percent of quarterly GDP, are much less now than they were in 1947, immediately following a very costly war. "We are not in uncharted territory." they write. The federal deficit cannot be treated as a policy problem when it is a nearly inevitable result of low

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economic growth, which reduces tax revenues. “We are adamant that there is no justification for the belief that cutting spending or raising taxes by any amount will reduce the federal deficit, let alone permit solid growth,” they write. Furthermore, “Deficit spending helps the private sector, and the effects of higher deficits have moderated, and ultimately ended, most postwar U.S. recessions.”

In their study, Papadimitriou and Hannsgen explore the question of how much of the current deficit is merely the result of a severe recession and financial crisis, however damaging it might be to fiscal health: and how much reflects freer spending by the Congress and the president. They find that, according to the Congressional Budget Office, stimulus bill spending for 2009 amounted to only 0.7 percent of GDP, and that discretionary spending, often considered the big problem by conservatives, increased by only 1.2 percent of GDP from 2007 to 2009. Meanwhile, tax revenues fell from 18.5 percent to 14.8 percent of national output in that period. “Once Congress sets tax policy, it is the strength of the economy that determines tax revenues,” the authors write. “The stimulus bill accounts for 0.6 percentage points of this 3.7 percentage-point decline. The point of stating these facts is not to claim that the budget deficit is unrelated to recent political decisions, but to make it clear that America’s current fiscal stance is part and parcel of the recession and financial crisis, and not the product of political whims.”

The Levy scholars acknowledge that the national debt and its size are very important political and economic issues. They maintain, however, that fears about inflation and a sharp drop in the dollar have not materialized, with key interest rates continuing on a downward trend. Furthermore, they assert that the U.S. government as a sovereign nation cannot go bankrupt. A far more substantial fear, they say, are the consequences of continued low growth and high unemployment for both the government’s long-term fiscal stance, via tax revenues, and the American public. One-point-four million Americans declared bankruptcy last year. But these bankruptcies “were mostly due not to personal failings or bad character but to the problems that we as a society have failed to address,” the authors write. “And these bankruptcies were mostly the result of problems that are within society’s power to ameliorate: victimization by fraudulent or imprudent financial practices; an economy with more than four job seekers for every opening; and a medical system in which many Americans resort to the use of credit cards to pay hospital bills.”

To conclude, Papadimitriou and Hannsgen recommend a variety of financial reforms, including addressing the ways individuals incur debt via reform of the legislative process, campaign financing, lending practices, and consumer regulations. They also strongly suggest mending holes in the U.S. social safety net, including an employer-of-last-resort program that would address the upward trends in unemployment and poverty.

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