Contact: Mark Primoff
845-758-7749
primoff@bard.edu

FOR IMMEDIATE RELEASE

**LEVY INSTITUTE DISTINGUISHED SCHOLAR WYNNE GODLEY ISSUES WARNING ABOUT SURGING TRADE DEFICIT AND PRIVATE DEBT**

ANNANDALE-ON-HUDSON, N.Y.—Despite adequate growth rates, a soaring trade deficit and other imbalances in the U.S. economy are threatening to push the country toward recession, suggests a new policy note from The Levy Economics Institute of Bard College. Levy Institute Distinguished Scholar Wynne Godley argues that, as the trade deficit continues to expand to record proportions, the U.S. economy is once again relying on private expenditure relative to income for growth, as it did in the "Goldilocks" period of the 1990s. Should that private spending falter in the face of record levels of private debt, Godley contends that policymakers will have few options for stimulating the economy with the federal government already running a substantial deficit.

In his new policy note, *Imbalances Looking for a Policy*, Godley explores two destructive trends in the U.S. economy: the surging trade deficit and the reliance on private spending to fuel growth. On the former, he stresses that the trade deficit has continued to surge despite a 17 percent depreciation in the dollar. He credits this outcome to the fact that the terms of trade—the prices of non-oil imports of goods and services, relative to those of exports—have improved and kept imports soaring. Godley expects the trade deficit to continue growing given that imports of goods and services are now more than 50 percent higher than exports. "If output continues to grow at 3.5 to 4 percent per annum, there will probably have to be a 12 percent annual average increase in the volume of exports sustained over four years (a growth rate rarely achieved in the past) to get any significant improvement in the overall balance," writes Godley.

Furthermore, Godley says that the surging trade deficit has pushed private spending back

***-continued-***

to the forefront as the main engine for growth in the United States. Given that private debt has reached about 175 percent of private disposable income, Godley argues that this trend is not sustainable. "Private debt and borrowing cannot continue to provide the motor for expansion for more than a couple of years, particularly if interest rates go on rising. The growth in private debt must eventually slow down, causing net lending to fall and thus threatening recession, exactly as happened in 2000," writes Godley. "But there can be no remedy this time in the shape of a fiscal expansion. A repeat of the 2000–03 stimulus would take the budget deficit to 9 percent of GDP!"

Godley maintains that the trade deficit must eventually be turned around, but points out that there are few options for accomplishing this. "Any lasting solution will probably require a new international order, but at the moment no one has a motive for bringing this about. After all, the United States enjoys consuming 6 percent more than it produces," writes Godley, stressing that it is likely that the current account balance will go on exercising a negative influence on demand for some time. In his conclusion, Godley says that, given the likelihood of an increasing trade deficit and the limitations of private spending, the prospect of recession is "dangerously increased" if President Bush follows through on plans to cut the deficit in half during the next four years. "Taken everything together, there is plenty to worry about."

# # #

Policy Note 2005/4, *Imbalances Looking for a Policy*

(4.12.05)