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REVENUE SHARING AND GOVERNMENT JOBS PROGRAM WILL HELP SUSTAIN U.S. ECONOMY, NEW LEVY REPORT SAYS

ANNANDALE-ON-HUDSON, N.Y.—As the U.S. economy continues to show signs of resurgence, many analysts and policymakers are discussing ways to address the record budget and trade deficits and to guard against inflation. In a new report from The Levy Economics Institute of Bard College, Senior Scholar L. Randall Wray discusses the threats facing the U.S. economy; dismisses budget deficits and debt, the trade deficit, and depreciation as potential impending crises; and urges policymakers to adopt a strategy that fosters a lower-growth, high-consumption, and full-employment economy.

In his policy note, *Those "D" Words: Deficit, Debt, Deflation, and Depreciation*, Wray argues that budget deficit-to-GDP and debt-to-GDP ratios are not high compared to past levels and that global demand for dollar assets makes it unlikely that the trade deficit will lead to a run on the dollar. Wray contends that the greatest risk to the U.S. economy comes from a potential demand gap created by years of private spending in excess of income alongside renewed calls for fiscal responsibility. "While private sector deficits today are much smaller than they were in 2000, we are still in a very unusual situation as a result of continuous deficit spending for the past eight years," he writes, stressing that the private sector historically averages surpluses of 2 to 3 percent of GDP with higher levels during downturns. "A simple return to the historical average would open up an aggregate demand gap of $300 to $400 million. If this occurred, it is very difficult to see how a deep recession with double-digit unemployment could be avoided."

Wray maintains that the government budget balance is, to a large extent, nondiscretionary because it must respond to the other sectoral balances, trade and, especially, private spending. In other words, an appropriate fiscal stance depends on the private sector's

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desired level of spending, given its income and the external balance. Should the government hesitate to relax its fiscal stance in the face of retrenched private spending, a demand gap will open up, he says. While he calls on the federal government to meet any gap in demand, Wray stresses that a jobs program, payroll tax cuts, and revenue sharing with state and local governments would be more effective than the fiscal policies adopted by the Bush administration. "The Bush tax cuts have been largely targeted to upper-income households and nonwage income. The employment-multiplier effects of such tax cuts, as expected, have been fairly small," he writes.

Wray contends that payroll tax cuts would do more on the demand side, by stimulating consumption, and on the supply side, by increasing incentives for employers to hire and workers to work. Furthermore, he maintains that a government public service employment program would target lower-income families directly, make much needed improvements to public infrastructure and education, and boost consumption and employment in a sustainable and affordable way that will reduce inflationary pressures. "Direct job creation that puts people to work doing useful things can ad to national output and raise living standards without generating much inflationary pressure," Wray writes, stressing that a spending plan that creates demand for highly skilled jobs will generate wage inflation long before jobs trickle down to those with the least education and training.

To conclude, Wray suggests that a low-growth economy pinned to full employment and high consumption could help avert the fragility, instability, and potential demand gaps that seem to result from high-growth strategies that generally favor private investment. Regarding the wave of commentary on the supposed financial crises that are looming as a result of the impending retirement of millions of baby-boomers, Wray argues that policymakers should assure senior citizens that future commitments to social security benefits can and will be met, and that fear-mongering poses a great risk to the economy. "If we have learned anything from Japan's decade-long malaise, it should be that, once the population loses faith that its government will provide for its future, private savings can never be high enough. Even with substantial trade surpluses and budget deficits reaching 8 percent of GDP, households and firms in Japan struggle to run larger budget surpluses, which is a rational response to a climate of uncertainty and fear about the future."

Policy Note 2004/2, *Those "D" Words: Deficit Debt, Deflation, and Depreciation*
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