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**INTERNATIONAL EFFORT NEEDED TO ADDRESS SERIOUS ECONOMIC
THREATS POSED BY U.S. TRADE IMBALANCE, NEW LEVY STUDY SAYS**

**End of Housing and Refinance Booms Could Force Economic Issues
Created by Structural Imbalances in U.S. Economy, Levy Macro Team Says**

ANNANDALE-ON-HUDSON, N.Y.—In recent months, Federal Reserve Chairman Alan Greenspan has acknowledged “froth” in the U.S. housing sector and also declared that the housing boom is likely to cool in the coming years. Because spending in excess of income and the accumulation of record levels of debt by American households—fueled largely by the housing and refinance booms—have been counted on so heavily for U.S. economic growth, it is critical to explore the implications of any slip in housing prices. A new Strategic Analysis from The Levy Economics Institute of Bard College suggests that a pullback in U.S. housing prices over the next decade could trigger serious domestic and global economic consequences because of the unsustainable structural imbalances in the U.S. economy, chiefly the record deficit in the current account.

In their Strategic Analysis, *The United States and Her Creditors: Can the Symbiosis Last?*, the Levy Institute's Macro Modeling Team—President Dimitri B. Papadimitriou, Distinguished Scholar Wynne Godley, and Research Scholars Claudio H. Dos Santos and Gennaro Zezza—maintains that the economic benefits of the U.S. housing boom, which has created large increases in net lending to households, record low savings rates, and record levels of debt, will peak within the next decade and that a new source of stimulus needs to be found. They argue that, given the likelihood of decreased private spending and the unlikelihood of a dollar devaluation to balance the current account deficit, an international agreement to realign the pattern of global demand and adjust prices will be needed to avoid a global slowdown.

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In their analysis, the Levy scholars contend that over the next five years, housing will slow and private spending decline, and the current account deficit will continue to climb toward 8.5 percent, requiring the federal deficit climb to an equal level to maintain growth and unemployment. Such a deficit would raise public debt to 150 percent. “The situation being imagined is one in which aggregate demand is being rapidly depleted at an increasing rate by higher saving and a negative balance of payments. If there is to be an adequate growth in aggregate demand, this hemorrhage needs to be offset by increasing transfusions in the form of net income generated by the government,” the Macro Team writes, stressing that the only other way to avoid stagnation would be to stimulate export demand.

While the Levy scholars contend that it is critical for the United States to raise export demand in the medium term, they admit the options for doing so are limited. A major dollar devaluation is unlikely because the current trade deficit has allowed China and other Asian countries to accumulate vast dollar reserves and to build massive industrial capacity, while enabling America to consume 6 percent more resources than she produces. The disastrous consequences of this increased penetration of foreign goods on what remains of U.S. manufacturing industry have prompted calls for protectionist policies against China, but the Levy team contends that such a course would be ineffective in rebalancing the U.S. and world economies and would have a deplorable effect on global trading arrangements. While the scholars offer a uniform nondiscriminatory tariff on all imports as an option that would be similar in effect to a dollar devaluation, they admit that such a move yields uncertain results and is an unlikely choice for American policymakers.

Finally, Papadimitriou, Godley, Dos Santos, and Zezza argue that strategic policy options for the United States to address its imbalances are beginning to shut down. “As the normal equilibrating forces (changes in exchange rates) are being subverted, it is very far from obvious what the United States can do on her own,” the authors write, stressing that protectionist policies are unlikely to resolve or force the issue. “A satisfactory long-term solution probably resides in new international arrangements whereby the price mechanism (i.e. revaluation of currencies) redirects the trade flows, while changes in fiscal and monetary stance (restrictive in the United States and expansionary in other countries) sustains aggregate demand on a global scale.”

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Strategic Analysis, *The United States and Her Creditors: Can the Symbiosis Last?*

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