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FEDERAL GOVERNMENT MUST PLAY BIGGER ROLE IN ECONOMY

Significant Stimulus Needed to Stem Recession, Improve Nation's Infrastructure and Restore Long-term Growth, According to New Levy Institute Report

ANNANDALE-ON-HUDSON, N.Y.--Though still expecting the current U.S. recession to be mild and a recovery to begin soon, most policymakers are calling for a modest temporary stimulus package to boost the economy. This approach marks a return to Keynesian economic policy, which has been out of favor in academic circles and in Washington, D.C. for nearly three decades. In a new report from the Levy Economics Institute of Bard College, however, Levy President Dimitri Papadimitriou and Senior Scholar L. Randall Wray argue that the current proposals are not truly Keynesian policies in that they are temporary and too heavily weighted with supply-side tax cuts for the wealthy. The authors contend that a more significant long-term stimulus plan is needed to restore growth and address sever deficiencies in public infrastructure and social programs that have been neglected by the market-driven policies of recent decades.

In their policy note titled *Are We All Keynesians (again)?*, Papadimitriou and Wray maintain that the pursuit of unbridled free markets by recent administrations and congresses--through cuts in government programs, fiscal austerity, and the relaxation of trade barriers--has led to the deterioration of public infrastructure, unprecedented levels of household debt, and little economic improvement for middle- and lower-income Americans. At the same time, they assert that this market-driven approach--thought masked by the unsustainable, debt-fed boom of the late 1990s--allowed for serious national and international financial crises and, by running a federal budget surplus, pulled money out of the economy, undercutting long-term growth.

"The best government is *not* that which governs least. The best economy is *not* that which is abandoned to the invisible fist of the unconstrained market. Our national and individual security is *not* best left to the fate of the private pursuit of maximum profit," the authors write, stressing that a truly Keynesian policy would recognize that modern economies need the long-term stabilizing influences of government spending and programs. Papadimitriou and Wray maintain that those still predicting a speedy economy recovery and a restoration of productivity-driven growth are overlooking the significance of the record private deficit that has resulted from structural imbalances in the federal budget.

"Such predictions are based on the belief that a continuation of the Fed's easy-money policy, together with the administration's proposed stimulus program, will restore private confidence and spending," they write. "Any long-term strategy that relies on a sustained private sector deficit and a sustained public sector surplus is doomed to fail because the structurally tight government budget will result in a recession and a cyclical budget deficit--precisely what is currently taking place."

To make up for the shortfall in demand, Papadimitriou and Wray say that an eventual fiscal adjustment of approximately 3 percent of Gross Domestic Product (GDP), or about $600 billion, will be needed, depending on the trade deficit. The fiscal stance can be tightened to the extent that the trade deficit declines. In addition, to the $55 billion already approved for emergency spending and the approximately $100 billion in tax breaks expected to be passed by Congress, Papadimitriou and Wray recommend the implementation of a permanent revenue sharing agreement with the states, in the form of an annual $150 billion infrastructure investment program. They also call for $150 billion to expand the Earned Income Tax Credit, extend medical insurance to the uninsured, increase federal spending on unemployment compensation, and significantly improve public health services.

"It is both unfortunate and 'non-Keynesian' that the proposed demand stimulus package is envisioned as temporary, while supply-side policies (trickle-down tax cuts for the wealthy) are proposed for long-term growth," write Papadimitriou and Wray. "If 'Keynesian' policies are to be successful, it must be recognized that the real problem is a structurally unbalanced budget that will kill recovery by generating surpluses at a low growth rate."

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Policy Note 2001/10, *Are We All Keynesians (Again)?*