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HOW LONG CAN THE UNITED STATES ACT AS THE WORLD'S SPENDER OF LAST RESORT?

ANNANDALE-ON-HUDSON, N.Y.--The U.S. economy continues to grow with surprising vigor, thanks largely to private spending. In 1998 the volume of U.S. private spending rose by almost twice the increase in disposable income. The key question now is whether or not this pattern of demand growth can continue.

In ***How Negative Can U.S. Saving Get?*** a new Policy Note from The Jerome Levy Economics Institute, Levy Institute Distinguished Scholar Wynne Godley, with coauthor Bill Martin, chief economist at Phillips and Drew, answer with a resounding no. While short-term prospects for U.S. economic growth are difficult to predict, the authors write that "in the next few years, it seems to us wholly improbable that the United States can continue to act as the world's spender of last resort."

"American demand has been kept alive by a burst of spending by households and companies well in excess of after-tax incomes," they write. "An unprecedented gap between private spending and income now exists, and that gap has been financed primarily by an increase in borrowing." They note that in 1998 private spending rose by 6 percent, almost twice the increase in disposable income. Without this spending, the authors say, the economy would have stagnated, especially given recent and projected U.S. trade performance.

For this pattern of demand growth to continue over the next five years, private spending would have to exceed income by an amount double the unprecedented 1998 level and equivalent to over 8 percent of the gross domestic product. The authors calculate that the flow of net lending to the private sector would have to rise to over 20 percent of disposable income, and external net debt would then rise to over 30 percent of GDP, thanks to a large and widening trade gap.

This debt load, the authors contend, is clearly unsustainable. "At some stage, private sector spending will subside to a rate at best equal to, and more probably below, private sector income," they write. This would bring U.S. economic growth to a halt, with serious collateral damage to the rest of world, they explain.

While monetary policy would surely be adjusted to compensate for slowing growth, the authors maintain that fiscal policy, in the form of coordinated fiscal pump-priming in Europe and the United States, offers the most plausible solution.

Policy Note 1999/1, *How Negative Can U.S. Saving Get?*

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