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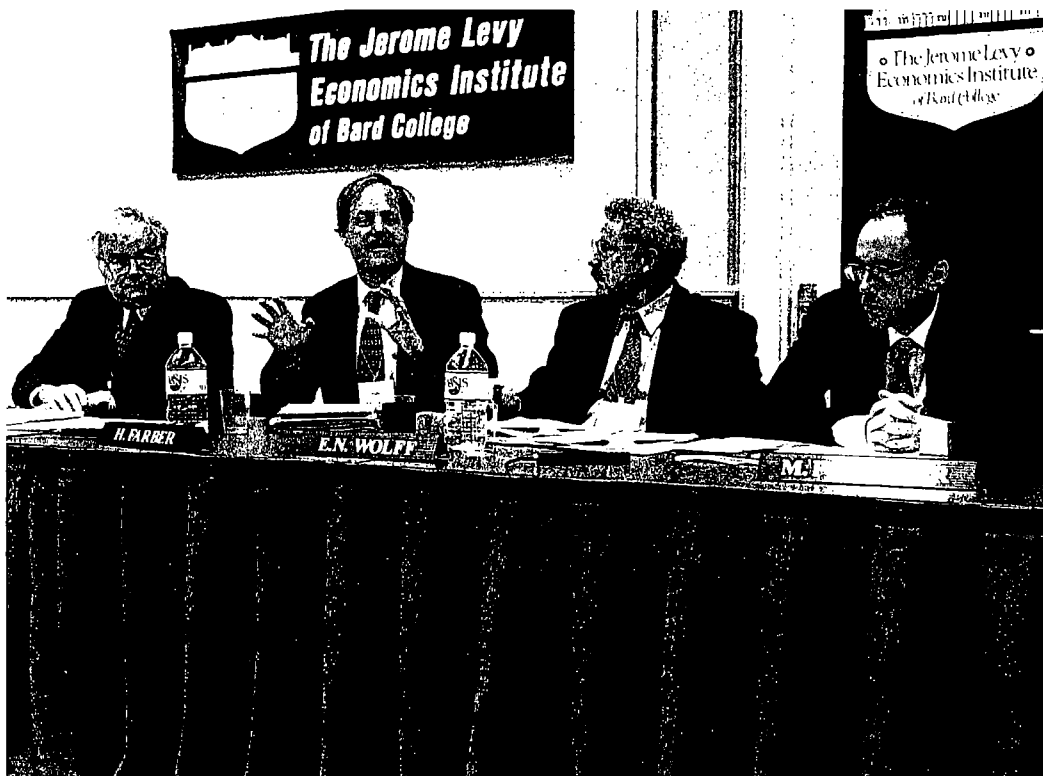


The Jerome Levy Economics Institute of Bard College

Report

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LEVY INSTITUTE



Scholars gather at a Levy Institute symposium to discuss the persistence of poverty in the United States and policies to reduce it (see page 3). From left to right: Vernon M. Briggs Jr., Cornell University; Henry Farber, Princeton University; Edward N. Wolff, New York University and the Levy Institute; and Mathew Forstater, the Levy Institute.

- Leon Levy talks about weaknesses in the American economy that make it—and the stock market—vulnerable to downturns (see page 7).
- James K. Galbraith and George Purcell trace the chain of worldwide events that followed from the Fed's failure to pursue interest rate cuts (see page 12).
- Researchers and policymakers looking for the causes of the Asian financial crisis should take a closer look at the role played by derivatives, argues Jan A. Kregel (see page 15).
- Poverty is commonly defined in terms of income, but Robert Haveman and Andrew Bershader propose a new definition, based on the capacity to be self-reliant (see page 15).

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LEVY INSTITUTE

What to Do with the Surplus: Fiscal Policy and the Coming Recession

Dimitri B. Papadimitriou and L. Randall Wray

Neither Congress nor the president is on the right track. Rather than protecting the surplus, we should be increasing spending and cutting taxes to contain the looming world recession.

The United States has enjoyed a Goldilocks economy since the early 1990s: robust growth, low unemployment, and low inflation. After much debate, many resolutions, historic budget agreements, and a strong equity market, the federal government finally managed to balance its fiscal 1998 budget (indeed, ran a surplus) for the first time in more than a generation. Predictably, a new debate—over “what to do with the surplus”—has emerged. Some policy-makers favor tax cuts, others prefer debt reduction, and the president has advocated the rescue of Social Security. We argue that the budget surplus will be short-lived as the coming worldwide recession slows growth in the United States and lowers tax revenues. In our judgment the deficit reduction during the 1990s played a significant role in depressing aggregate demand, which was offset only by unsustainable private sector borrowing. As the private sector in the United States becomes cognizant of declining equity markets, the spread of financial crises from Asia to Russia and Latin America, and falling world demand, it will be forced to reduce borrowing and repay loans. This will cause an economic downturn in the United States. While we applaud the Federal Reserve’s recent timid moves to lower interest rates, we do not believe that monetary policy alone can stabilize the U.S. economy. Rather, substantial fiscal stimulus will be required. Although well-targeted tax cuts may do some good and should be considered, the stimulus should be supplied mainly in the form of an increase in the federal government’s budget.

Dimitri B. Papadimitriou is executive director of The Jerome Levy Economics Institute and Jerome Levy Professor of Economics at Bard College. *L. Randall Wray* is a senior scholar at The Jerome Levy Economics Institute. The Levy Institute’s Marc-André Pigeon provided valuable research assistance.