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## Nobel Laureate Phelps Says U.S. Recovery Will 'Run Out of Gas'

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By Jeffrey Donovan and Erik Schatzker



Nov. 6 (Bloomberg) -- The U.S. economic recovery will probably "run out of gas" as it heads toward a "new normal" of lower long-term growth and higher unemployment than over the previous decade, Nobel laureate **Edmund Phelps** said.

The U.S. economy "is groggy, but it's getting to its feet," Phelps, who won the Nobel Prize in 2006, said in an interview with Bloomberg Television today in New York. "We're already seeing a strong recovery, I just think that it's going to run out of gas."

The U.S. **unemployment rate** rose to a 26-year high of 10.2 percent in October, a level not seen since 1983, and payrolls fell more than economists forecast, a report today showed. While the economy grew the most in two years in the third quarter and the decline in payrolls may bottom in the first quarter of 2010, that doesn't change the fact that the economy has lost its "dynamism," Phelps said.

The jobless rate in the medium-term may settle at between 6 percent and 7.5 percent, said Phelps, who was speaking before the payrolls data was published. That compares with a 4.9 percent average in the decade through 2007.

### Economists' Battle

"As output goes up, employment is going to continue to lag," said Phelps. "Firms have gotten rid of a lot of their workforce cushion, so to speak, and they're going to do without that for a quite a while."

Phelps, wading into a battle between Keynesian economists, who favor fiscal stimulus, and neoclassicists, who believe markets best solve economic problems on their own, said both may be ignoring the fact that the economy has changed.

"Neither of these schools recognizes the structural changes that the economy is susceptible to," he said. "There are signs that the economy has lost its dynamism, its urge to innovate, or its ability to innovate."

Phelps also said that while government stimulus "made sense" during the height of the slump to balance supply and demand, there is less need for it now.

"In that situation it made perfect sense for the government to throw in some fiscal stimulus," he said. "But now we are in an equilibrium. We don't like it, it's a bad equilibrium, but now it's no longer appropriate to think there is an imbalance between supply and demand."

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