

Tripped up by globalisation

By: Jeffrey D. Sachs

A failure of economic strategy and leadership lies behind the near simultaneous collapse of market confidence in the eurozone and US economies. No need to blame the rating agencies: governments in Europe and America have been unable to cope with the realities of global capital markets and competition from Asia – and deserve the lion's share of the blame.

I've watched dozens of financial crises up close, and know that success means showing the public a way out that is bold, technically sound and built on social values. Transatlantic leadership is falling short on all counts. Neither the US nor Europe has even properly diagnosed the core problem, namely that both regions are being whipsawed by globalisation.

Jobs for low-skilled workers in manufacturing, and new investments in large swaths of industry, have been lost to international competition. Employment in the US and Europe during the 2000s was held up only by housing construction stoked by low interest rates and reckless deregulation – until the construction bubble collapsed. The path to recovery now lies not in a new housing bubble, but in upgraded skills, increased exports and public investments in infrastructure and low-carbon energy. Instead, the US and Europe have veered between dead-end, consumption-oriented stimulus packages and austerity without a vision for investment.

Macroeconomic policy has not only failed to create jobs, but also to respond to basic social values too. Let me be clear: good social policy does not mean running big deficits. Public debts are already too large in both Europe and the US. But it does mean a completely different balance between cuts to social services and [tax increases on the rich](#). The simple fact is that globalisation has not only hit the unskilled hard but has also proved a bonanza for the global super-rich. They have been able to invest in new and highly profitable projects in emerging economies. Meanwhile, [as Warren Buffett argued this week](#), they have been able to convince their home governments to cut tax rates on profits and high incomes in the name of global tax competition. Tax havens have proliferated even as the politicians have occasionally railed against them. In the end the poor are doubly hit, first by global market forces, then by the ability of the rich to park money at low taxes in hideaways around the world.

An improved fiscal policy in the transatlantic economies would therefore be based on three realities. First, it would expand investments in human and infrastructure capital. Second, it would cut wasteful spending, for instance in misguided military engagements in places such as Iraq, Afghanistan, and Yemen. Third, it would balance budgets in the medium term, in no small part through tax increases on high personal incomes and international corporate profits that are shielded by loopholes and overseas tax havens. Infrastructure investment also need not increase deficits if any new projects pay their own way. Even if they require upfront borrowing, projects will not add to net financial liabilities if they are repaid through future revenues. Currently, budget accounting in the

US and Europe generally fails to distinguish between these self-financing capital projects – such as bridges, which earn revenue through future tolls – and those financed by general revenues.

Export-led growth is the other under-explored channel of recovery. Part of this must be earned through better skills and technologies – another reason not to cut education. But another part can be earned through better financial policies. China, realising this, has sold [Africa](#) many billions of dollars per year of infrastructure export projects, financed by long-term Chinese loans. Yet the US and Europe have virtually ceded that market to China by the lack of financing to African and other fast-growing economies.

The last missing piece for any recovery, however, is clarity of purpose from the political class. In Europe, a coherent response led by the European Union has been sidelined to policymaking by national governments – the [pact between France and Germany](#) being only the latest example. For months, Europe’s fate has been decided by German state elections and small Finnish parties. The European Central Bank has been so divided that it too has neglected core functions of stabilising panicked markets. There is no way the euro can survive if European-wide institutions continue to be so weak, slow and divided. The US has similarly devolved into a mélange of sector, class, and regional interests.

President Barack Obama is the incredibly shrinking leader, waiting to see whether Congressional power barons will call. More generally, the US cannot prosper while its politicians go hat in hand to the vested interests that finance their nonstop campaigning. The recent swoon in financial markets and the stalled recovery in the US and Europe reflect these fundamental shortcomings. There is no growth strategy, only the hope that scared and debt-burdened consumers will return to buying houses they don’t need and can’t afford. Sadly, these global economic currents will continue to claim jobs and drain capital until there is a revival of bold, concerted leadership. In the meantime, the markets will gyrate in pangs of uncertainty.

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