Waiting in Vain for the Quick Fix

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Investors are awaiting the miraculous delivery from crisis by the ECB and the Fed, but they are waiting in vain. The economic problems in the U.S. and Eurozone are mostly structural, not monetary. Unfortunately ideologues and politicians on both sides of the spectrum are interested in quick fixes rather than the real groundwork of economic progress.

Consider the new U.S. unemployment announcement. If you are a college graduate, there is no employment crisis. 72.7 percent of the college-educated population age-25 and over is working. The unemployment rate is 4.1 percent. Incomes are good.

If you have less than a high-school diploma, however, you are barely scraping by. Only 40.4 percent of those without a high-school diploma have a job. Their unemployment rate is 12.7 percent. Incomes are too low to make ends meet.

There are two Americas: the college-educated crowd that may have taken a hit in their retirement accounts, but who are generally doing well. Then there are the rest, around 60 percent of the population, who are increasingly dropping out of the middle class. Nearly one-half of American households are now classified as low-income, within twice the poverty line.

Most observers other than the ideologues and economists can see why this is so. Those at the top have been favored in three ways during the past 30 years. The ongoing digital revolution has been their friend, adding heft to the knowledge economy. The globalization of trade has brought a surfeit of low-priced consumer goods (including the computers and smart phones that are their daily companions). And the money-fed political system has ensured a stream of political favors for the affluent: low tax rates, offshore tax havens, financial deregulation, mere hand-slaps for corporate abuse, and more.

The rest of the labor force, however, is hurting. The digital revolution has automated millions of jobs. Globalization has offshored millions more jobs. And politics has increasingly neglected the bottom half of the population. The bottom half are fodder for TV-based campaign propaganda but not for policymaking. Tax cuts at the top are paid for by budget cuts on education, environment, and infrastructure. The Democrats are slightly better than the Republicans on this count, but the practical as opposed to rhetorical differences should not be exaggerated.

And then there are the three miracle cures. Keynesians propose to solve the unemployment problem by another dose of temporary deficit-financed stimulus. The approach doesn’t work. A stimulus might at best create another temporary construction bubble. Yet the effect would be at best temporary and the hangover would again be serious. In practice, the outcomes of stimulus packages are even more meager. The temporary tax cuts and transfer payments in the recent Obama packages have been more saved than spent, adding to public debt rather than to aggregate demand even in the short term.

Quantitative easing by the Fed is a similarly weak salve. Monetary easing can potentially stoke more asset bubbles large and small, but cannot solve structural problems. Arguably the monetary hangovers are as bad as the fiscal hangovers. We are, after all, still digging out from the Hayek-type crisis of misplaced investment in real estate caused by excessive liquidity expansion during the past decade.

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The Eurozone of course has its own added structural challenges. When German banks over-lent for most of a decade, and Spanish, Greek, Irish, Portuguese and Italian banks over-borrowed, the boom-bust cycle crossed national boundaries. ECB President Mario Draghi cannot solve the basic political problem that resulted. Southern Europe's debts need to be written down, and owners of German banks need to bear the losses. If that means that the German taxpayer ultimately must pay to recapitalize the banks, then so be it.

A few northern European countries have successfully avoided the deep structural problems. They've done this not through monetary, Keynesian, or tax-cut policies, but by ensuring that every child receives a decent education and skill training, no matter whether they are born poor or rich. Families are backed by generous family support of various kinds. Active labor market policies promote school-to-job transitions.

Therein lie the successful formulas of the German social-market economy, Scandinavia's famed social democracies, or the Netherlands' polder model. In all of those countries, ample public financing levels the playing field across households. Structural
crises between the haves and have-nots have been contained even as market forces have tended to widen income and skill inequalities.

So where does that leave the U.S. and Europe in macroeconomic policymaking? The U.S. needs long-term public investments -- in education, skills, and infrastructure -- so that its dual economy can once again become an inclusive middle-class economy. Our kids should be in school and training, rather than in unemployment or low-skilled work. The Eurozone needs debt relief, cleaned-up banks, and social inclusion in the south that matches the more successful north. The entire rich world needs to understand that it faces a new era, in which its growth will be earned the hard way, by having sufficient skills and technology to warrant a significant wage premium over the emerging economies.

And all countries rich and poor will need to plug two more structural holes. The first is the explosion of tax havens, the kind where Mr. Romney reportedly keeps his savings. Without adequate taxation of corporate and high-end income, there is no way to close budget gaps in the U.S. and Europe. The second is ecological. No economic trick, no amount of education and training, will suffice, if we do ourselves in by human-induced droughts, heat waves, famines, and floods. It's time, in short, to put away the gimmicks and to start thinking about the sustainable economic prosperity, built on education, skills, social inclusion, and environmental responsibility.

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