Move America’s economic debate out of its time warp

America’s economic debate is stuck in a time warp. On the one side, Mitt Romney’s conservative advisors defend tax cuts for the rich and spending cuts for the poor as if we hadn’t just lived through 30 years of failed Reaganomics. On the other side, Paul Krugman defends crude Keynesianism as if we’ve learned nothing in recent years about the severe limitations of short-term fiscal stimulus. Both sides merely raise their decibel levels at each announcement of bad news, as with last Friday’s data showing the failure of the US economy to generate sufficient new jobs in June.

The two sides of the debate live in timeless and increasingly irrelevant ideologies. The prescriptions of free market economics peddled by the Republicans – slash taxes and spending, end financial and environmental regulations – are throwbacks to the 1920s, far more naïve than even modern conservatives such as Milton Friedman and Friedrich Hayek, who recognised the need for government intervention for the poor, the environment, health care and more. Today’s free market ideologues are uninfluenced by the lessons of recent history, such as the financial crisis of 2008 or the devastating climate shocks hitting the world with ever-greater frequency and threatening far more than the economy. Their single impulse is the libertarianism of the rich: the liberty to enjoy one’s wealth no matter what the consequences for the economy or society.

The other side is also wide of the mark. In Paul Krugman’s telling, we are in the 1930s. We are in a depression, even though the collapse of output and rise of unemployment in the Great Depression was incomparably larger and different in character from today’s economic stagnation. Krugman channels Keynes, yet Keynes lived in a very different era.

In Krugman’s simplified Keynesian worldview, there are no structural challenges, only shortfalls in aggregate demand. There is no public debt problem. There is no global competitiveness challenge, since “competitiveness” is a myth when applied to national economies. Fiscal multipliers are predictable, timeless, persistent, and large. All growth reversals can be solved through larger deficits. Politicians can be trusted to design short-term stimulus spending programmes of hundreds of billions of dollars. Tax cuts are about as good as increases in government spending, and short-term boosts in spending are about as good as long-term public investments. Not one of these conclusions stands scrutiny.

Why have we come to this vacuous debate between a free-market extremism and a Keynesian superficiality that addresses none of the subtleties, trade-offs, and uncertainties of the real situation? There are probably two main reasons. First, the world is noisy and overloaded with media messaging. Getting heard seems to require a short, sharp and exaggerated idea endlessly repeated: economics as a media brand. Second, the world is facing novel problems at the global level, and novelty is hard to factor into economics, which is a rigid, ideological, theoretically based, and largely backward-looking field.

Here are some of the new problems of macroeconomic significance.

First, the financial markets are global while regulation is at best national (and sometimes almost non-existent or criminal). This is killing the euro, but it is also undermining financial regulation
and monetary policy everywhere. The US and UK are far more interested in defending Wall Street and the City than in fixing the global regulatory landscape. Germany has been much more interested in coddling its errant banks than in fixing the eurozone banking system.

Second, the world of work is being fundamentally transformed. Low-skilled work is the work of offshore workers, or immigrants, or machines. In high-income countries, the only route to middle class jobs is through education, skills and active labour market policies that match jobs and needs. Germany and other countries of northern Europe have generally succeeded in creating these institutions. The US and southern Europe have generally failed. Keynesian aggregate demand cannot create long-term employment for the low-skilled workers left to sink or swim in today’s globalised labour market. Only temporary bubbles (such as the dotcom bubble of the late 1990s or the housing bubble of the 2000s) briefly employ the low-skilled, but soon they unemployed again when the bubbles burst.

Third, tax collections today are little more than a Swiss cheese of tax evasion and tax havens for the rich and corporations. VAT and payroll taxes can still be collected while capital income of all kinds increasingly escapes taxation. These trends greatly exacerbate the market forces pulling to increase inequality of wealth and income.

Fourth, we are in the age of the Anthropocene, where global growth is limited by natural resources, climate change and hazards. If the world economy grows at 4 per cent or more, oil prices soar above $100 per barrel and food prices hit historic highs. This fact is of fundamental importance yet not properly part of any country’s economic strategy. The American illusory answer, hydrofracking of natural gas and more offshore drilling, will not solve the heat waves, floods, droughts and other disasters hitting the US and much of the world this year. Nor will it do much to ease the worsening resource constraints that will squeeze economic growth until we shift to new and sustainable technologies.

Fifth, the combination of falling tax collections on capital income and the rich, and rising costs of retirement and health care for a quickly aging population, poses serious long-term solvency challenges for most of our governments. These challenges can be met but require a long-term financial outlook and new approaches to pensions and healthcare delivery.

Sixth, in a world that requires serious regulation – for the environment, land use, financial markets and more – there are bound to be problems in coordinating public policies with private investments, and across sectors of the economy. Coherent economic strategies can help to break through investor pessimism and stagnation. Well-designed public investments (eg in infrastructure) can unlock significant private investments as well.

In short, we need new economic strategies to overhaul broken systems of finance, labour markets, taxation, ecological management, budget management and investment incentives. Those challenges cannot be fixed through lowering taxes on the rich or higher fiscal deficits to create aggregate demand. The new approaches must be long-term, structural, sensitive to inequalities of skills and education, aligned with the need for more sustainable technologies and “smarter” infrastructure (empowered by information technology) and congruent with long-term demographic trends. It’s time we moved beyond the Republican Party economics of the
1920s and the Democratic Party economics of the 1930s, to a new macroeconomics for the 21st century.