The time for big economic decisions is arriving quickly for President-elect Obama. The US and EU are in recession, and growth in Asia is beginning to fall significantly. US unemployment has already risen to 6.5%, a 14-year high. Demands for emergency action are everywhere. Yet even more important is a steady policy that will steer us through an unavoidable short-run recession to arrive at a much healthier economy within three to five years.

The recession is already at hand, and will intensify in the months ahead. Families vastly overborrowed in recent years, and now they are retrenching. Household spending will fall much further than it has to date, and sales of homes, cars and other consumer durables will decline markedly. Unemployment will continue to rise, most likely to 8%-10% of the labour force.

Much of the financing for the consumer boom came from abroad. The US ran huge foreign deficits, borrowing roughly $700bn annually from abroad in recent years. It is most unlikely that this could be sustained, given the reluctance of foreign investors to continue to put such large sums into US assets, and it would be reckless for the US to try. The dangers of massive and growing foreign indebtedness for the economy and for geopolitics are real.

Thus a steep decline in US consumer spending should be offset partly through a rise in net exports, and partly through a return to investment at home. The US needs not just a stimulus in spending, but structural change.

The need for export growth in the US highlights a parallel need for a fiscal expansion abroad in the current-account surplus countries, notably China and Japan. These countries should adjust to the US downturn by boosting internal demand, replacing the loss of exports to the US with increased spending at home, including increased purchases of US goods that will accompany higher internal demand. It implies that the US must cooperate with China and Japan on macroeconomic and trade policy. This is often overlooked in the current debate, where many Democrats want to «get tough» with China on trade. That position is absurd. China is a large creditor of the US, a vital purchaser of its goods and an indispensable global partner in any real solution to climate change.

Many in Congress would like to throw everything the US has into stopping the recession: massive tax cuts, big government spending increases, zero interest rates, across-the-board bail-outs of homeowners. This approach is very dangerous. It is panic, not policy. We need a steady hand that recognises the inevitability of a temporary downturn, tries to ameliorate it without panic, and prepares for the longer term - not only with greater exports and investments, but with a much sounder economic and social structure, including reforms to healthcare, energy policy, education and other infrastructural ailments.

The US has had nine business downturns since 1950 and nine recoveries. We’ll have a 10th recovery and need not lose our heads. Yes, the Federal Reserve working with other central banks should continue to take critical steps to prevent an outright downward spiral. Yes, the government should provide some fiscal stimulus, without losing sight of objectives five to 10 years from now. Yes, the government should help those who are displaced. But we should not lose sight of the medium term.
The US budget deficit is vast and rapidly expanding. We can’t simply gut the tax system further. Any short-term stimulus should be consistent with a long-term expansion of the tax base as a share of GNP, not a reduction. The emphasis should be on spending increases rather than tax cuts. Transfers to cash-strapped states and local governments to meet urgent needs of healthcare, public housing and other basic services for the poor, working class and unemployed make enormous sense.

There is much talk about a «green recovery» - that is, government-led investments in clean energy and energy efficiency, including public transport, renewable energy sources, a more efficient power grid and mass uptake of electric-powered vehicles. This is a superb concept. It should certainly be done. But it’s not a short-term counter-cyclical strategy. It will stretch out over five to 10 years and should be done well and not wastefully.

Meanwhile, we should not lose sight of the world’s poor. Not only do they suffer and die from crises such as the current recession, ongoing high food prices and chronic deep poverty, but their suffering turns into ours as well - in violence, conflict, instability, disease transmission, mass desperate migration and more. One win-win strategy would be to increase aid in the form of long-term suppliers’ credits on easy terms to the poorest countries, to invest in infrastructure built by companies in the US, Europe and Asia suffering from a collapse of orders at home.

A mess has accumulated through years of household excesses, unregulated finance and woefully deficient government leadership. We need to turn this around, but can’t do so overnight. Let’s batten down for the recession, work with the world to keep it as limited as possible, and plan to emerge on the other side - which we will, with a fairer, environmentally sustainable and more productive global economy.

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