Jeffrey Sachs: Moving Beyond Washington’s Stale Economic Debate

Last week’s announcement of the slowdown in US economic growth underscores the failure of the Obama Administration’s economic strategy. The economy will not grow fast enough to produce jobs and there is little recovery in sight. Moreover, the budget deficit is likely to remain above $1 trillion for years to come, putting America into a deeper and deeper fiscal crisis. Neither the Obama Administration nor the Republican opposition has put forward a realistic response to the deepening crisis.

It’s easy to understand why the Administration’s policies are failing. The Administration believed that with a temporary stimulus the economy would revert naturally to the situation before the financial crisis. The Administration counted on personal saving rates reverting to the low levels of the pre-2008 period, at 3 percent of disposable income or less, and new home building to recover to more than 1 million units per year. In this approach, the stimulus would boost the economy during the short period needed to stabilize financial markets, after which household spending on housing and personal consumption goods and services would restore growth. Instead, the personal saving rate now tops 6 percent as debt-strapped households continue to restrain their spending, and housing starts remain below 600,000 units per year, and far below the rates of 2009, much less the rates before the 2008 crisis.

The Obama strategy reflected a misjudgment about the macroeconomic situation. The crisis of 2008 marked a watershed. The debt-driven consumer-led framework of economic growth had hit the wall by 2008. Households were deep in debt after years of over-spending, while critical investment needs (such as in infrastructure, energy, and education) required our increased attention. The US economy was losing long-term competitiveness. US consumer spending was creating jobs in China, not in the US.

The US economy therefore needed structural change, not just a temporary boost of deficit spending. The time had come to shift from consumption-led growth to investment-led and export-led growth. The 2009 stimulus idea therefore failed on three counts. First, it distracted the government and country from the real task of building a new framework for long-term growth. It squandered Obama’s political capital in a Hail Mary pass without a receiver downfield. Last year should have been the year for carefully designing long-term investments in energy, transport, water and sanitation, higher education and job skills. Instead, we got a hodgepodge of tax cuts and scattered spending that is now running out. Second, it focused on «shovel-ready» investments when few of those really exist, and what we needed was a decade-long investment strategy based on well-designed policies. Third, Obama took on the full political onus of the budget crisis by willfully boosting Bush’s roughly trillion-dollar deficit into a $1.5 trillion dollar deficit.

Readers of the economic news last week would have come across a report by the Congressional Budget Office supposedly attributing between 2.0 million and 4.8 million jobs to the stimulus legislation compared with what would otherwise have occurred. This report was used by the Administration to declare the stimulus a great success, even in the same week that made clear that the economy is slowing. Careful readers of the CBO Report, however, could quickly understand the paradox of the supposed good news and poor economic outcomes.

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The CBO didn’t actually measure any actual effects of the stimulus, or suggest a «counterfactual» economic scenario of what might have happened had the Administration chosen a different strategy, such as one based on investment-led recovery. All the CBO did was to apply assumed fiscal multipliers to the stimulus policies, multipliers not based on observed outcomes but rather on economic models. In other words, the CBO numbers are purely theoretical estimates, not in any way tested or verified by actual outcomes. The CBO could have prepared its report in January 2009 and come to the very same numbers it presented last week since they were not based on actual outcomes during the past one-and-a-half years.

The debate over the stimulus is confused right across the political spectrum. On the Administration’s side and some on the left, the stimulus is defended on crude Keynesian grounds (as in the CBO report) without recognizing that there are much more promising alternatives that would address the economy’s structural needs, instead of a failed attempt to restore the pre-2008 consumption bubble. On the Republican side, there is a far more reckless clamoring for further tax cuts on the vague notion that tax cuts would spur growth and that spending cuts would follow on to offset the tax cuts.

The Republican tax-cut approach lacks an iota of realism. The only major spending cuts feasible are ending the two absurd and tragic wars and cutting back on expensive and wasteful weapons systems. Yet the Republicans ardently support the wars, the weapons systems, and the Pentagon budget. And even if we accomplished all of the merited Pentagon cuts, that might reach around $300 billion of the more than $1 trillion deficit.

While the Obama strategy offers us continued stagnation and chronic budget deficits, the Republican strategy, if it can be dignified by that word, offers us a complete collapse of the federal government (and state governments supported by federal taxes) and of course even more explosive deficits. Neither side offers us a realistic pathway to a healthy, growing, and job-creating economy, one based on forward thinking with a time horizon of five to ten years.

Progressives have come to berate deficit hawks as if concern about the budget deficit is somehow intrinsically reactionary. I view deficit reduction as progressive, because it reflects a concern to protect our future wellbeing, and especially that of our children. What counts is not deficit reduction per se, but how it’s done. If it comes as the Republicans propose, by slashing government programs for health, education, retirement, and infrastructure, it would indeed be a disaster. If it comes instead by taxing the banks, higher incomes, and fossil-fuel pollution (initially at a low, but then rising rate), while simultaneously investing more in clean energy, modern infrastructure, education and jobs skills, then deficit reduction is prudent, progressive, and wholly supportive of sustainable prosperity.

The stimulus versus no-stimulus debate is passé. So too is the debate concerning deficit increases versus deficit cuts. A new approach needs to be based on spurring long-term investments — in energy, infrastructure, environment, and people — combined with a serious plan to restore fiscal integrity and the quality and honesty of public-sector management. A serious plan should also cut outrageous CEO and senior management salaries down to size, and use the saved enterprise income to promote more job-sharing, skill training, improved pay, guaranteed leave and vacation time, and improved work quality for the labor force. The poor and middle-class need not suffer more in the process. They’ve been bamboozled for long enough by the super-wealthy bankers and CEOs who took over both political parties thirty years ago and have since manipulated Washington to ruin, for their own personal benefit.
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