The Washington Post

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# Can global economic policy be freed from its paralysis?

**By Robert J. Samuelson,**

The Bank for International Settlements in Switzerland has just published its annual report, and it is a dour document. The BIS (as it's known) was created in 1930 to handle post-World War I reparation payments from Germany to Britain and France. The Great Depression ended reparations, and now the BIS provides — among other things — sober commentary on the global economy. Its latest report oozes foreboding.

Consider:

l On government debt: "The market turbulence surrounding the fiscal crises in Greece, Ireland and Portugal would pale beside the devastation that would follow a loss of investor confidence in the sovereign debt of a major economy."

l On the need for higher interest rates: "Our attempts to cushion the blow from the last crisis must not sow the seeds of the next one."

l On inflation: "Inflation risks have been driven up by . . . dwindling economic slack and increases in the prices of food, energy and other commodities."

By the BIS report, you'd hardly know that there are almost 45 million unemployed in the advanced countries, up 50 percent from 2007. But can governments do anything about it? The BIS has no answer. Economic policy seems paralyzed. There's an almost palpable sense of helplessness, whether reading the BIS report or listening to Federal Reserve Chairman Ben Bernanke at his recent news conference. Economics seems to have emptied its toolbox. Patience and prayer are what's left: Last week's release of oil stocks, for example, was a desperate prayer for lower gasoline prices.

To be fair, some Keynesian economists (after the English economist John Maynard Keynes) argue that the problem is timidity, not impotence. Governments could do more; they just aren't. They could spend more or cut taxes more; budget deficits — at least in the United States — don't matter much at the moment. The Fed could have a QE3, buying more bonds to try to lower long-term interest rates.

Perhaps the Keynesians are right. But they have not prevailed because there are plausible reasons — though not conclusive — that they are wrong. Economists argue furiously over "multiplier" effects of

larger government deficits: how much bang you get for every buck. One study concluded that the effect is much greater during recessions than during recoveries. This seems sensible and suggests that President Obama's 2009 stimulus helped, but that a new one would do less.

A new stimulus might prompt neutralizing actions. Suppose consumers interpret it as a sign of fear and lose confidence. If they raised their savings rate by one percentage point, that would offset $120 billion of extra government spending. Or investors might react to higher government borrowing by boosting interest rates, though that hasn't happened yet. (Rates on 10-year Treasury bonds are 3 percent.)

The uncertainty is enormous. The same caveat applies to the Fed; the evidence that QE2 — the purchase of $600 billion of Treasury securities — helped the economy is slim, though Bernanke claims it dispelled fears of deflation, i.e. falling prices.

Another economic school, typified by the BIS, asserts that an obsessive focus on short-term economic results got us into trouble, and we should not repeat that mistake. Piling up too much debt now may make future crises worse. Ignoring incipient signs of inflation will spawn more inflation. Good policies will ultimately be rewarded with sound growth. This seems wise but raises practical concerns.

It may be that gobs of stimulus can't rescue the global economy but that gobs of austerity might sink it. Our predicament is that it's not just a few countries that face austerity but most advanced nations. We've arrived at a historical reckoning of the post-World War II welfare state, burdened with aging populations and huge debts. Germany's gross public debt is 87 percent of its economy (gross domestic product); Japan's, 213 percent; Britain's, 89 percent; and the United States', 101 percent, reports the BIS. (Its debt definition results in higher numbers than the standard U.S. measure.) Greece is not alone.

The United States, Europe and Japan still constitute roughly half the world economy. If all cut spending and raised taxes (to control debt) and increased interest rates (to pre-empt inflation), where would growth come from?

On paper, there are answers. Governments could commit to future deficit reductions without weakening the recovery if their measures are "credible." This is easier said than done. Or the expanding "new world" — China, India, Brazil — could rescue the old. Maybe. But these countries also have the highest inflation: almost 6 percent in China, 9 percent in India. Or today's slowdown could prove temporary; private demand could revive.

The present need to sustain recovery seems to collide with future needs to curb debt. Our public debate is confusing and our policy paralyzed because no one — most obviously, Obama — has disarmed the contradiction.

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