

EXCLUSIVE INTERNATIONAL COLUMN

The politics of economic stupidity

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IN 2014, the world economy remained stuck in the same rut that it has been in since emerging from the 2008 global financial crisis. Despite seemingly strong government action in Europe and the United States, both economies suffered deep and prolonged downturns. The gap between where they are and where they most likely would have been had the crisis not erupted is huge. In Europe, it increased over the course of the year.

Developing countries fared better, but even there the news was grim. The most successful of these economies, having based their growth on exports, continued to expand in the wake of the financial crisis, even as their export markets struggled. But their performance, too, began to diminish significantly in 2014.

In 1992, Bill Clinton based his successful campaign for the US presidency on a simple slogan: "It's the economy, stupid." From today's perspective, things then do not seem so bad; the typical American household's income is now lower. But we can take inspiration from Clinton's effort. The malaise afflicting today's global economy might be best reflected in two simple slogans: "It's the politics, stupid" and "Demand, demand, demand."

The near-global stagnation witnessed in 2014 is man-made. It is the result of politics and policies in several major economies – politics and policies that choked off demand. In the absence of demand, investment and jobs will fail to materialize. It is that simple.

Nowhere is this clearer than in the eurozone, which has officially adopted a policy of austerity – cuts in government spending that augment weaknesses in private spending. The eurozone's structure is partly to

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blame for impeding adjustment to the shock generated by the crisis; in the absence of a banking union, it was no surprise that money fled the hardest-hit countries, weakening their financial systems and constraining lending and investment.

In Japan, one of the three "arrows" of Prime Minister Shinzo Abe's program for economic revival was launched in the

wrong direction. The fall in GDP that followed the increase in the consumption tax in April provided further evidence in support of Keynesian economics – as if there was not enough already.

The US introduced the smallest dose of austerity, and it has enjoyed the best economic performance. But even in the US, there are roughly 650,000 fewer public-sector employees than there were before the crisis; normally, we would have expected some two million more. As a result, the US, too, is suffering, with growth so anemic that wages remain basically stagnant.

Much of the growth deceleration in emerging and developing countries reflects China's slowdown. China is now the world's largest economy (in terms of purchasing power parity), and it has long been the main contributor to global growth. But China's remarkable success has bred its own problems, which should be addressed sooner rather than later.

The Chinese economy's shift from quantity to quality is welcome – almost necessary. And, though President Xi Jinping's fight against corruption may cause economic growth to slow further, as paralysis grips public contracting, there is no reason for Xi

to let up. On the contrary, other forces undermining trust in his government – widespread environmental problems, high and rising levels of inequality, and private-sector fraud – need to be addressed with equal vigor.

In short, the world should not expect China to shore up global aggregate demand in 2015. If anything, there will be an even bigger hole to fill.

Meanwhile, in Russia, we can expect Western sanctions to slow growth, with adverse effects on an already weakened Europe. (This is not an argument against sanctions: The world had to respond to Russia's invasion of Ukraine, and Western CEOs who argue otherwise, seeking to protect their investments, have demonstrated a disturbing lack of principle.)

For the past six years, the West has believed that monetary policy can save the day. The crisis led to huge budget deficits and rising debt, and the need for deleveraging, the thinking goes, means that fiscal policy must be shunted aside.

The problem is that low interest rates will not motivate firms to invest if there is no demand for their products. Nor will low rates inspire individuals to borrow to consume if they are anxious about their

future (which they should be). What monetary policy can do is create asset-price bubbles. It might even prop up the price of government bonds in Europe, thereby forestalling a sovereign-debt crisis. But it is important to be clear: the likelihood that loose monetary policies will restore global prosperity is nil.

This brings us back to politics and policies. Demand is what the world needs most. The private sector – even with the generous support of monetary authorities – will not supply it. But fiscal policy can. We have an ample choice of public investments that would yield high returns – far higher than the real cost of capital – and that would strengthen the balance sheets of the countries undertaking them.

The big problem facing the world in 2015 is not economic. We know how to escape our current malaise. The problem is our stupid politics.

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