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Stiglitz: All Roads Won't Lead to Economic Downfall, Doom

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The country is — or should be — focused on jobs. Some 25 million Americans who want a full-time job can't get one. The youth unemployment rate is as much as twice that of the already unacceptable national average.

America has always thought of itself as a land of opportunity — but where is the opportunity for our youngsters who face such bleak prospects? Historically, those who lose their jobs quickly got another, but an increasingly large fraction of the unemployed — now more than 40 percent — have been out of work for more than six months.

President Barack Obama will deliver an address Thursday outlining his vision of what can be done. Others should be doing the same.

Around the country there is growing pessimism. The rhetoric will be fine. But is there anything that anyone can really do — given the country's looming debt and deficit?

The answer from economics is: There is plenty we can do to create jobs and promote growth.

There are policies that can do this and, over the intermediate to long term, lower the ratio of debt to gross domestic product. There are even things that, if less effective in creating jobs, could also protect the deficit in the short run.

But whether politics allows us to do what we can — and should — do is another matter.

The pessimism is understandable. Monetary policy, one of the main instruments for managing the macro-economy, has proved ineffective — and will likely continue to be. It's a delusion to think it can get us out of the mess it helped create. We need to admit it to ourselves.

Meanwhile, the large deficits and national debt apparently preclude the use of fiscal policy. Or so it is claimed. And there is no consensus on which fiscal policy might work.

Are we doomed to an extended period of Japanese-style malaise — until the excess leverage and real capacity works its way out? The answer, I have suggested, is a resounding "no." More accurately: This outcome is not inevitable.

First, we must dispose two myths. One is that reducing the deficit will restore the economy. You don't create jobs and growth by firing workers and cutting spending. The reason that firms with access to capital are not investing and hiring is that there is insufficient demand for their products. Weakening demand — what austerity means — only discourages investment and hiring.

As Paul Krugman emphasizes, there is no “confidence fairy” that magically inspires investors once they see the deficit go down. We’ve tried that experiment — over and over. Using the austerity formula, then-President Herbert Hoover converted the stock market crash into the Great Depression. I saw firsthand how the International Monetary Fund’s imposed austerity on East Asian countries converted downturns into recessions and recessions into depressions.

I don’t understand why, with such strong evidence, any country would impose this on itself. Even the IMF now recognizes you need fiscal support.

The second myth is that the stimulus didn’t work. The purported evidence for this belief is simple: Unemployment peaked at 10 percent — and is still more than 9 percent. (More accurate measures put the number far higher.) The administration had announced, however, that with the stimulus, it would reach only 8 percent.

The administration did make one big error, which I pointed out in my book “Freefall” — it vastly underestimated the severity of the crisis it inherited.

Without the stimulus, however, unemployment would have peaked at more than 12 percent. There is no doubt that the stimulus could have been better designed. But it did bring unemployment down significantly from what it otherwise would have been. The stimulus worked. It was just not big enough, and it didn’t last long enough: The administration underestimated the crisis’s durability as well as its depth.

Thinking about the deficit, we need to reflect back 10 years, when the country had such a large surplus at 2 percent of GDP that the Federal Reserve Bank chairman worried we would soon pay off the entire national debt — making the conduct of monetary policy difficult. Knowing how we went from that situation to this helps us think through how to solve the deficit problem.

There have been four major changes: First, tax cuts beyond the country’s ability to afford. Second, two costly wars and soaring military expenditures — contributing roughly $2.5 trillion to our debt. Third, Medicare Part D — and the provision restricting government, the largest drug buyer, from negotiating with pharmaceutical companies, at a cost of hundreds of billions of dollars over 10 years. Fourth, the recession.

Reversing these four policies would quickly put the country on the road of fiscal responsibility. The single most important thing, however, is putting America back to work: Higher incomes mean higher tax revenues.

But how do we get America back to work now? The best way is to use this opportunity — with remarkably low long-term interest rates — to make long-term investments that America so badly needs in infrastructure, technology and education.

We should focus on investments that both yield high returns and are labor intensive. These complement private investments — they increase private returns and so simultaneously encourage the private sector.

Helping states pay for education would also quickly save thousands of jobs. It makes no sense for a rich country, which recognizes education's importance, to be laying off teachers — especially when global competition is so fierce. Countries with a better educated labor force will do better. Moreover, education and job training are essential if we are to restructure our economy for the 21st century.

The advantage of having underinvested in the public sector for so long is that we have many high-return opportunities. The increased output in the short run and increased growth in the long run can generate more than enough tax revenues to pay the low interest on the debt. The result is that our debt will decrease, our GDP will increase and the debt to GDP ratio will improve.

No analyst would ever look at just a firm's debt — he would examine both sides of the balance sheet, assets and liabilities. What I am urging is that we do the same for the U.S. government — and get over deficit fetishism.

If we can't, there is another, not as powerful but still very effective, way of creating jobs. Economists have long seen that simultaneously increasing expenditures and taxes in a balanced way increases GDP. The amount that GDP is increased for every dollar of increased taxes and spending is called the "balanced-budget multiplier."

With well-designed tax increases — focused on upper-income Americans, corporations that aren't investing in America or closing tax loopholes — and smart expenditure programs that are focused on investments, the multiplier is between 2 and 3.

This means asking the upper 1 percent of our country, who now garner some 25 percent of all U.S. income, to pay a little more in taxes — or just pay their fair share. Investing this could have a significant effect on output and employment. And because the economy would grow more in the future, again, the debt to GDP ratio would come down.

There are some taxes that could actually improve the efficiency of the economy and the quality of life, with an even bigger effect on national output, if we correctly measure output. I chaired an International Commission on the Measurement of Economic Performance and Social Progress, which identified large flaws in our current system of measurement.

There is a basic principle in economics: It is better to tax bad things that generate negative externalities than good things. The implication is that we should tax pollution or destabilizing financial transactions. There are also other ways of raising revenues — better auctions of our country's natural resources, for example.

If, for some reason, such revenue enhancements are ruled out — and there is no good economic reason why they should be — there is still room to maneuver. The government can change the design of tax and expenditure programs — even within the current budget envelope.

Increasing taxes at the top, for example, and lowering taxes at the bottom will lead to more consumption spending. Increasing taxes on corporations that don't invest in America and lowering them on those that do would encourage more investment. The multiplier — the amount GDP increases per dollar spent — for spending on foreign wars, for example, is far lower than education, so shifting money here stimulates the economy.

There are things we can do beyond the budget. The government should have some influence over the banks, particularly given the enormous debt they owe us for their rescue. Carrots and sticks can encourage more lending to small- and medium-sized businesses and to restructure more mortgages. It is inexcusable that we have done so little to help homeowners, and as long as the foreclosures continue apace, the real estate market will continue to be weak.

The banks' anti-competitive credit card practices also essentially impose a tax on every transaction — but it is a tax with revenues that go to fill the banks' coffers, not for any public purpose — including lowering the national debt. Stronger enforcement of antitrust laws against the banks would also be a boon to many small businesses.

In short, we are not out of ammunition. Our predicament is not a matter of economics. Theory and experience show that our arsenal is still strong. Of course, the deficit and debt do limit what we can do. But even within these confines, we can create jobs and expand the economy — and simultaneously bring down the debt to GDP ratio.

It is simply a matter of politics: whether we choose to take the steps we need to take to restore our economy to prosperity.

Joseph E. Stiglitz served as chairman of the Council of Economic Advisers under President Bill Clinton. He was chief economist of the World Bank from 1997 to 2000 and was awarded the Nobel Memorial Prize in Economic Sciences in 2001. His most recent book is "Freefall: America, Free Markets and the Sinking of the World Economy."