Viewpoints
August 2010

This article was originally published on [washingtonpost.com on 27 August 2010.]

Why Another Fiscal Stimulus Won't Do
By Mohamed El-Erian

The great hope a few months ago was for a "recovery summer," with the economy responding favourably to various policy initiatives. Yet the recovery has lost momentum, and while the end of the year will not be as gut-wrenching as the final 3 1/2 months of 2008, when the global economy suffered a cardiac arrest, it will be as consequential in affecting the welfare of millions of people.

Throughout the summer, data signals have become more alarming. Despite all the rhetoric about job creation, unemployment remains stubbornly high and the problem is becoming structural in nature (and, therefore, harder to solve). Consumer credit continues to contract while small companies find it difficult to access new bank lines of credit. Housing activity is falling, and home values are poised for further declines as foreclosures increase. The trade balance has taken an ominous turn, with exports stagnating and imports surging. More Americans are falling through the large holes in the country's safety net.

The equity markets are again under pressure while yields on Treasury bonds have collapsed, reflecting that market's growing concerns about the weak economic outlook. With such fragility, households and companies have become even more cautious, undermining the "animal spirits" needed for economic expansion.

Meanwhile, the United States has received little help from the rest of the world. Yes, German growth is up, but a significant part reflects its well-functioning export machine. The beneficial spillover effects have been immaterial. And despite the political narrative to the contrary, market concerns with debt solvency in some eurozone countries (Greece, Ireland, Portugal and Spain) remain high.

Even a steadily growing China is proving to be of limited help. While Beijing is implementing additional structural changes to reorient its economy toward domestic consumption, the pace remains measured; what is understandable from a Chinese national perspective does little to help sustainably rebalance the global economy.

In sum, the current policy approaches here and abroad are unlikely to deliver a durable and robust US recovery and, critically, create sufficient growth in jobs. Yet the main debate in Washington is whether to do more of the same -- namely, another fiscal stimulus and another round of quantitative easing by the Federal Reserve. This clearly conflicts with evidence that a broader and more holistic response is needed.

These realities will fuel debate among economists, who already hold unusually divergent views, and reignite the discomforting notion that economic unthinkables and improbables -- such as a double-dip recession and a deflation trap -- are more of a possibility.

What is critical to keep in mind is that this situation is part of a broad, multiyear process driven by national and global realignments. It's a secular phenomenon that needs to be better understood and navigated -- by recognising its structural dimensions and by urgently broadening the excessively cyclical policy mindsets that abound. Unfortunately, the approach in too many industrial countries has been to kick the can down the road, seemingly hoping for a series of immaculate economic recoveries.

Policymakers must break this active inertia by implementing a structural vision to accompany their current cyclical focus. Measures are needed to address key issues, which include the change in drivers of growth and employment creation; the high risk of skill erosion and lost labour productivity; financial deleveraging in the private sector; debt overhangs; the uncertain regulatory environment; and the unacceptably high risks facing the most vulnerable segments of society.

Specific measures would include pro-growth tax reform, housing finance reform, increased infrastructure investments, greater support for education and research, job retraining programs, removal of outdated interstate competition barriers and stronger social safety nets.

That, of course, is what is desirable; how about what is likely?

With the recovery's visible loss in momentum, more people are coming to appreciate the importance of structural issues. Indeed, some elements of the package are visible. Yet, to my dismay, the prospects for a sufficiently bold policy reaction are doubtful. Post-financial crisis, it is no longer just about the "unusually uncertain" economic outlook and related challenges for a policy approach that remains too reactive and ad hoc. The politics of structural change are now a material impediment.

An already polarised political environment is becoming even more fractured by real and far less substantive issues. There is virtually no political centre that can anchor consensus and enable sustained implementation of policy. Meanwhile, as anti-Washington sentiments rise, interest in a national agenda is increasingly giving way to the election cycle. Internationally, the impressive degree of cross-border coordination seen during the global financial crisis has been reduced to inconsistent -- and at times contradictory -- national responses.

This worrisome trio of increasingly ineffective national and global policy stances, intense political polarisation and growing social pressures speaks to the risk that the economy's recent soft patch will evolve into something even more troublesome and sinister.

I hope that sober policy responses will accompany the coming cooler temperatures. Given the proximity of the November elections, however, I worry they may not.

About the author:
Dr. El-Erian is CEO and co-CIO of PIMCO and is based in the Newport Beach office. He re-joined PIMCO at the end of 2007 after serving for two years as president and CEO of Harvard Management Company, the entity that manages Harvard's endowment and related accounts. Dr. El-Erian also served as a member of the faculty of Harvard Business School. He first joined PIMCO in 1999 and was a senior member of PIMCO's portfolio management and investment strategy group. Before coming to PIMCO, Dr. El-Erian was a managing

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