FROM THE FOUNDER

Attitude Matters

After the Democratic Party's losses in the recent midterm elections, President Obama explained that the problem was one of communications. Voters never heard the good news on the economy, including the drop in the official unemployment rate.

President Obama should use another line.

Since the financial crisis in 2008 (see "Off the News"), most of the new jobs were produced in Texas. Texas civilian employment jumped by 12 percent, from 11 million to 12.3 million jobs as of September 2014. For the rest of the country during the same period, civilian employment dropped from 135.26 million to 134.27 million. The election results should not have been surprising.

Is Mr. Obama now really willing to give fracking the credit for the modest improvement in his employment picture?

The President needs a post mortem. For starters, why did his $830 billion fiscal stimulus fail to lead to the expected dramatic increase in aggregate demand? His acolytes suggest the stimulus was not large enough. Maybe so, but it looks increasingly as if two other factors were at work: the concerns by middle-class families over debt and/or global deflationary pressures.

Driven by fear and uncertainty, households in the face of the crisis massively deleveraged even as the non-financial corporate sector failed to invest. Before the crisis, household liabilities were 135 percent of GDP. By the beginning of 2014, that figure had dropped to 100 percent. People were scared, and still are, no doubt in part because U.S. public debt since the crisis has soared.

For a fiscal stimulus to work, the public has to be convinced the program makes sense for the long term. Yet American households and businesses both arrived at the same conclusion—debt matters.

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When all is said and done, debt has to be repaid.

Today the entire world is mired in debt. As economist Jørgen Ørstrøm Møller quipped (page 42), "No wonder it is so difficult to engineer a global recovery." Since the 2008 crisis, Japan's public and

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
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Washington, D.C. 20002
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private debt has jumped from 450 percent to 610 percent of GDP; the eurozone's from 343 percent to 387 percent; and China's from 150 percent to 240 percent. Total global public and private debt exceeds $150 trillion.

But what is a trillion? Consider the number in terms of time. A thousand seconds is less than twenty minutes. A hundred thousand seconds is about a full day plus four hours. A million seconds? Twelve days. A billion seconds? A whopping thirty-six years.

A trillion seconds is the equivalent of 36,000 years. That's more time than in all recorded history. One hundred fifty trillion is an amount beyond the public's comprehension. No wonder consumers and investors are holding back. They are smart to be terrified of the potential exponential costs of runaway debt.

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In an economy, attitude matters. Today, the American people's positive animal spirits have dissipated. Average folk wonder: Is today's massive debt something we can live with? Or are we flirting with a crippling scenario as soon as interest rates return to their normal levels? The truth is that nobody knows. The United States and Europe would seem to be particularly vulnerable because of the short-term nature of their debt that would have to be quickly rolled over at higher interest rates.

Attitude affects monetary policy as well. The level of interest rates doesn't matter if economic risk-takers are terrified of tomorrow.

But it's not just the relative ineffectiveness of America's fiscal and monetary tools that has given Mr. Obama a more modest recovery than expected. The entire world economy may be undergoing a tectonic shift. Average folk seem to feel that shift in their bones. Something's not right. With today's disinflationary downdraft, wage growth can't gain any traction.

China has become the dominant contributor to this disinflationary downdraft. With its GDP growth rate nearly halved, global energy prices, industrial commodity prices, and shipping freight rates have all dropped. What hasn't dropped is China's excess capacity, the growth of which almost across the board is mind-boggling. In the past two years alone, China has produced more cement than the United States produced throughout the entire twentieth century, calculates financial strategist Tadashi Nakamae (page 34). Yet China is so big and economically powerful, it does whatever it wants regardless of the global consequences. Now the world has reason to be concerned. Of the forty-six central banks that target inflation, thirty are below target.

An increasing amount of global public debt is denominated in dollars. Global capital seeking safe haven is flowing into the United States at twice the rate as before the financial crisis. If the world follows Japan and deflation takes hold (and the relative strength of the dollar continues to rise as a result of those inflows), the real value of all that external debt will skyrocket. We could see a debt crisis.

So welcome to the brave new world. Mr. Obama's advisors offer him the theory of secular stagnation—that because of lack of demand, the U.S. economy's potential medium- to long-term growth rate is limited. Maybe so, but the problem may be not only secular stagnation but policy stagnation: the lack of an effective game plan to control the long-term growth of debt while stoking up the economy's entrepreneurial fires of innovation and job creation.

With a new Congress, Mr. Obama should strike a bipartisan deal: entitlement reform directed to those retiring a decade or more from now in order to bend the U.S. public debt curve downward, in exchange for moving up infrastructure spending on things like airports that will have to be done anyway. He should ask Congress to reform Dodd-Frank, which has led to an insane situation where a dozen still-too-big-to-fail zombie banks control 75 percent of bank financing while small business risk-taking continues to be underfinanced.

Successful economies are propelled by powerful narratives. In the 1980s, the narrative was the end of stagflation and middle-class tax bracket creep. In the 1990s, it was the rise of globalization and the peace dividend with the fall of the Berlin Wall.

Today people want a compelling narrative. They want answers beyond Washington's normal vacuous spin. And the great irony is that they are the answer.

—David M. Smick
Founder and editor, TIE, *and author of* The World Is Curved: Hidden Dangers to the Global Economy