

Sachs and Krugman on global crisis

WHAT ARE TO DO By TAN SRI LIN SEE YAN



Sachs is a Confucian.

Met up with two old friends during the past month.

Prof Jeffrey Sachs (pic) of Columbia University was back in Kuala Lumpur after a long absence as orator of the Tan Sri Lim Goh Tong Memorial Public Lecture at University of Malaya on Oct 23.

Besides being an old friend he was my freshie during our Ph.D studies at Harvard University in the late 70s Jeff is a fantastic and outstanding economist. Prior to moving to New York, Jeff spent over 20 years at Harvard (where he was appointed full professor of economics at 25, the youngest ever), most recently as director of the Centre for International Development and Galen Stone Professor of International Trade.

At Columbia, Jeff serves as director of The Earth Institute, Quetelet Professor of Sustainable Development and Professor of Health Policy & Management. He is special advisor to United Nation secretary-general on the Millennium Development Goals, having first held that position under his predecessor. He is co-founder of Millennium Promise Alliance, and a director of the Millennium Villages Project.

He authored three New York Times bestsellers. Sachs is widely considered as the world's leading expert on economic development and its fight against poverty. He was twice named among Time Magazine's 100 most influential world leaders and was called by The New York Times, "probably the most important economist in the world," and by Time Magazine, "the world's best known economist".

A recent survey by The Economist ranked Sachs among the world's three most influential economists of the past decade. His syndicated monthly newspaper column appears in more than 80 countries. For the past 25 years, Jeff has advised dozens of heads of state and governments on economic strategy in the Americas, Europe, Asia, Russia, Africa and the Middle East.

Prof Paul Krugman of Princeton University was back in Singapore to deliver the Sim Kee Boon Institute Public Lecture at Singapore Management University on Nov 7.

I last met Krugman formally about 10 years ago when I moderated a dialogue between him and Tun Dr Mahathir in Kuala Lumpur. When I reminded him of it, his immediate response was: “My God!” That was it. I had since met up with him on a few occasions in New York.

Krugman is one of the pre-eminent economists of our time, having won the 2008 Nobel Prize in Economic Science for his ground-breaking work on international trade and economic geography. For his early work, the American Economic Association awarded him its '91 John Bates Clark medal, given to the “economist under 40 who is adjudged to have made significant contribution to economic knowledge.”

Today, he is best known worldwide as a regular op-ed columnist for The New York Times where he speaks the truth as he sees it; he calls a “spade a spade” often in the most blunt terms. I enjoy his works a lot.

The author (and editor) of more than 20 books, Krugman's most recent: “End This Depression Now!” is a call for action. In it, Krugman sends a convincing message to all who are affected by the recent Great Recession a quick, strong recovery is just a step away, he says: “if only our leaders can find the intellectual clarity and political will” to end the depression now. He is widely recognised as a pioneer in basic economic studies and founder of a groundbreaking new theory in international trade.

Sachs' public lecture was entitled Macroeconomic Challenges in the US, Europe and China. I had the distinct pleasure to introduce Sachs the man. Here's what I said: “In a nutshell, he is an outstanding economist; as a friend, he is a fantastic human being.

What is not reflected in the write-up, however, is Sachs' character and his colourful career I have always known Sachs to be never afraid of controversy.

Indeed, I think he welcomes it I recall him confronting European unions during the first oil shock in the 70s; facing angry New York bankers over his proposed “hair-cuts” amid the Latin American debt crisis in the 80s, and confronting fighting-fit Russian leftists when the USSR turned to become more capitalist.

That's the character of the man loves sinking his teeth into the heart of crises and sticking to his guns. When Sachs first published his book The End of Poverty in 2005, my friend Jared Diamond (Pulitzer Prize-winning author of Guns, Germs And Steel) called Sachs “that rare phenomenon: an academic economist famous for his practical work in helping poor countries become richer”.

Sachs wrote yet another best-seller three years later. Last year, he wrote his most recent bestseller The Price of Civilisation.

By now, Sachs has become a seasoned author and a much sought after speaker, having matured in my view from an “accomplished academic economist” to a “wise problem-solver”. Confucius describes wisdom as when you are aware of what you know and to maintain that you know it; and when you do not, to acknowledge your ignorance.

First, according to Confucius, a wise man reads and learns everything he can, and to suspend judgement when in doubt; is cautious in what he says.

In that way, his mistakes will be few. Second, a wise man widens his experience, but is beware of hazardous places and always gives heed to where he wanders. In that way, he will seldom have occasion for regret. Third, a wise man lets experience guide his words & actions. In that way, he let actions reinforce his words. That's the Sachs I know.

That's why you will find his latest book to be wise in the ways of the world; it's down to earth and realistic about life.

In it, Sachs warns that the United States is experiencing the greatest degree of inequality among high income democracies, where the top 1% of household takes almost one-quarter of all household income a share not seen since the 1920s.

The media has since picked this up under the caption: "the greedy 1% versus the hard-done-by 99%". This widening gap between the rich and the poor places Sachs once again at the very centre of controversy in the recent US election campaign.

His conclusion: the United States needs highly effective government in the era of globalisation. Put simply, the United States now need more government, not less. But he argues, government governance needs to be modernised and smart in order to be able to meet new challenges in an inter-connected world economy.

This remains hotly debated. But Sachs is a Confucian man of principle, who as one will always have something to say that is worth listening to; but men of words are not necessarily men of principle. He who cares for his fellowmen needs to be bold, but the bold may not necessarily care for their fellowmen. So, you have as your speaker this morning a bold and principled man, one who is not afraid to innovate and expose fresh ideas to back-up what he says.

For his many contributions as a Harvard alumni the Harvard Graduate School of Arts & Sciences Alumni Council, on which I was its chairman, awarded the Harvard Centennial Gold Medal to Sachs in 2007 for his many contributions for the betterment of mankind.

In Sachs' latest book, he talks about what Time Magazine now labels the "Screwed Generation," i.e. the young generation aged 35 and below who are screwed, not once, but thrice-over, whether they like it or not: first, their household income is down 68% from a quarter century ago; second their unemployment rate is 12%-14% in the United States (almost double the national average) compared with 50% in Spain and Greece, 35% in Italy and 22% in France and the United Kingdom, but well above 8% in Germany; and third, this "screwed generation" is now loaded with huge debts, handed-down by "senior boomers" to their offspring who will have to pay-it-off through higher taxes, less infrastructure and social spending, and the prospect of painfully slow growth. Let me introduce Prof Jeff Sachs who will tell you more about how "screwed" the world is today; and about the "never-had-it-so-bad" toxic legacy of the "screwed generation".

Sach's focus

At the public lecture and the private lunch thereafter, Sachs made a number of points that are of public interest:

- On Keynesian theory resorting to fiscal deficits to stimulate growth, he said: “I don't think it would work and I don't think it has worked. We should make our economic policies with a 10-year horizon, not a three-month horizon. We should ask ourselves what kind of investment, education and environmental management we want. Then, we will end up closer to where we want to be”;
- On quantitative easing, Sachs said: “Short-term financial stimulus is dangerous because “the overhang of bad debts is unpayable”;
- Sachs attributes the current crisis to high fiscal debts in the high income nations. “We don't have a global crisis. We have a world that is operating at these two-speeds; slow in the high income world and rather fast in the developing countries.” So the gap is narrowing, but the ride towards convergence is bumpy because adjustments in the United States and Europe to this reality have not been smooth: “This is the legacy of tax cuts, social spending cuts, lack of investment in infrastructure, training and regulation.”
- US created a housing bubble which went bust in 2007, making unemployment miserable: “The Federal Government has put interest rates to near zero; but none of it works. The only thing we haven't tried is a structural look at our situation. It would require raising taxes, and ready access to quality education is the ticket for the lower and middle income classes to move upwards.”
- “The situation in Europe is much more complicated because it has a shared currency But Northern Europe is doing well.”
- China will grow financially in the next 20 years its biggest crisis is environmental. The slowdown in China is due to the massive catch-up”; and
- Sachs expressed reservations on Malaysia's Lynas rare-earth processing project (to both Prime Minister and MPs in Parliament) stating its national value added appears marginal amid safety & environmental concerns. Krugman, the liberal

At the public lecture entitled Global Economic Outlook: Preventing the Next Economic Crisis, Krugman spent much time tracing the key causes of the crisis, concluding that although the United States has some of the tools needed to avert another crisis, they are still not ready enough to prevent the next crisis; but would make sense to be better prepared to deal with it when it does come. “A lot more needs to be done.” Some of his thoughts bear repeating:

- The crisis had its roots both in banking and the massive household debt. The advent of “shadow” banking involving entities such as hedge funds, private equity, insurance companies, etc, not classified as banks but functioning like banks, had rendered regulation ineffective.
- The 10 Dodd-Frank regulations lack the needed punch to do the job. Krugman says: “The rules lack clarity (and required) more mechanical definitions of what constitutes a regulated financial institution.”

- New regulations lacked effective resolution authority; “systematically important institutions” are poorly identified (you only know it when you see it); derivatives need to be better and smarter regulated; and consumer protection has yet to be fully worked out.
- Much of real estate household debt would need to be “forgiven.” At the private lunch, Krugman (clearly a President Barack Obama's supporter, couldn't hold back his great delight on an “amazing victory”) counselled Obama to use his new mandate to “hang tough” on the looming fiscal cliff (a self-imposed deadline involving US\$600bil of spending cuts and higher taxes early in 2013 if there is no deal to fix the budget deficit), which could push the United States back into recession: “No deal is better than a bad deal.”

What, then, are we to do?

We heard the views of two big guns they don't come any bigger. Their concern is centred on a possible global double-dip recession. For all practical purposes, the eurozone is already in recession (gross domestic product: -0.1% in the fourth quarter from -0.2% in the second quarter).

Industrial production dropped the most in more than three years in September (-2.5% for 17-nation eurozone), led by a 12.6% fall in Ireland, 12% in Portugal, 2.1% in Germany and 2.7% in France. If there is no deal to resolve the fiscal cliff, the non-partisan Congressional Budget Office estimates the US economy to contract by 0.5% next year.

As a senior CEO stated at the recent US Business Roundtable: they're playing with nitroglycerin. “It could turn into a conflagration.” All this uncertainty continues to hold back the economy. As I see it, it's not a fiscal crisis, it's a political crisis brought on by the United States and European politicians' intransience, taking the world economy “hostage”. The consequence: back into recession. When will they ever learn?

- Former banker, the writer is a Harvard educated economist and a British Chartered scientist who speaks, writes and consults on economic and financial issues. Feedback is most welcome; email:starbizweek@thestar.com.my.