A New Macroeconomic Strategy

NEW YORK – I am a macroeconomist, but I dissent from the profession’s two leading camps in the United States: the neo-Keynesians, who focus on boosting aggregate demand, and the supply-siders, who focus on cutting taxes. Both schools have tried and failed to overcome the high-income economies’ persistently weak performance in recent years. It is time for a new strategy, one based on sustainable, investment-led growth.

The core challenge of macroeconomics is to allocate society’s resources to their best use. Workers who choose to work should find jobs; factories should deploy their capital efficiently; and the part of income that is saved rather than consumed should be invested to improve future wellbeing.

It is on this third challenge that both neo-Keynesians and supply-siders have dropped the ball. Most high-income countries – the US, most of Europe, and Japan – are failing to invest adequately or wisely toward future best uses. There are two ways to invest – domestically or internationally – and the world is falling short on both.
Domestic investment comes in various forms, including business investment in machinery and buildings; household investment in homes; and government investment in people (education, skills), knowledge (research and development), and infrastructure (transport, power, water, and climate resilience).

The neo-Keynesian approach is to try to boost domestic investment of any sort. Indeed, according to this view, spending is spending. Thus, neo-Keynesians have tried to spur more housing investment through rock-bottom interest rates, more auto purchases through securitized consumer loans, and more “shovel-ready” infrastructure projects through short-term stimulus programs. When investment spending does not budge, they recommend that we turn “excess” saving into another consumption binge.

Supply-siders, by contrast, want to promote private (certainly not public!) investment through more tax cuts and further deregulation. They have tried that on several occasions in the US, most recently during the George W. Bush administration. Unfortunately, the result of this deregulation was a short-lived housing bubble, not a sustained boom in productive private investment.

Though policy alternates between supply-side and neo-Keynesian enthusiasm, the one persistent reality is a significant decline of investment as a share of national income in most high-income countries in recent years. According to IMF data, gross investment spending in these countries has declined from 24.9% of GDP in 1990 to just 20% in 2013.

In the US, investment spending declined from 23.6% of GDP in 1990 to 19.3% in 2013, and fell even more markedly in net terms (gross investment excluding capital depreciation). In the European Union, the decline was from 24% of GDP in 1990 to 18.1% in 2013.

Neither neo-Keynesians nor supply-siders focus on the true remedies for this persistent drop in investment spending. Our societies urgently need more investment, particularly to convert heavily polluting, energy-intensive, and high-carbon production into sustainable economies based on the efficient use of natural resources and a shift
to low-carbon energy sources. Such investments require complementary steps by the public and private sectors.

The necessary investments include large-scale deployment of solar and wind power; broader adoption of electric transport, both public (buses and trains) and private (cars); energy-efficient buildings; and power grids to carry renewable energy across large distances (say, from the North Sea and North Africa to continental Europe, and from California’s Mojave Desert to US population centers).

But just when our societies should be making such investments, the public sectors in the US and Europe are on a veritable “investment strike.” Governments are cutting back public investment in the name of budget balance, and private investors cannot invest robustly and securely in alternative energy when publicly regulated power grids, liability rules, pricing formulas, and national energy policies are uncertain and heavily disputed.

In the US, public investment spending has been slashed. Neither the federal government nor the states have political mandates, funding strategies, or long-term plans to catalyze investment in the next generation of smart, clean technologies.

Both neo-Keynesians and supply-siders have misunderstood the investment paralysis. Neo-Keynesians see investments, public and private, as merely another kind of aggregate demand. They neglect the public-policy decisions regarding energy systems and infrastructure (as well as the targeted R&D to promote new technologies) that are needed to unleash smart, environmentally sustainable public and private investment spending. Thus, they promote gimmicks (zero interest rates and stimulus packages), rather than pressing for the detailed national policies that a robust investment recovery will require.

The supply-siders, for their part, seem utterly oblivious to the dependence of private investment on complementary public investment and a clear policy and regulatory framework. They advocate slashing government spending, naively believing that the private sector will somehow magically fill the void. But, by cutting public investment, they are hindering private investment.
Private electricity producers, for example, will not invest in large-scale renewable energy generation if the government does not have long-term climate and energy policies or plans for spurring construction of long-distance transmission lines to carry new low-carbon energy sources to population centers. Such messy policy details have never much bothered free-market economists.

There is also the option of using domestic saving to boost foreign investments. The US could, for example, lend money to low-income African economies to buy new power plants from US companies. Such a policy would put US private saving to important use in fighting global poverty, while strengthening the US industrial base.

Yet here, too, neither the neo-Keynesians nor the supply-siders have exerted much effort to improve the institutions of development finance. Instead of advising Japan and China to raise their consumption rates, macroeconomists would be wiser to encourage these economies to use their high savings to fund not only domestic but also overseas investments.

These considerations are reasonably clear to anyone concerned with the urgent need to harmonize economic growth and environmental sustainability. Our generation’s most pressing challenge is to convert the world’s dirty and carbon-based energy systems and infrastructure into clean, smart, and efficient systems for the twenty-first century. Investing in a sustainable economy would dramatically boost our wellbeing and use our “excess” savings for just the right purposes.

Yet this will not happen automatically. We need long-term public-investment strategies, environmental planning, technology roadmaps, public-private partnerships for new, sustainable technologies, and greater global cooperation. These tools will create the new macroeconomics on which our health and prosperity now depend.


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