

May 7, 2012

The Structural Revolution

By DAVID BROOKS

The country is divided when different people take different sides in a debate. The country is really divided when different people are having entirely different debates. That's what's happening on economic policy.

Many people on the left are having a one-sided debate about how to deal with a cyclical downturn. The main argument you hear from these cyclicalists is that the economy is operating well below capacity. To get it moving at full speed, the government should borrow and spend more. The federal government is now running deficits of about \$1 trillion a year. Some of these cyclicalists believe the deficit should be about \$1.4 trillion.

The cyclicalists rail against what they see as American austerity-mongers who resist new borrowing. They really rail against the European ones. They see François Hollande's victory in France as a sign that, in Europe at least, the pendulum might finally be swinging from austerity to growth.

Other people — some on the left but mostly in the center and on the right — look at the cyclicalists and shrug. It's not that they are necessarily wrong to bash excessive austerity. They're simply failing to address the core issues.

The diverse people in this camp — and I'm one of them — believe the core problems are structural, not cyclical. The recession grew out of and exposed long-term flaws in the economy. Fixing these structural problems should be the order of the day, not papering over them with more debt.

There are several overlapping structural problems. First, there are those surrounding globalization and technological change. Hyperefficient globalized companies need fewer workers. As a result, unemployment rises, superstar salaries surge while lower-skilled wages stagnate, the middle gets hollowed out and inequality grows.

Then there are the structural issues surrounding the decline in human capital. The United States, once the world's educational leader, is falling back in the pack. Unemployment is high, but companies still have trouble finding skilled workers.

Then there is political sclerosis. Over the decades, companies and other entities have implanted a growing number of special-interest deals into the tax and regulatory codes, making it harder for politically unconnected, new competitors, making the economy less dynamic.

These and other structural problems have retarded growth and wages for decades. Consumers tried to compensate by borrowing more. Politicians tried to compensate by reducing the tax bill, increasing deficit spending, ensuring easy credit for homebuyers and by helping workers shift out of

the hypercompetitive, globalized part of the economy and into the less productive and more sheltered parts of the economy — mostly into health care, government and education.

But you can only mask structural problems for so long. The whole thing has gone kablooeey. The current model, in which we try to compensate for structural economic weakness with tax cuts and an unsustainable welfare state, simply cannot last. The old model is broken. The jig is up.

Unlike the cyclicalists, we structuralists do not believe that the level of government spending is the main factor in determining how fast an economy grows. If that were true, then Greece, Britain and France would have the best economies on earth. (The so-called European austerity is partly mythical.) We believe that the creativity, skill and productivity of the work force matter most, and the openness of the system they inhabit.

Running up huge deficits without fixing the underlying structure will not restore growth. As Raghuram Rajan of the University of Chicago writes in the current issue of *Foreign Affairs*, “Since the growth before the crisis was distorted in fundamental ways, it is hard to imagine that governments could restore demand quickly — or that doing so would be enough to get the global economy back on track. The status quo ante is not a good place to return to because bloated finance, residential construction and government sectors need to shrink, and workers need to move to more productive work.”

Structuralists face a tension: How much should you reduce the pain the unemployed are feeling now, and how much should you devote your resources to long-term reform? There has to be balance. For my taste, the Germans are a bit too willing to impose short-term pain on the diverse national economies in Europe. But they are absolutely right to insist on the sort of structural reforms they themselves passed in the 1990s.

In the United States, there are almost no politicians willing to embrace the cyclicalist agenda, which would mean much larger deficits. Structuralists don’t have a perfect champion either. President Obama is too minimalist. He doesn’t seem to believe America’s structural problems are that big, making his reform ideas small. Mitt Romney and Representative Paul Ryan understand the size of the structural problems, but their reform plans are constrained by the Republican Party’s single-minded devotion to tax cuts.

Make no mistake, the old economic and welfare state model is unsustainable. The cyclicalists want to preserve the status quo, but structural change is coming.