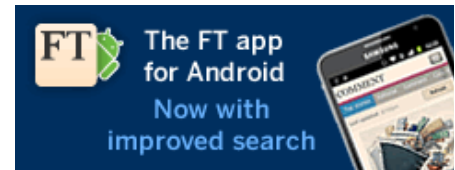


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FINANCIAL TIMES

The economic recovery is floundering

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by Eswar Prasad and Karim Foda

In the lead-up to the G20 summit in Los Cabos, the Brookings-FT Tiger index shows that this stop-and-go global recovery has stalled once again.

The engines of world growth are running out of steam while the trailing wagons are going off the rails. Emerging market economies are facing sharp slowdowns in growth while many advanced economies slip into recession.

Political fragmentation and gridlock have hurt confidence and stunted the effectiveness of macroeconomic policies. Financial markets have shed their optimism and investors are clamoring to retreat to safe havens as confidence has tumbled.

The US economy had been a relatively bright spot, although a fragile one, but growth is showing signs of slowing and employment growth has weakened even as the economy gets closer to an impending fiscal crunch. The UK and many of the eurozone economies are in or at the edge of recession. Even the once-mighty German economy seems to have lost its footing while Japan's economy is stirring but remains mired in weak growth.

In the eurozone and other advanced economies, politicians seem unable to come to terms with the need for decisive policy actions, instead settling for half-measures and defensive policy interventions when backed into a corner. This often compounds the cost of policy measures, especially if the delay contributes to a worsening of the macroeconomic environment. For instance, the recent move to shore up the Spanish banking system brings into sharp relief how expensive it will now be to cordon off the rest of the eurozone periphery if the elections in Greece were to trigger a meltdown.

Emerging markets are running out of steam as they continue to be buffeted by weak environments in global trade and finance.

China's growth outlook has darkened as the economy grapples with domestic policy challenges, an unexpectedly rocky political transition, and uncertainties in global trade and finance. China's government still has considerable policy room and has signaled its intention to respond aggressively if adverse spillover effects from the eurozone debt crisis were to intensify.

In India, fiscal policy is adrift while the reform process has ground to a halt, eroding confidence in economic prospects and scaring away many foreign investors. Monetary policy is fighting a lonely battle to sustain growth, tamp down inflation and contain the plunge in the value of the rupee. The burden of making up for structural economic weaknesses, a large fiscal burden and policy paralysis has driven monetary policy to a corner.

Brazil, Russia and many other emerging markets are also facing mounting headwinds, both from home and abroad, which threaten to blow their recoveries off course.

The time has come for a policy reboot. A better mix of policies would relieve monetary policy of the entire burden of preventing cataclysm as well as supporting growth. The right mix and timing of policies is necessarily country-specific, but in most countries fiscal policy and structural reform measures need to shoulder more of the burden of restoring financial stability, rebuilding confidence and reviving growth.

In the US, the looming fiscal crunch in the absence of a budget deal could once again lead to a messy short-term compromise that does little to tackle long-term fiscal sustainability issues. In the peripheral economies of the eurozone, harsh austerity measures are hammering growth and eroding political support for structural reforms that are essential to regain competitiveness.

What's needed in countries with vulnerable fiscal positions is a detailed and realistic plan for deficit reduction over the next three to five years rather than strict austerity at a time of weak growth. The concern is that even if they could articulate such a plan, policymakers may have lost credibility to deliver.

There is one way out of this conundrum: front-loading structural reform measures in order to rebuild credibility and create some space for back-loading measures to bring public debt accumulation under control. This will take serious political resolve as such reforms to labour, product and financial markets involve taking on powerful vested interests, but there may be little choice when it comes to restoring

long-term competitiveness.

The global economic recovery is being held hostage by political brinksmanship that has created policy paralysis, undermined confidence and stymied the effectiveness of macroeconomic policy tools. In the absence of political leadership to undertake decisive and concerted policy actions, it is hard to see the recovery gaining traction.

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