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Another dose of the drug to mask the disease

From Mr Daniel J Aronoff.

Sir, I think Martin Wolf is trying to solve a dilemma ("Bad advice from Basel's Jeremiah", July 2). He recognises that the large trade deficits run by Europe and the US, and the increased share of income going to the top 1 per cent, have generated a savings glut in those economies. The attendant underconsumption creates a chronic stagnation in demand, while the glut of savings depresses interest rates and creates an incentive for investment booms, which are doomed to end in bust so long as sustainable demand remains insufficient to support high levels of consumption. He also recognises that the debt overhang legacy from the leveraged housing boom has mired the west in debt-deflation slump.

Yet Mr Wolf doubts the capacity of the political systems in the affected countries to confront and remediate the core problems of trade imbalances, income inequality and debt restructuring, and his pessimism is justified by the inaction on those matters thus far. So, rather than bemoaning the infeasibility of attaining the optimal solution, he argues for a second-best strategy of boosting employment through government deficit spending.

Assuming Keynesian stimulus will boost employment, there remains the question of where it all leads if the underlying problems remain unaddressed. Will the increase in government debt guide the economy to a point where private-sector demand kicks in and thereafter generates sustainable high employment? Or will it simply conjure another bubble destined to burst; last time housing, next time government finances? If that happens, Mr Wolf's advocacy of pursuing full employment at all costs will appear in retrospect to have been a plea for another dose of the drug to mask the disease.

A dilemma, indeed.

Daniel J Aronoff, President, The Landon Companies, Royal Oak, MI, US

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