

## FINANCIAL TIMES

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# Economic orthodoxy is no longer sustainable

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*From Dr Sumon Bhaumik.*

Sir, In the current environment, continuing fiscal contraction will not only have an adverse impact on cyclical upturn in the US and Europe, but will also impair business confidence to a point that would have a negative impact on the long-term trend growth of these economies. Businesses in these countries are waiting and watching, but another sharp economic contraction might trigger off business closures, and hence loss of tacit knowledge, networks and agglomeration economies that partly drive long-term growth.

The problem, as highlighted by the experience of Greece, Spain and Italy, is that fiscal expansion may not be feasible if it is contingent on borrowing from the market. It is therefore time to consider a large-scale and co-ordinated monetisation of the sovereign debt, not just as a tactical measure such as the purchase of Greek, Spanish and Italian bonds by the European Central Bank, but as a strategic response to the underlying crisis of debt overhang. This would provide these countries with fiscal wriggle room to stimulate aggregate demand, without affecting their cost of borrowing.

There also has to be a change in the mandate of the central banks such that they are able to tolerate a much higher level of inflation, and the Bank of England seems to have already moved in that direction. While a double digit inflation rate of (say) 10 per cent would reduce real income of households, it would also rapidly reduce the real value of both household and sovereign debt. There will be intense political pressure on governments if these levels of inflation are permitted, but the alternative to this cathartic process of debt reduction is years of stagnation, with stagnation or decline in employment opportunities and real earnings. In Europe, such stagnation will also irreparably damage the welfare state that the households cherish.

One of the most important reasons for the policy paralysis in the US and especially Europe is that politicians and policymakers are attempting to deal with the crisis using conventional economic tactics. We are now reaching a point where they will have to think outside the box, perhaps even learn from the experience of smaller, even developing, countries that have a long history of indebtedness and using monetisation and inflation to pare down debt. There is no more room to sustain economic orthodoxy on either end of the political-ideological spectrum.

**Sumon Bhaumik,**

**Economics and Strategy Group,**

**Aston Business School,**

**Birmingham, UK**

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