

## COMMENT

### Housing is the rotting core of the US recovery

**Robert Reich**

Economic cheerleaders on Wall Street and in the White House are taking heart. The US has had three straight months of faster job growth. The number of Americans filing new claims for unemployment benefits is down by more than 50,000 since early January. Corporate profits are healthy. The S&P 500 on Friday closed at a post-financial crisis high.

Has the American recovery finally entered the sweet, virtuous cycle in which more spending generates more jobs, more jobs make consumers more confident and the confidence creates more spending? On the surface it would appear so.

American consumers in recent months have let loose their pent-up demand for cars and appliances. Businesses have been replacing low inventories and worn equipment. The richest 10 per cent, owners of approximately 90 per cent of the nation's financial capital, have felt freer to splurge. Consumer confidence is at a one-year high, according to data released on Friday.

Yet the US economy has been down so long that it needs

substantial growth to get back on track – far faster than the 2.2 to 2.7 per cent projected by the Fed for this year (a projection which itself is likely to be far too optimistic).

A strong recovery cannot rely on pent-up demand for replacements or on the spending of the richest 10 per cent. Consumer spending is 70 per cent of the US economy, so a buoyant recovery must involve the vast middle class.

But America's middle class is still hobbled by net job losses and shrinking wages and benefits. Although the US population is much larger than it was 10 years ago, the total number of jobs today is no more than it was then. A significant portion of the working population has been sidelined – many for good. And the median wage continues to drop, when adjusted for inflation. On top of all that, rising fuel prices are squeezing home budgets even more.

Yet the biggest continuing problem for most Americans is their homes. Purchases of new homes are down 77 per cent from their 2005 peak. They dropped another 0.9 per cent in January. Home sales overall are still dropping and prices are still falling – despite already being down by a third from their 2005 peak. January's

average sale price was \$154,700, down from \$162,210 in December.

Houses are the major assets of the middle class. Most Americans are therefore far poorer than they were six years ago. Almost one out of three homeowners with a mortgage is now "underwater", owing more to the banks than their homes are worth on the market.

**In the late 60s and 70s baby boomers took out large mortgages and watched their nesteggs grow into ostrich eggs**

Optimists point to declining home inventories in relation to sales, but they are looking at an illusion. Those supposed inventories do not include about 5m housing units with delinquent mortgages or those in foreclosure, which will soon be added to the pile. Nor do they include approximately 3m housing units that stand vacant – foreclosed upon but not yet listed for sale, or vacant homes that owners have pulled off the market because they

can't get a decent price for them.

We are witnessing a fundamental change in the consciousness of Americans about their homes. Starting at the end of the second world war, houses were seen as safe investments because home values rose continuously. In the late 1960s and 1970s, baby boomers took out the largest mortgages they could afford, and watched their nesteggs grow into ostrich eggs. Homes morphed into ATMs, as Americans used them as collateral for additional loans. Most assumed their homes would become their retirement savings.

When the time came, they would trade them in for a smaller unit and live off the capital gains.

The plunge in home values has changed all this. Young couples are no longer buying homes; they are renting because they are not confident they can get, or hold, jobs that will reliably allow them to pay a mortgage. Middle-aged couples are underwater or unable to sell their homes at prices that allow them to recover their initial investments. They cannot relocate to find employment. They cannot retire.

Under these circumstances it is not enough to rely on low interest rates and to make it easier for homeowners

who have kept up with their mortgage payments to refinance their underwater homes, as the Obama administration has done. The government should also push to alter the federal bankruptcy law, so homeowners can use the protection of bankruptcy to reorganise their mortgage loans. (Few will do so, but the change would give homeowners more bargaining power to get lenders to voluntarily alter the terms.)

A second possibility is for the Federal Housing Administration to take on a portion of a household's mortgage debt in exchange for a share in the home, of the same proportion, when it is sold. Such debt-for-equity swaps could help homeowners struggling to keep up with mortgage payments, while not adding to the federal budget in future years when prices are expected to rise.

However, the negative wealth effect of home values, combined with declining wages, makes it highly unlikely the US will enjoy a robust recovery any time soon.

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### Emerging economies should start to prepare for the worst

**Felipe Larraín**

The world economy is under threat. In spite of better news from some quarters, Europe is in a clear recession that started in the second half of 2011, and the US economy will undergo a fiscal adjustment in excess of 1 per cent of output at the end of this year. China – along with much of the developing world – is in a deceleration phase.

The fear of another crisis is still here and the question is whether anyone can help to alleviate its impact. In this context, emerging markets could have a new and important role to play. Their relative importance in the world economy has increased dramatically. Currently, they represent 50 per cent of global gross domestic product (in purchasing power parity terms) up from only 30 per cent 20 years ago.

These countries now have more room for manoeuvre in the face of a deterioration in economic conditions. Most have adopted sound macroeconomic policies controlling inflationary pressures and consolidating improved fiscal positions – in contrast to their more developed peers.

Chile, for example, runs fiscal policy according to a structural rule whereby spending is determined by anticipated revenues, which depends on an independent committee's estimates of the long-term copper price and potential output growth. Fiscal policy is countercyclical, resulting in a surplus in the good times and a deficit in the bad times. The rule allows Chile to accumulate more than \$20bn (about 9 per cent of GDP) in sovereign wealth funds, most of which can be used in case of significant shocks.

### Fiscal policy has allowed Chile to accumulate over \$20bn in sovereign wealth funds, to protect against external shocks

Given their greater room for manoeuvre, the challenge now for emerging economies is to draw up well-structured contingency plans to counteract the pressures coming from the developed world. Most have room for a more expansionary fiscal policy during 2012 and are acting accordingly, as the examples of China, India, Mexico, and Chile demonstrate.

Yet, if things worsen in the global economy, countries should be ready to react quickly. Public investment is a case in point. There are opportunities to expedite investments and to bring forward new projects that have passed the appraisals. It is also possible to have in the toolbox a set of incentives for private investments that may bring more private projects forward.

However, a well-designed contingency plan should go beyond fiscal policy. At its heart, it should include measures promoting flexibility and work incentives in labour markets in order to combat unemployment's pernicious social effects. Emergency public programmes to employ people directly may be needed, but these programmes also create long-term dependency of workers on low-paying, low-productivity jobs. Temporary incentive schemes for private-sector employment are generally a better option.

Careful monitoring of domestic financial markets is also key to limiting the fallout of a crisis stemming from the developed world. It should be a priority to identify systemic risks and make ready a battery of prudential instruments to provide liquidity to the banking system quickly. These include the timely use of repurchase agreements ("repos") by the central bank and the auctioning of foreign exchange deposits by the treasury.

It is also essential that countries establish a financial stability council that brings together the main economic decision-makers (including at least the finance minister, central bank president and the heads of banking and security regulation) to monitor financial risks and coordinate policy responses.

Authorities must be keenly aware that there is no reasonable prospect from fiscal policy that may fully counteract a credit crunch, as the recent experience of 2009 shows.

These measures are at the core of the contingency plan we have been designing in Chile during the past few months. At recent meetings with my emerging market colleagues, especially from Latin America, we have discussed the design of contingency programmes that will enable us to respond effectively

## The case for staying out of Syria

**Gideon Rachman**

"No one can here understand how the international community can let this happen." So said Marie Colvin, in an interview given from Homs, just a day before she herself was killed by a Syrian bombardment.

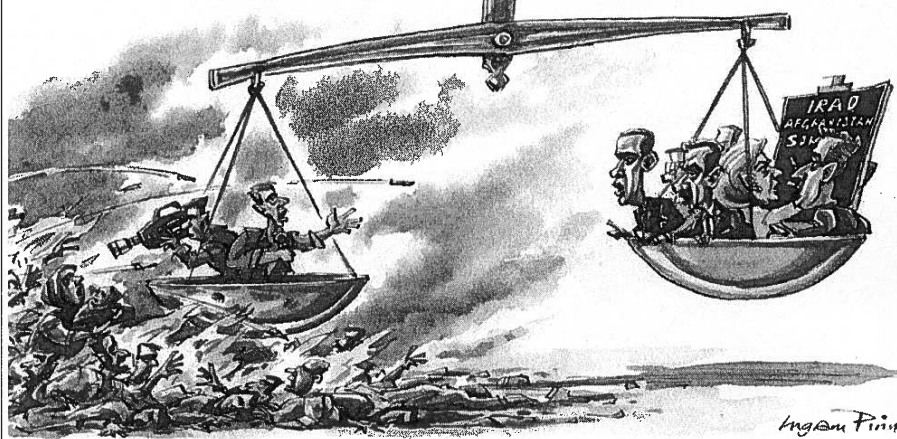
Colvin, a gallant war reporter, put her finger on a recurring dilemma in international politics. Does the outside world have a duty to intervene to prevent the mass killing of civilians?

Those who see vicious cruelty up close tend to react like Colvin. Almost all the journalists I know who covered the Bosnian war became convinced advocates of outside intervention. It is the natural human response. You see innocent people being killed, day after day. You know that there is a vast arsenal of military might, sitting back home, that could overwhelm the aggressors. It seems impossible and immoral not to advocate stopping the killing. I had a similar reaction after being appalled by a visit to East Timor, when it was under Indonesian occupation.

The human rights workers and journalists who risk their lives to tell the stories of mass atrocities play a vital and honourable role. But so do the less glamorous bureaucrats and politicians, sitting safely in their offices thousands of miles away, who must try to weigh up a response.

It is their job to balance the humanitarian impulse, with the public duty to think through the consequences. They must ask not just "Can we stop the killing?" but also "What happens next?" They must also ask: "Is it possible that, in intervening to stop one evil, we will create a greater evil in the future?" This is not a popular question. For while the advocates of intervention deal in moral absolutes, those who hang back are moral relativists – weighing one evil against another. Inevitably, they often sound shy and heartless. But, if they make the wrong decision, they could be responsible for causing more deaths than they prevent.

The current conflict in Syria poses these difficult questions in an acute form. As the killing worsens, the response of the "international community" looks feeble. It is not



just the Russian and Chinese veto of a UN resolution. The Arab and western nations that are strongest in condemning Syria are also hesitating. And for good reason.

The key question for any outside intervention is not just whether it can stop the killing – but also whether it can decisively tip the balance in favour of a peaceful and sustainable political solution. If that does not happen, foreign intervention can simply intensify a conflict.

Sometimes intervention has clearly worked. After years of hanging back, Nato did ultimately stop the Bosnian war. The more limited effort in East Timor in 1999 achieved its goals. The recent Libyan campaign almost certainly prevented a horrible massacre in Benghazi and still stands a strong chance of leaving Libya with a half-decent government.

Yet, a brief glance at the news provides ample reminders of other, less successful, interventions. More than a decade after Nato troops arrived in Afghanistan – with high hopes of establishing a democracy that respected human rights – they are facing a newly inflamed insurgency. Somalia – the scene of a failed US intervention in 1993, is now the archetype of a failed state. Iraq turned into a bloodbath.

Sadly, Syria looks like a country where outside intervention has a particularly strong chance of going wrong. The Assad regime has a powerful army, and more domestic and international support than Gaddafi had in Libya. If fighting escalates in Syria, the risk of a prolonged civil war is considerable. The fact that many outside powers – from Iran to Saudi Arabia to Israel – have a strong interest in who controls Syria means that there is a real chance of that war turning into a broader regional conflict.

There is also no guarantee of the character of the successor regime to the Assad. The opposition forces have been endorsed not just by the US, but also by al-Qaeda – which must be a first.

Remembering that western weapons once supplied the weapons of the Taliban in Afghanistan, the west should be extremely careful about who it backs and arms in Syria. Instead, through economic and diplomatic channels, the outside world should pressure the Assads – making it clear they can never regain global acceptance.

But advocates of peaceful pressure should be honest. At this stage, sanctions and condemnatory UN

resolutions will probably act too slowly to stop the savagery of a government that is fighting for its life. Other apparently peaceful moves – such as setting up safe havens for refugees or humanitarian corridors for the delivery of relief – would, in fact, require the use of military force. Supplying arms to the rebels, as advocated by the Saudis, would certainly stoke the conflict.

A further unpleasant truth is that, at the back of their minds, foreign policymakers must weigh the question: "How much is too much?" If this was the Holocaust or the Rwandan genocide (which claimed 800,000 lives), the imperative to intervene would rightly overwhelm fears about the consequences. The death toll in Syria is currently said to be 7,000 – and will certainly rise.

That is appalling. But it does not yet justify taking on the huge risks involved in outside military intervention in Syria.

I am sure if I had seen first hand the horrors that Colvin and her colleagues witnessed I would feel very differently. But sometimes distance and detachment have their place. The emotional response is not always the right response.

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**The A list**

Eurozone countries should raise their retirement ages and reform their pension systems rather than cut spending now, write Jean Pisani-Ferry and Coen Teulings

[ft.com/allist](http://ft.com/allist)

## Africa is rising – and Britain's bwanas are out of step

**Michael Holman**

Africa is on the move. From a basket case to a potential bread basket, from doggy debtor to investor opportunity. Too bad that Britain risks remaining out of step and out of touch.

Last week's London summit on Somalia was remarkable for its high turnout and admirable in its good intentions. No one can dispute the damage done by piracy in waters used by international shipping, or the threat posed by extremists who shelter behind a collapsed administration. But safety at sea is dependent on economic recovery on land. And restoring a failed state means tackling poverty.

This needs a summit of a different

changes that give hope to the people of shattered Somalia and beyond.

There is much to celebrate. A market of nearly 1bn people, about a third of them under 21, is waking up for five wasted post-independence decades. From Johannesburg to Djibouti, from Lagos to Lusaka, something dramatic is afoot. Fueled by booming oil exports, boosted by higher commodity prices, funded by cheap loans from China and by returning capital from the diaspora, as well as by foreign investment, Africa's social and physical landscape is being reshaped.

But it is gaining more than new shopping malls and airport terminals and skyscrapers. The military by and large stay in the barracks. Human rights are higher on the agenda. And in a sign of the change afoot in a

To many African officials and business leaders, Britain – for so long Africa's traditional partner in Europe – has seemed slow to respond to the challenge posed by this new era and, unable to see the need for a fresh relationship, has failed to turn Commonwealth membership and the shared English language to commercial advantage.

Part of the reason may be the malaise that still hangs over the continent, a legacy from past disappointments. Many diplomats see Africa as life in the slow career track; academics struggle for research funds; retired colonial civil servants take their knowledge to the grave; journalists drop in and move on; and business leaders who once forged careers on the continent now see a stint in Lagos or Luanda as a

hardship post. The result? Contracts are lost, markets seek new suppliers, old ties count for little and old friendships go unrecognised.

And when the time of the reason goes back, I suspect, to Britain's colonial past – with an unexpected twist. For years UK ministers have lectured Africa's leaders on the need to rise above their colonial heritage. The continent has been urged to put aside old grievances and start afresh.

How ironic, then, that while a youthful continent breaks free of this legacy, welcoming new investors from Turkey, Malaysia and elsewhere, it should be Britain – not Africa – that at times seems burdened by the past.

Perhaps embedded in the national consciousness, seldom recognised and rarely acknowledged, are attitudes

policy when natural disaster strikes. Increasing aid is seen as the path to economic growth and African entrepreneurs resent the assumption that the City of London – and not Beijing – will be their first port of call when seeking project finance.

Until recently Africa had no choice but to put up with this. After all, there was no denying postcolonial governments had been corrupt and incompetent. Weak economies had no option but to take the medicine from the International Monetary Fund.

Today the Fund has other matters on its mind, preoccupied as it is with saving European economies. And for the first time, loans from the World Bank to Africa – the reward for taking the IMF medicine – have been overtaken by soft loans from China. The stick once used with abandon is