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The world economy is entering a new phase after the failure of fiscal stimulus to create a sustained recovery in either the US or Europe. In the US, consumers have retrenched, housing starts have crashed and a double-dip recession is possible. In Europe, fiscal retrenchment is under way after intense market pressures. A new approach to recovery is needed.

The striking feature in the current debate about austerity and stimulus has been the lack of attention to investment. Consumers will not provide the engine of recovery, nor should they after overspending for a decade. Instead, the US and Europe should be using the recent corrective boost in saving rates to promote long-term investments in physical and human capital as the proper way back to sustained growth.

Despite the evident need for a rise in national saving after 2008, [President Barack Obama](#) tried to prolong the consumption binge by aggressively promoting home and car sales to already exhausted consumers, and by cutting taxes despite an unsustainable budget deficit. The approach has been hyper short term,

driven by America's two-year election cycle. It has stalled because US consumers are taking a longer-term view than the politicians.

By contrast, the administration's interest in boosting investment has been haphazard. Mr Obama has shown a strange inability to articulate an operational and forward-looking policy framework in signature areas such as [healthcare](#), energy, [climate change](#), and long-term fiscal policy. At a time when China is building hundreds of miles of subway lines, tens of thousands of miles of highways, a couple of dozen nuclear power plants, and a network of tens of thousands of miles of high-speed intercity rail lines, the US struggles to launch a single substantial project. China saves and invests; the US talks, consumes, borrows, and talks some more.

It is wrong in this context to believe that the only choice is further fiscal stimulus versus a repeat of the Great Depression. Further short-term tax cuts or transfers on top of America's \$1,500bn budget deficit are unlikely to do much to boost demand, while they would greatly increase anxieties over future fiscal retrenchment. Households are hunkering down, and many will regard an added transfer payment as a temporary windfall that is best used to pay down debt, not boost spending.

Businesses, for their part, are [distressed by the lack of direction](#). The US Chamber of Commerce was not simply lobbying when its director of government affairs recently declared to the Financial Times that: "When businesses try to plan out what their tax liabilities will be next year, or game out credit availability or the investment climate, they just don't know what it will look like. Uncertainty is a real killer."

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A proper US investment recovery plan has five parts. The first is a significant boost in investments in clean energy and an upgraded national power grid. These should be promoted through guaranteed price subsidies to clean energy to be financed by gradually rising carbon taxes, as the clean energy capacity comes on line during the coming decade. The alternative cap and trade system is cumbersome, unnecessary and politically dead.

The second is a decade-long programme of infrastructure renovation, with projects such as high-speed inter-city rail, water and waste treatment facilities and highway upgrading, co-financed by the federal government, local governments and private capital. Such projects are complex, requiring government leadership in land management, project design, public-private co-operation and partial subsidy or credit guarantees. New tools can help, such as a national infrastructure bank – championed last year before plans were strangely downplayed.

The third component is more education spending at secondary, vocation and bachelor-degree levels, to recognise the reality that tens of millions of American workers lack the advanced skills needed to achieve full employment at the salaries that the workers expect. The [unemployment crisis](#) is largely a structural crisis of job skills. It is hitting young workers – many of whom should still be learning – and older workers who lack a degree.

The penultimate part of the plan is boosting infrastructure exports to Africa and other low-income countries. China is running circles around the US and Europe in promoting such exports of infrastructure. The costs are modest – essentially just credit guarantees – but the benefits are huge, in increased exports, support for African development and a boost in geopolitical goodwill and stability.

The fifth and final element should be a medium-term fiscal framework that will credibly reduce the

federal budget deficit to sustainable levels within five years. This can be achieved partly by cutting defence spending by two percentage points of gross domestic product, meaning ending the Iraq and Afghanistan occupations and cutting wasteful weapons systems. Other measures should include gradually phasing out the tax subsidy on high-end health insurance, taxing Wall Street bank profits and bonuses, raising high-end marginal tax rates and, if necessary, introducing a small value added tax. Public investment costs could be financed mainly by public tolls, gradually rising carbon taxes and by repayments of international loans to finance the export of infrastructure.

The Obama administration and Republican opposition are both guilty of irresponsible short-termism and lack of forward-thinking. Both would dangerously prolong the budget deficit, the first through a combination of increased fiscal transfers and tax cuts, and the latter through even larger and more unsustainable tax cuts. Neither would do what America needs and China is doing better: investing for the future through serious attention to sustainable energy, cutting-edge infrastructure, enhanced labour-force skills and the promotion of international development through the export of infrastructure.

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