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World leaders note: this is the time for inaction

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Whether it's dealing with a dictator or a financial crisis, sometimes restraint is better than blundering in

To everything there is a season. There is a time to act and a time to refrain from acting — and this is as true in politics, economics and even warfare as it is in everyday life.

The liberation of Libya from the Gaddafi tyranny has been slower and deadlier than some people expected, but it now seems almost certain to be achieved. If so, then the response of the French, British and American governments to this complex humanitarian and geopolitical challenge should go down in history as a model of the way that boldness must be combined with patience and restraint.

The good news from Tripoli could even offer some relief to Barack Obama, David Cameron, Nicolas Sarkozy and other beleaguered political leaders whose summer has been spent fretting about the awful possibility of another recession. If conditions in Libya are stabilised, the resulting decline in oil prices would clearly help the world economy and financial markets — but there is another, less obvious, reason for additional relief.

At a time when investors and commentators all over the world are demanding panic measures to prevent another economic meltdown, Libya reminds us that governments must sometimes be more patient than financial markets or newspapers.

To say that Presidents Obama and Sarkozy, both of whom face daunting elections next year, should consider the virtues of inaction in response to the summer's economic challenges is not to endorse the right-wing fantasy that free markets will solve all problems if only politicians would leave them alone. The world is still paying an enormous price for the quasi-religious faith in markets and the Manichean hatred of government action represented by President Bush and the Republican Party in the US.

But just because government inaction was disastrous in the summer of 2008 does not mean that more government action is needed in the summer of 2011. The precise combination of market forces and government actions required to keep the world economy moving forward is not an absolute matter. The appropriate balance between activism and restraint depends on time and particular circumstances. This is just as true in economic management as in geopolitics and military interventions.

In Libya military intervention was timely and effective and therefore justified, whereas in Iraq it probably was not. Similarly, massive economic stimulus was certainly justified after the Lehman meltdown, and aggressive financial intervention would have been even more justified to prevent the collapse of Lehman and other banks. This does not mean, however, that repeating and redoubling similar measures would be effective — and therefore justifiable — today.

The situation in 2011 is very different from what it was three years ago, especially in the US, which was then the epicentre of the world's economic crisis but is today threatened by a breakdown of political consensus, not of financial stability. The Obama Administration and the Federal Reserve Board have already done about as much as they plausibly could to stimulate the US economy. These actions may or may not prove sufficient to undo the errors of the Bush Administration, but announcing even more aggressive measures, which is what many investors on Wall Street are now demanding — and are hoping to hear as soon as Friday in a speech by Ben Bernanke, the Chairman of the Fed — will not improve things and could well make matters worse.

Mr Bernanke has already made an unprecedented commitment to keep US interest rates effectively at zero until the middle of 2013. If he went any farther and supplemented this controversial promise with even more forceful new ideas for monetary stimulus, he would risk precipitating a collapse of the dollar and an outbreak of inflation panic instead of the improvement in business and consumer confidence he needs to inspire. Even worse, he would exacerbate the political polarisation that is a far greater threat to America's long-term future than any purely economic or fiscal challenges.

The best thing that Mr Bernanke and Mr Obama can do for the US economy, therefore, is simply to show some patience, as the benefits of zero interest rates, lower oil prices and a post-tsunami recovery in the Japanese economy gradually become apparent.

To a lesser extent this also applies to Mr Cameron, George Osborne and Mervyn King. It might well have been better for the British economy if the coalition had been slower and more circumspect in reducing its deficits. It would also have helped if the Bank of England had started a second round of monetary easing in the spring, instead of fanning public fears about the transitory inflation created by the combination of rising oil prices and last January's VAT rise.

But that is now water under the bridge. Given the fragile state of public and business confidence in the government and the central bank today, sticking patiently to existing policies probably makes sense, especially as Britain should see some benefits from the same international factors that are likely to help America in the second half of this year.

In Europe, on the other hand, much more active government decision-making is needed in at least one clear respect. As even the Bundesbank has publicly suggested this week, Germany's commitment to the survival of the euro is now in serious doubt. The Bundesbank has described the European Central Bank's policy of supporting the Greek, Spanish and Italian governments by buying their bonds as inconsistent with the EU treaties. It has stated that the treaties must be revised to create a proper legal basis for a federal fiscal policy across Europe — or that support for the Mediterranean governments must be withdrawn. This latter policy would lead almost inevitably to the break-up of the euro and a global banking crisis of apocalyptic proportions.

There is one bold government action that really could transform the global economic outlook today. Germany should put up or shut up when it comes to the euro. Either the German Government should set aside the Bundesbank's objections and give full support to other eurozone governments or it should pull out of the euro, leaving its management to France, assisted by Italy and Spain.

The liberation of Libya succeeded after Germany opted out of joining the Nato-led intervention. Why shouldn't the same be true of the single currency?