Fighting fiscal phantoms

By Paul Krugman
November 26, 2012 – *The New York Times*

These are difficult times for the deficit scolds who have dominated policy discussion for almost three years. One could almost feel sorry for them, if it weren't for their role in diverting attention from the ongoing problem of inadequate recovery, and thereby helping to perpetuate catastrophically high unemployment.

What has changed? For one thing, the crisis they predicted keeps not happening. Far from fleeing U.S. debt, investors have continued to pile in, driving interest rates to historical lows. Beyond that, suddenly the clear and present danger to the American economy isn't that we'll fail to reduce the deficit enough; it is, instead, that we'll reduce the deficit too much. For that's what the "fiscal cliff" — better described as the austerity bomb — is all about: the tax hikes and spending cuts scheduled to kick in at the end of this year are precisely not what we want to see happen in a still-depressed economy.

Given these realities, the deficit-scold movement has lost some of its clout. That movement, by the way, is a hydra-headed beast, comprising many organizations that turn out, on inspection, to be financed and run by more or less the same people; dig down into many of these groups' back stories and you will, in particular, find Peter Peterson, the private-equity billionaire, playing a key role.

But the deficit scolds aren't giving up. Now yet another organization, Fix the Debt, is campaigning for cuts to Social Security and Medicare, even while making lower tax rates a "core principle." That last part makes no sense in terms of the group's ostensible mission, but makes perfect sense if you look at the array of big corporations, from Goldman Sachs to the UnitedHealth Group, that are involved in the effort and would benefit from tax cuts. Hey, sacrifice is for the little people.

So should we take this latest push seriously? No — and not just because these people, aside from exhibiting a lot of hypocrisy, have been wrong about everything so far. The truth is that at a fundamental level the crisis story they're trying to sell doesn't make sense.

You've heard the story many times: Supposedly, any day now investors will lose faith in America's ability to come to grips with its budget failures. When they do, there will be a run on Treasury bonds, interest rates will spike, and the U.S. economy will plunge back into recession.

This sounds plausible to many people, because it's roughly speaking what happened to Greece. But we're not Greece, and it's almost impossible to see how this could actually happen to a country in our situation.

For we have our own currency — and almost all of our debt, both private and public, is denominated in dollars. So our government, unlike the Greek government, literally can't run out of money. After all, it can print the stuff. So there's almost no risk that America will default on its debt — I'd say no risk at all if it weren't for the possibility that Republicans would once again try to hold the nation hostage over the debt ceiling.

But if the U.S. government prints money to pay its bills, won't that lead to inflation? No, not if the economy is still depressed.

Now, it's true that investors might start to expect higher inflation some years down the road. They might also push down the value of the dollar. Both of these things, however, would actually help rather than hurt the U.S. economy right now: expected inflation would discourage corporations and families from sitting on cash, while a weaker dollar would make our exports more competitive.

Still, haven't crises like the one envisioned by deficit scolds happened in the past? Actually, no. As far as I can tell, every example supposedly illustrating the dangers of debt involves either a country that, like Greece today, lacked its own currency, or a country that, like Asian economies in the 1990s, had large debts in foreign currencies. Countries with large debts in their own currency, like France after World War I, have sometimes experienced big loss-of-confidence drops in the value of their currency — but nothing like the debt-induced recession we're being told to fear.

So let's step back for a minute, and consider what's going on here. For years, deficit scolds have held Washington in thrall with warnings of an imminent debt crisis, even though investors, who continue to buy U.S. bonds, clearly believe that such a crisis won't happen; economic analysis says that such a crisis can't happen; and the historical record shows no examples bearing any resemblance to our current situation in which such a crisis actually did happen.

If you ask me, it's time for Washington to stop worrying about this phantom menace — and to stop listening to the people who have been peddling this scare story in an attempt to get their way.