

The story of our time

By Paul Krugman

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Those of us who have spent years arguing against premature fiscal austerity have just had a good two weeks. Academic studies that supposedly justified austerity have lost credibility; hard-liners in the European Commission and elsewhere have softened their rhetoric. The tone of the conversation has definitely changed.

My sense, however, is that many people still don't understand what this is all about. So this seems like a good time to offer a sort of refresher on the nature of our economic woes, and why this remains a very bad time for spending cuts.

Let's start with what may be the most crucial thing to understand: the economy is not like an individual family.

Families earn what they can, and spend as much as they think prudent; spending and earning opportunities are two different things. In the economy as a whole, however, income and spending are interdependent: my spending is your income, and your spending is my income. If both of us slash spending at the same time, both of our incomes will fall too.

And that's what happened after the financial crisis of 2008. Many people suddenly cut spending, either because they chose to or because their creditors forced them to; meanwhile, not many people were able or willing to spend more. The result was a plunge in incomes that also caused a plunge in employment, creating the depression that persists to this day.

Why did spending plunge? Mainly because of a burst housing bubble and an overhang of private-sector debt — but if you ask me, people talk too much about what went wrong during the boom years and not enough about what we should be doing now. For no matter how

lurid the excesses of the past, there's no good reason that we should pay for them with year after year of mass unemployment.

So what could we do to reduce unemployment? The answer is, this is a time for above-normal government spending, to sustain the economy until the private sector is willing to spend again. The crucial point is that under current conditions, the government is not, repeat not, in competition with the private sector. Government spending doesn't divert resources away from private uses; it puts unemployed resources to work. Government borrowing doesn't crowd out private investment; it mobilizes funds that would otherwise go unused.

Now, just to be clear, this is not a case for more government spending and larger budget deficits under all circumstances — and the claim that people like me always want bigger deficits is just false. For the economy isn't always like this — in fact, situations like the one we're in are fairly rare. By all means let's try to reduce deficits and bring down government indebtedness once normal conditions return and the economy is no longer depressed. But right now we're still dealing with the aftermath of a once-in-three-generations financial crisis. This is no time for austerity.

O.K., I've just given you a story, but why should you believe it? There are, after all, people who insist that the real problem is on the economy's supply side: that workers lack the skills they need, or that unemployment insurance has destroyed the incentive to work, or that the looming menace of universal health care is preventing hiring, or whatever. How do we know that they're wrong?

Well, I could go on at length on this topic, but just look at the predictions the two sides in

this debate have made. People like me predicted right from the start that large budget deficits would have little effect on interest rates, that large-scale “money printing” by the Fed (not a good description of actual Fed policy, but never mind) wouldn’t be inflationary, that austerity policies would lead to terrible economic downturns. The other side jeered, insisting that interest rates would skyrocket and that austerity would actually lead to economic expansion. Ask bond traders, or the suffering populations of Spain, Portugal and so on, how it actually turned out.

Is the story really that simple, and would it really be that easy to end the scourge of unemployment? Yes — but powerful people

don’t want to believe it. Some of them have a visceral sense that suffering is good, that we must pay a price for past sins (even if the sinners then and the sufferers now are very different groups of people). Some of them see the crisis as an opportunity to dismantle the social safety net. And just about everyone in the policy elite takes cues from a wealthy minority that isn’t actually feeling much pain.

What has happened now, however, is that the drive for austerity has lost its intellectual fig leaf, and stands exposed as the expression of prejudice, opportunism and class interest it always was. And maybe, just maybe, that sudden exposure will give us a chance to start doing something about the depression we’re in.