Phony fear factor

By Paul Krugman
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We live in a golden age of economic debunkery; fallacious doctrines have been dropping like flies. No, monetary expansion needn't cause hyperinflation. No, budget deficits in a depressed economy don't cause soaring interest rates. No, slashing spending doesn't create jobs. No, economic growth doesn't collapse when debt exceeds 90 percent of G.D.P.

And now the latest myth bites the dust: No, "economic policy uncertainty" — created, it goes without saying, by That Man in the White House — isn't holding back the recovery.

I'll get to the doctrine and its refutation in a minute. First, however, I want to recommend a very old essay that explains a great deal about the times we live in.

The Polish economist Michal Kalecki published "Political Aspects of Full Employment" 70 years ago. Keynesian ideas were riding high; a "solid majority" of economists believed that full employment could be secured by government spending. Yet Kalecki predicted that such spending would, nonetheless, face fierce opposition from business and the wealthy, even in times of depression. Why?

The answer, he suggested, was the role of "confidence" as a tool of intimidation. If the government can't boost employment directly, it must promote private spending instead — and anything that might hurt the privileged, such as higher tax rates or financial regulation, can be denounced as job-killing because it undermines confidence, and hence investment. But if the government can create jobs, confidence becomes less important — and vested interests lose their veto power.

Kalecki argued that "captains of industry" understand this point, and that they oppose job-creating policies precisely because such policies would undermine their political influence. "Hence budget deficits necessary to carry out government intervention must be regarded as perilous."

When I first read this essay, I thought it was over the top. Kalecki was, after all, a declared Marxist (although I don't see much of Marx in his writings). But, if you haven't been radicalized by recent events, you haven't been paying attention; and policy discourse since 2008 has run exactly along the lines Kalecki predicted.

First came the "pivot" — the sudden switch to the view that budget deficits, not mass unemployment, were the crucial policy issue. Then came the Great Whine — the declaration by one leading business figure after another that President Obama was undermining confidence by saying mean things about businesspeople and doing outrageous things like helping the uninsured. Finally, just as happened with the claims that slashing spending is actually expansionary and terrible things happen if government debt rises, the usual suspects found an academic research paper to adopt as mascot: in this case, a paper by economists at Stanford and Chicago purportedly showing that rising levels of "economic policy uncertainty" were holding the economy back.

But, as I said, we live in a golden age of economic debunkery. The doctrine of expansionary austerity collapsed as evidence on the actual effects of austerity came in, with officials at the International Monetary Fund even admitting that they had severely underestimated the harm austerity does. The debt-scare doctrine collapsed once independent economists reviewed the data. And now the policy-uncertainty claim has gone the same way.

Actually, this happened in two stages. Soon after it became famous, the proposed measure of uncertainty was shown to be almost comically flawed; for example, it relied in part on press mentions of "economic policy uncertainty," which meant that the index automatically surged once that phrase became a Republican talking point. Then the index itself plunged, back to levels not seen since 2008, but the economy didn't take off. It turns out that uncertainty wasn't the problem.

The truth is that we understand perfectly well why recovery has been slow, and confidence has nothing to do with it. What we're looking at, instead, is the normal aftermath of a debt-fueled asset bubble; the sluggish U.S. recovery since 2009 is more or less in line with many historical examples, running all the way back to the Panic of 1893. Furthermore, the recovery has been hobbled by spending cuts — cuts that were motivated by what we now know was completely wrongheaded deficit panic.

And the policy moral is clear: We need to stop talking about spending cuts and start talking about job-creating spending increases instead. Yes, I know that the politics of doing the right thing will be very hard. But, as far as the economics goes, the only thing we have to fear is fear-mongering itself.