The New York Times

July 7, 2013

Defining Prosperity Down

By PAUL KRUGMAN

Friday's employment report wasn't bad. But given how depressed our economy remains, we really should be adding more than 300,000 jobs a month, not fewer than 200,000. As the Economic Policy Institute points out, we would need more than five years of job growth at this rate to get back to the level of unemployment that prevailed before the Great Recession. Full recovery still looks a very long way off. And I'm beginning to worry that it may never happen.

Ask yourself the hard question: What, exactly, will bring us back to full employment?

We certainly can't count on fiscal policy. The austerity gang may have experienced a stunning defeat in the intellectual debate, but stimulus is still a dirty word, and no deliberate job-creation program is likely soon, or ever.

Aggressive monetary action by the Federal Reserve, something like what the Bank of Japan is now trying, might do the trick. But far from becoming more aggressive, the Fed is talking about "tapering" its efforts. This talk has already done real damage; more on that in a minute.

Still, even if we don't and won't have a job-creation policy, can't we count on the natural recuperative powers of the private sector? Maybe not.

It's true that after a protracted slump, the private sector usually does find reasons to start spending again. Investment in equipment and software is already well above pre-recession levels, basically because technology marches on, and businesses must spend to keep up. After six years during which hardly any new homes were built in America, housing is trying to stage a comeback. So yes, the economy is showing some signs of healing itself.

But that healing process won't go very far if policy makers stomp on it, in particular by raising interest rates. That's not an idle worry. A Fed chairman famously declared that his job was to take away the punch bowl just as the party was really warming up; unfortunately, history offers many examples of central bankers pulling away the punch bowl before the party even starts.

And financial markets are, in effect, betting that the Fed is going to offer another such example. Long-term interest rates, which mainly reflect expectations about future short-term rates, shot up after Friday's job report — a report that, to repeat, was at best just O.K. Housing may be trying to bounce back, but that bounce now has to contend with sharply rising financing costs: 30-year mortgage rates have risen by a third since the Fed started talking about relaxing its efforts about two months ago.

Why is this happening? Part of the reason is that the Fed is constantly under pressure from monetary hawks, who always want to see tighter money and higher interest rates. These hawks spent years warning that soaring inflation was just around the corner. They were wrong, of course, but rather than change their position they have simply invented new reasons — financial stability, whatever — to advocate higher rates. At this point it's clear that monetary hawkery is mainly a form of Puritanism in H. L. Mencken's sense — "the haunting fear that someone, somewhere may be happy." But it remains dangerously influential.

Unfortunately, there's also a technical issue that plays into the prejudices of the monetary hawks. The statistical techniques policy makers often use to estimate the economy's "potential" — the maximum level of output and employment it can achieve without inflationary overheating — turn out to be badly flawed: they interpret any sustained economic slump as a decline in potential, so that the hawks can point to charts and spreadsheets supposedly showing that there's not much room for growth.

In short, there's a real risk that bad policy will choke off our already inadequate recovery.

But won't voters eventually demand more? Well, that's where I get especially pessimistic.

You might think that a persistently poor economy — an economy in which millions of people who could and should be productively employed are jobless, and in many cases have been without work for a very long time — would eventually spark public outrage. But the political science evidence on economics and elections is unambiguous: what matters is the rate of change, not the level.

Put it this way: If unemployment rises from 6 to 7 percent during an election year, the incumbent will probably lose. But if it stays flat at 8 percent through the incumbent's whole term, he or she will probably be returned to power. And this means that there's remarkably little political pressure to end our continuing, if low-grade, depression.

Someday, I suppose, something will turn up that finally gets us back to full employment. But I can't help recalling that the last time we were in this kind of situation, the thing that eventually turned up was World War II.