Paul Krugman - New York Times Blog

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Spending Cuts and Monetary Policy

I’ve often argued on this blog and in the column that now is a particularly bad time to cut spending, because unlike in normal times, the adverse effects on demand can’t be offset by cutting interest rates. One way to highlight the point is to compare where we are now with a historical episode: the fairly large cuts in federal purchases of goods and services that took place in the early 1990s, as the US military shrank with the end of the Cold War. Here’s federal consumption and investment spending as a share of potential GDP (blue, left scale) versus the Fed funds rate (red, right scale):

The Fed could and did cut rates, helping to cushion the impact of spending cuts. It can’t do anything like this now, because the Fed funds rate has already been cut more or less to zero in an attempt to fight the effects of financial crisis.

Austerity right now is a really, really bad idea.

While about 8 percent of Americans are unemployed, nearly a quarter of Americans say they were laid off at some point during the recession or afterward, according to the survey. More broadly, nearly eight in 10 say they know someone in their circle of family and friends who has lost a job.

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Of those laid off in recent years, nearly a quarter said they still had not found a job. Re-employment rates for older workers have been particularly bad, with nearly two-thirds of unemployed people 55 and older saying they actively sought a job for more than a year before finding one or had still not found work.

But the Very Serious People — who, I would guess, are for the most part members of the 1 in five who *don’t* have anyone in their circle who lost a job — insist that all of this is as nothing compared with the threat from invisible bond vigilantes.