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DEBATING POLITICS, ECONOMICS AND OTHER TIMELY TOPICS WITH PAUL KRUGMAN OF THE NEW YORK TIMES

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PAUL KRUGMAN

Europe's Leaders Disregard Anti-Austerity Logic

Simon Wren-Lewis recently tried to show some sympathy for the devil. In a post titled "The View From Brussels" on his blog, the Oxford professor attempted to get into the mindset of European officials who defend austerity. And he got at an important point in the process, although he may have let the austerians off too lightly.

As he suggests, the crucial place to start at is why economists like himself, Brad DeLong, Martin Wolf, Larry Summers (at this point, anyway), yours truly and others are against austerity now. We're not always against fiscal consolidation; give me the right economic circumstances and I'll turn at least modestly deficit hawk. We are, instead, against implementing austerity when the interest rate is against the zero lower bound because the economy is in a liquidity trap, so the contractionary effects of fiscal tightening can't be offset by monetary expansion.

So do the austerians reject this argument? No — they fail to even acknowledge that it exists. Actually, before I get there, let me offer a real-world example to illustrate what I'm talking about.

Ladies and gentlemen, allow me to present the Canadian austerity zombie.

What? Or, rather, eh? Well, Canada in the 1990s keeps coming up as an alleged example of expansionary austerity. And it's true that Canada did a lot of fiscal consolidation in the '90s, while simultaneously experiencing a strong recovery from the decade's early slump. See the chart on the fiscal stance estimate. And then see the chart on the unemployment rate.

Austerity roolz! Or, actually, not.

There were several special factors that affected Canada's experience, including the Clinton boom south of the border, but the most obvious point from a macroeconomic perspective is that Canada was able to offset its fiscal contraction with a dramatic loosening of monetary policy.

This looser monetary policy both fueled domestic demand and weakened the Canadian dollar, helping exports.

The point, of course, is that right now, with policy interest rates near zero, nothing like this can happen in Europe. The contractionary effect of austerity is unmitigated. And that's a very good reason for euro zone officials not to engage in austerity now — in fact, to provide stimulus — and wait until the aftereffects of the housing/debt bubble have worn off, and monetary policy is once again available as a counter to fiscal contraction.

'The QUESTION then BECOMES, what accounts for THIS BLIND SPOT?'

So how do European Commission economists respond to this argument? Basically, not at all.

A paper titled "The Debate on Fiscal Policy in Europe: Beyond the Austerity Myth," published by the commission last month and referred to by Mr. Wren-Lewis in his post, barely mentions monetary policy.

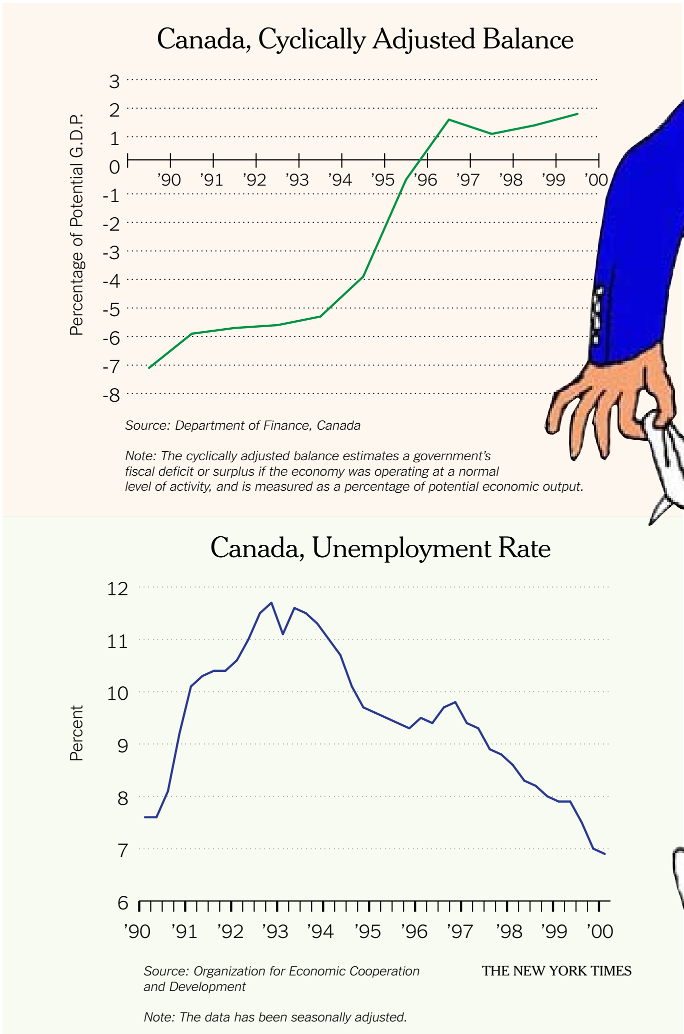
The question then becomes, what accounts for this blind spot, which seems even bigger in Europe than it is in the United States?

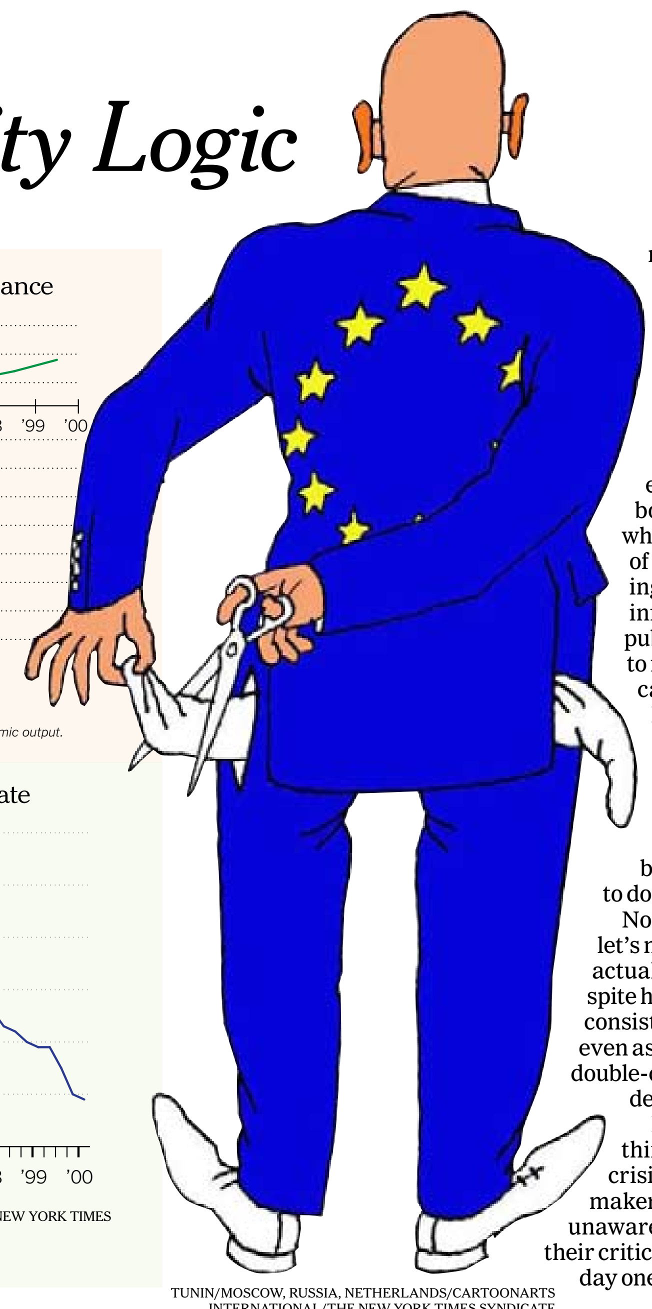
Let me venture a guess: It may have a fair bit to do with the European Central Bank's narrow mandate. In the United States, the Federal Reserve explicitly has a dual mandate, which charges it with achieving full employment as well as price stability (this makes it natural for the Fed to consider the difference being at the zero lower bound makes). In Britain, for whatever reason, the Bank of England has proved willing to tolerate above-target inflation for a while, and the public policy debate does tend to focus on what the B.O.E. can do to offset austerity.

But in Europe, the E.C.B. simply doesn't talk about its responsibility to stabilize the real economy, nor how the liquidity trap in the European core may be compromising its ability to do so.

Nor is it just a failure to talk; let's not forget that the E.C.B. actually raised rates in 2011, despite high unemployment, and has consistently refused to cut rates even as Europe slides deeper into double-dip recession — and ever deeper into fiscal austerity.

It's quite a remarkable thing: we're five years into this crisis, and key European policy makers still talk as if they were unaware of the central argument their critics have been making from day one.





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In Canada, an Economic Slump With Familiar Origins

Most comments are condensed from longer postings.

I was an economist at the Bank of Canada throughout this period. It is useful to recall that the near-miraculous improvement *in Canada's budget deficits was preceded by: (a) political courage, determination and an ability to force tough budget cuts into law, and (b) by many years of dismal economic performance, a period that became known as "The Great Canadian Slump."*

Fiscal improvement came with a big depreciation of the Canadian dollar, which matters a lot for a small economy, and a substantial fall in the interest rates on government bonds.

Many of the factors that helped Canada cannot help the United States. For example, how much lower can bond yields go in the United States? However, Canada's experience may help to illustrate how progress on the deficit can depend on appropriate monetary policy.

— Simon van Norden, Canada

Why was the economy so bad in Canada in the early 1990s? Why, it was the Great Canadian Slump, *brought on by an incompetent government that kept inflation at bay with interest rates at 12 percent.*

— Andrew, Japan

Respectfully, you are missing the point. The European Central Bank was created *with a monolithic focus on inflation in order to sell the euro to a skeptical German public that did not want to give up its strong deutsche mark and distrusted France's support for bringing into the euro zone a bunch of weak Club Med nations with histories of devaluation, inflation and banana republic-style accounting. The Germans worried that they would end up bailing out these nations. They were correct.*

— Scott, Minnesota

The notion of political union is clearly not on the E.C.B.'s *front burner. It will probably take a miracle for the euro to survive.*

— E., France

The E.C.B. lacks an effective sense of democratic accountability. This large committee is never dragged before a proper parliament *and forced to answer questions. At press briefings they give canned responses to journalists who don't really know what they are talking about. Officials from the E.C.B. need to be cross-examined over a period of several hours.*

— Chris, Ireland

'It will probably take a MIRACLE for the EURO to SURVIVE.'

Despite the evils of austerity under current economic conditions, there is an upside: *the European Union seems to be implementing real financial reform, while the United States is doing very little. I suspect that the banks are a necessary scapegoat for politicians who are implementing austerity measures while trying to survive.*

— Name withheld, Maryland

Mr. Krugman, since you have no legitimate arguments, you are reduced to insulting your opponents, *and you have coined the term "austerian" to do so more easily. I think we need a term for ideological Keynesians who refuse to moderate their worldview in any substantial way no matter how many times it is contradicted. I suggest calling these people the Krugmen.*

— Name withheld, Massachusetts

BACKSTORY

An Uncertain Future

While in office from 2007 to 2012, former French President Nicolas Sarkozy was a champion of austerity, partnering with German Chancellor Angela Merkel to impose fiscal consolidation plans on heavily indebted European nations.

The policies proved to be deeply unpopular in France, and in May 2012 Mr. Sarkozy lost his bid for re-election to François Hollande, who pledged to ease austerity measures, increase taxes on the wealthy and push for a focus on growth across the European Union. Following the election, Mr. Sarkozy started working on launching his own private equity firm. During his presidency he had developed close ties to the Qatari ruling family, and in December 2012 the family's financial arm, the Qatar Investment Authority, agreed to provide Mr. Sarkozy's venture with 250 million euros.

However, progress on launching the fund has stalled. Reporting for the Financial Times, Anne-Sylvaine Chassany and Camilla Hall explained: "In part, this stems from the revival of hopes for a political comeback as François Hollande has suffered a steep decline in popularity. Some friends have cautioned the fund would hinder Mr. Sarkozy's chances, not even a year after Mr. Hollande got elected as French president on a promise to tax the rich."

French authorities announced on March 21 that Mr. Sarkozy was under investigation for allegedly exploiting the L'Oreal heiress Liliane Bettencourt to obtain money to finance his presidential campaign in 2007. Ms. Bettencourt had been diagnosed with dementia a year before.

Mr. Sarkozy has denied the charges, and while many commentators in France believe it is unlikely that he will be convicted, most agree that his political and professional future rests on the outcome of this investigation.

PAUL KRUGMAN

Sarkozy's Post-Political Ambitions

A while back, before moving to Slate, the commentator Matthew Yglesias had what I considered a brilliant insight into the incentives facing small-country political leaders.

"Normally you would think that a national prime minister's best option is to try to do the stuff that's likely to get him re-elected," he wrote in an article for Think Progress in 2011. "But in the era of globalization and E.U.-ification, I think the leaders of small countries are actually in a somewhat different situation. If you leave office held in high esteem by the Davos set, there are any number of European Commission or I.M.F. or whatnot gigs that you might be eligible for even if you're absolutely despised by your fellow countrymen. Indeed, in some ways being absolutely despised would be a plus."

How small does the country in question have to be? Maybe not very. See the article titled "Nicolas Sarkozy's Road From the Elysée to Private Equity," published in the Financial Times on March 28. As it turns out, Mr. Sarkozy's money-making plans may be on hold due to a strange combination of legal troubles and the possibility of a political comeback thanks to President François Hollande's timidity.

'THE CRITICS weren't exactly INVISIBLE OR INAUDIBLE.'

But it remains true that John Maynard Keynes's dictum — "Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally" — is probably even more true for politicians than it is for bankers. And this probably helps to explain the persistence of the austerity cult despite years of failure.

Very Ernstig People

The Financial Times recently reported on the lonely life of an austerity skeptic.

According to an article published on March 31: "(Coen) Teulings' (Central Planning Bureau) let loose with a report in March accusing Dutch politicians of ignoring a consensus among macroeconomists that cutting deficits does much more economic damage than usual during so-called 'balance-sheet recessions,' like the current one. Such contractions are driven by consumers and firms trying to pay down heavy debt loads, leaving government as the only actor in the economy still able to spend."

It continues: "Mr. Teulings is not the only economist in the Netherlands skeptical of austerity, but he has been the only one with any policy influence. Prominent austerity skeptics at universities and big banks say they have been shut out, not just from government policy-making bodies but from the counsels of political parties on both right and left."

Despite writing about all this stuff for years, I'm still amazed not just by the way policy makers threw basic macroeconomics out the window, but by the absolute unanimity of their turn to austerity. After all, the critics weren't exactly invisible or inaudible; how could everyone serious be so sure that prominent macroeconomists were all wrong, and bureaucrats with no predictive track record were right?

DOUG MILLS/THE NEW YORK TIMES

Nicolas Sarkozy, the former president of France.

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Never Let a Crisis Go to Waste

Most comments are condensed from longer postings.

Unfortunately, the right in Europe will not waste this crisis — they are committed to *pushing through their policies. Facts and sound economic policy are the least of their concerns. The left ought to know better, but I fear that 20 years of internalizing neoliberal economics has left its mark.*

— Bruno C., the Netherlands

I agree with a lot of the criticism directed at Europe's economic policies, but this is all a bit far-fetched. *When exactly were the good old days of Greek politics (the country cited in Matthew Yglesias' article) before its politicians got so corrupted by the European Union?*

As for former French President Nicolas Sarkozy, I'm not sure I understand the connection.

Given his career and political allies, his current business plans are hardly shocking. People knew about Mr. Sarkozy's background and voted for him anyway. Is that undemocratic? And what does it have to do with the E.U., anyway?

If European governments were, in fact, ruled by a group of politicians more loyal to some transnational Very Serious groupthink than to the interests of their own populations, one might have expected the 20 years of near constant treaty negotiations following the creation of the E.U. in 1991 to have been a bit more fruitful. But in the opinion of many observers, the exact opposite has been true: During the past two decades, European leaders have become even more focused on their national interests, making it very difficult to reach E.U.-wide agreement on anything.

— Carl, Britain

It's quite sad that the Netherlands is a member of the austerity camp given that it's generally a nation *that prides itself on doing what works, whatever the prevailing wisdom. Just look at the country's drug policies.*

Why are the Dutch kowtowing to the Germans on austerity?

They're surrounded by clear examples of austerity's negative consequences. If the Dutch could look at the United States and see where its war on drugs was leading, why can't they look at themselves and their neighbors today and see where austerity is heading?

— Noah Campbell, Canada

'Why are the DUTCH kowtowing to the GERMANS?'

Mr. Krugman, just wait until you and Mr. Yglesias find out that in the eyes of the world's corporate *and bureaucratic elites, we're all "small countries."*

— Peter, Pennsylvania

I can tell you from personal experience that there are consequences *for those in the financial consulting industry who try to make a case against austerity.*

There are a lot of powerful people invested in the idea of austerity, and they refuse to admit they're wrong or give any credibility to those who have spoken out against such policies.

— Name withheld, Denmark

For Paul Krugman's latest thoughts and to join the debate online, visit krugman.blogs.nytimes.com. Comments may also be sent to krugmannytsyn@nytimes.com. All comments may be excerpted and printed; please include your name and country.

About Paul Krugman

Paul Krugman joined The New York Times in 1999 as a columnist on the Op-Ed page and continues as a professor of economics and international affairs at Princeton University. He was awarded the Nobel in economic science in 2008.

Mr. Krugman is the author or editor of 21 books and more than 200 papers in professional journals and edited volumes. His books include "The Return of Depression Economics" (2008) and "End This Depression Now!" (2012).

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