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# Averting the Worst

By [PAUL KRUGMAN](#)

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So it seems that we aren't going to have a second Great Depression after all. What saved us? The answer, basically, is Big Government.



Paul Krugman

Just to be clear: the economic situation remains terrible, indeed worse than almost anyone thought possible not long ago. The nation has lost 6.7 million jobs since the recession began. Once you take into account the need to find employment for a growing working-age population, we're probably around nine million jobs short of where we should be.

And the job market still hasn't turned around — that slight dip in the measured unemployment rate last month was probably a statistical fluke. We haven't yet reached the point at which things are actually improving; for now, all we have to celebrate are indications that things are getting worse more slowly.

For all that, however, the latest flurry of economic reports suggests that the economy has backed up several paces from the edge of the abyss.

A few months ago the possibility of falling into the abyss seemed all too real. The financial panic of late 2008 was as severe, in some ways, as the banking panic of the early 1930s, and for a while key economic indicators —

world trade, world industrial production, even stock prices — were falling as fast as or faster than they did in 1929-30.

But in the 1930s the trend lines just kept heading down. This time, the plunge appears to be ending after just one terrible year.

So what saved us from a full replay of the Great Depression? The answer, almost surely, lies in the very different role played by government.

Probably the most important aspect of the government's role in this crisis isn't what it has done, but what it hasn't done: unlike the private sector, the federal government hasn't slashed spending as its income has fallen. (State and local governments are a different story.) Tax receipts are way down, but Social Security checks are still going out; Medicare is still covering hospital bills; federal employees, from judges to park rangers to soldiers, are still being paid.

All of this has helped support the economy in its time of need, in a way that didn't happen back in 1930, when federal spending was a much smaller percentage of G.D.P. And yes, this means that budget deficits — which are a bad thing in normal times — are actually a good thing right now.

In addition to having this “automatic” stabilizing effect, the government has stepped in to rescue the financial sector. You can argue (and I would) that the bailouts of financial firms could and should have been handled better, that taxpayers have paid too much and received too little. Yet it's possible to be dissatisfied, even angry, about the way the financial bailouts have worked while acknowledging that without these bailouts things would have been much worse.

The point is that this time, unlike in the 1930s, the government didn't take a hands-off attitude while much of the banking system collapsed. And that's another reason we're not living through Great Depression II.

Last and probably least, but by no means trivial, have been the deliberate efforts of the government to pump up the economy. From the beginning, I argued that the American Recovery and Reinvestment Act, aka the Obama

stimulus plan, was too small. Nonetheless, reasonable estimates suggest that around a million more Americans are working now than would have been employed without that plan — a number that will grow over time — and that the stimulus has played a significant role in pulling the economy out of its free fall.

All in all, then, the government has played a crucial stabilizing role in this economic crisis. Ronald Reagan was wrong: sometimes the private sector is the problem, and government is the solution.

And aren't you glad that right now the government is being run by people who don't hate government?

We don't know what the economic policies of a McCain-Palin administration would have been. We do know, however, what Republicans in opposition have been saying — and it boils down to demanding that the government stop standing in the way of a possible depression.

I'm not just talking about opposition to the stimulus. Leading Republicans want to do away with automatic stabilizers, too. Back in March, John Boehner, the House minority leader, declared that since families were suffering, "it's time for government to tighten their belts and show the American people that we 'get' it." Fortunately, his advice was ignored.

I'm still very worried about the economy. There's still, I fear, a substantial chance that unemployment will remain high for a very long time. But we appear to have averted the worst: utter catastrophe no longer seems likely.

And Big Government, run by people who understand its virtues, is the reason why.

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# Man Without a Plan

By ANNA JACOBSON SCHWARTZ

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## **Does Bernanke Deserve Another Term?**

Op-Ed Contributor: [The Great Preventer](#) (July 25, 2009)

AS Federal Reserve chairman, Ben Bernanke has committed serious sins of commission and omission — and for those many sins, he does not deserve reappointment.

Let me begin with the former. It is standard practice for a central bank like the Federal Reserve to ease monetary policy to combat a recession, and then to tighten it as recovery gets under way. Mr. Bernanke so far has only had to do the first half, and has conducted a policy of extreme ease. The Fed's Open Market Committee cut the federal funds rate in October to 1 percent from 1.5 percent, and then in December to a range of zero percent to 0.25 percent.

What drove down the funds rate was the Federal Reserve's decision to increase its depository bank reserves. Bank reserves have been rising since Sept. 17, as the Fed purchased securities and financed loans. When the Fed committee cut the rate to zero, it was merely ratifying the de facto rate.

Mr. Bernanke seems to know only two amounts: zero and trillions. Before 2008 there were only moderate increases in the Federal Reserve's aggregate balance sheet numbers, but since then the balance sheet has

exploded by trillions of dollars. The increase was spurred by the Fed's loans to troubled institutions and purchases of securities.

Why is easy monetary policy such a sin? Because in such an environment, loans are cheap and borrowers can finance every project that they dream up. This results in excesses, and also increases the severity of the recession that inevitably follows when the bubble bursts.

Let's move on to the sins of omission. After 2007, the Federal Reserve clearly observed that the mortgage loan industry was being transformed into an issuer of securities backed by a pool of mortgages of varying quality. Yet the Fed at no point clearly warned investors that these new instruments were difficult to price. (These securities were backed by everything from top-quality mortgages to subprime ones, and it was difficult to determine what value to assign to different mortgages.)

Partly as a result of the Fed's silence, investors who loaded up their balance sheets with these securities were ignorant of the great risks of trying to sell assets that are difficult to price. Other new instruments, like derivatives, were not risk-free, although the market became enamored of them.

The Fed is the manager of markets. There is thus every reason to expect that it would see the problems that these new instruments were likely to create for normal transactions, and speak up about them.

The Fed delivered plenty of rhetoric about the importance of transparency, yet failed to articulate its own goals. The market was thus bewildered when the Fed rescued certain firms and not others. Mr. Bernanke should have explained the principles behind these decisions. The market could not understand why the Fed rescued Bear Stearns and then permitted Lehman Brothers to die.

As a consequence, there was volatility in the credit and equity markets and a general sense of turmoil that demonstrated that participants were at a loss to understand the functioning of the Fed.

Last year, when the credit market became dysfunctional and normal channels for borrowing broke down, the Fed misread the situation. It persisted in believing that the market needed more liquidity, even though this was not a solution to the market disturbances. The real problem was that because of the mysterious new instruments that investors had acquired, no one knew which firms were solvent or what assets were worth. At the same time, these new instruments were being repriced in the market. The firms that owned them then needed to restore their depleted capital. When big firms experienced enormous losses, the Fed did not respond in a way that calmed markets. Most of all, Mr. Bernanke ultimately failed to convince the market that the Fed had a plan, and was not performing ad hoc.

I am certain that there are economists whose reputations for outstanding academic work in monetary policy are every bit as distinguished as Mr. Bernanke's, and who have good judgment and experience within the Federal Reserve System. President Obama should choose one of them.

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