Krugman: Economist or Ideologue?
By LIZ PEEK, The Fiscal Times Posted: Jan 28, 2011

Paul Krugman apparently missed the memo on civility. With his "often wrong but never in doubt" certainty, he blasts Representative Paul Ryan's State of the Union response, saying the Congressman "literally doesn't know the first thing about the debt crisis." He chides Ryan for lumping together the fiscal problems of Greece, England and Ireland, and concluding that soaring debt in all three countries led to "painful austerity measures." Mr. Krugman acknowledges that Ryan's conclusion is "more or less true" for Greece, but says "it isn't at all what happened in Ireland or Britain."

Oh really? In September 2010, England's debt to GDP had increased to 65% and was climbing rapidly. In the last fiscal year, the budget deficit in the U.K. amounted to more than 13% of GDP -- the highest among the OECD countries. A client note published by Morgan Stanley in November 2009 forecast a debt crisis in the U.K. and sell-off in government bonds, which could trigger a potentially damaging rate hike by the Bank of England. There was also, the report said, a good chance of a credit downgrade. In fact, as Mr. Cameron reminded his audience in Davos this week, S&P threatened to lower its rating on U.K. debt in May 2009; after the government passed its fiscal plan last year, the agency reaffirmed its triple A rating. The U.K. not only was spending too much, the trajectory, just as in the United States, promised even more dire budget problems down the road. For the record, the second-highest budget deficit in 2010 was in Ireland, at 12.2% of GDP.

Though neither the U.K. nor Ireland was in the top ranks of indebted countries measured by total debt to GDP, the trends in place would have taken them there. The ratio for the U.K. was 59%; that compares to 95% in Greece, and explains why the latter country's outlook was considered more fragile. Italy's debt to GDP is just over 100%.

Of course, these figures are static and don't tell the whole story. The United States, with a budget deficit over 10% of GDP and soaring debt, has avoided the inevitable downgrade of its bonds, in part because of the overall size and breadth of our economy. We have a still-growing country with considerable flexibility as to taxing power, unlike Greece. Consequently, the dollar continues to be viewed as a safe haven, allowing the Federal Reserve to maintain near-zero interest rates. It was in part the threat of higher rates that pushed the U.K. to tackle their unbalanced budget; paying ever-higher sums on their borrowings resulting from wariness over the pound's stability would have only increased their deficit, creating a never-ending cycle. Those who think it could never happen in the U.S. are fooling themselves.

Echoing Mr. Krugman's critical voice, I would point out that on the basis of the New York Times' leading editorial today, it is easy to conclude that the Times knows nothing whatsoever about how the private sector works. The Times cautions President Obama from becoming too cozy with the business community, warning that "the interests of corporations and their bosses are not necessarily always aligned with those of the country." They cite the nearly $2 trillion of cash sitting idle on corporate balance sheets, while unemployment tops 9%,  as proof of this divided interest.

Apparently, the NYT thinks that companies should put that money to work for the good of the country. Consider the outcome. Corporations that have stockpiled cash looking for good investment opportunities should begin to spend – even if they waste their money. The conclusion would be of course to lower investment returns and productivity, penalizing the long-term growth prospects of the U.S.

More absurd is that the Times rebuffs a call for lower corporate tax rates, reporting that taxes on corporate income only raise 2.1% of GDP in the U.S., compared to the OECD average of 3.5%. The NYT might want a refresher course in accounting; taxes are levied on profits, not revenue. That ratio might say a great deal more about the profitability of U.S. corporations compared to their OECD counterparts that it says about taxation; I don't have comparative profitability data, but neither does the NYT, I'm guessing. What I do know is that U.S. corporations pay a combined federal and state tax rate of over 39%, marginally lower than Japan's rate of 39.5%.

I also know that since 2000, 27 of the OECD countries have cut their corporate rate; we have not. Moreover, a study of taxation on new capital investments by the Cato Institute shows that while exemptions and credits do lower the U.S. corporate rate on such outlays to an effective rate of 35% that is considerably higher than the 29% paid on average by the G-7 countries and the 20% paid by OECD countries. Maybe a change here would start to unfreeze that cash hoard so offensive to the NYT.

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