



## **Paul Krugman Has Taught Them Nothing: Republicans Would Tank the Economy Again, Given Another Chance**

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The idea that George W. Bush “kept us safe” has rightly been exposed to ridicule recently by Donald Trump. But Bush also failed miserably on another front: keeping us safe economically, as he presided over the biggest economic catastrophe since the Great Depression — and his presidency was already an economic disaster before that, per Nobel Laureate Joseph Stiglitz.

On this second front, the GOP blame-shifting centers on Obama, in order to virtually erase the epic market failure from history. Just as Bush is supposed to get a pass for 9/11, while getting credit for “keeping us safe” afterwards, he’s also given a pass for the housing bubble and the financial crisis which gave us the Great Recession, so that all blame can be focused on Obama, who supposedly made things worse with his “job-killing” policies.

In the real world, empirically-based economists know this is ridiculous. In the third quarter of 2010, for example, the Congressional Budget Office estimated that the stimulus bill “increased the number of people employed by between 1.4 million and 3.6 million.” This was typical of CBO reporting of the impact the stimulus had, but the totality of policy responses was much broader than that, and a new report from the Center on Budget and Policy Priorities by economists Alan Blinder of Princeton and Mark Zandi of Moody Analytics updates their earlier work in 2010 to first provide a comprehensive overview and then draw lessons for the future.

On the first point, Zandi told a conference call briefing, “In its totality it was a resounding success,” adding, “That sounds a little odd,” because of how bad the recession was. “It was indeed a great recession, a very painful time, we’re still not completely free of it,” he said. But it could have been so much worse. “If not for the policy response, the recession would have been, as Alan is fond of saying, the Great Depression 2.0.”

More specifically, the paper estimates that, without that response:

- The peak-to-trough decline in real gross domestic product (GDP), which was barely over 4 percent, would have been close to a stunning 14 percent
- The economy would have contracted for more than three years, more than twice as long as it did
- More than 17 million jobs would have been lost, about twice the actual number

- Unemployment would have peaked at just under 16 percent, rather than the actual 10 percent
- The budget deficit would have grown to more than 20 percent of GDP, about double its actual peak of 10 percent, topping off at \$2.8 trillion in fiscal 2011
- Today's economy might be far weaker than it is — with real GDP in the second quarter of 2015 about \$800 billion lower than its actual level, 3.6 million fewer jobs and unemployment at a still-dizzying 7.6 percent.

That alone should be enough to silence right-wing critics of government activism in general, but of course it won't be. "I know there are still denialists who think the economy would have been just great in 2009-2010 if the government just left it alone, but I doubt they will read the Blinder-Zandi paper," economist Dean Baker told Salon. Baker, the co-director of the Center for Economic Policy Research, is one of a handful of economists who warned of the financial crisis before it occurred (none of whom, significantly, relied on standard macro-economic models). "For everyone else," Baker said, "you're left asking, 'What is this really telling us?'"

"Denialist" is an apt description. A 2010 paper by Adam Kessler in the *Real-World Economics Review*, "Cognitive dissonance, the Global Financial Crisis and the discipline of economics" examined the views of economists opposed to Obama's stimulus at the time, believers in *laissez faire* (BLF) who signed a letter from the Cato Institute to that effect, as opposed to economists in general. Kessler theorized that BLF responses to the crisis and ensuing recession could be explained in terms of cognitive dissonance, saying that, "Cognitive dissonance theory predicts that when real-world events 'disconfirm' deeply-held beliefs this creates psychological discomfort in persons and they will respond by means of distortion and denial."

BLFs naturally tend to believe that free markets work perfectly well and thus when they don't government must be held to blame, in denial of what has just occurred. Kessler queried this group of BLFs and a sample of economists from the American Economics Association, asking about their views were on 10 possible causes of the Great Recession. One possibility was the 1977 Community Reinvestment Act (CRA), which requires banks to reinvest in communities they serve which have traditionally been redlined (called "assessment areas" under the law). As the paper's abstract explains:

The notion that the CRA is a major cause of the crisis apparently has great resonance among the BLF but is demonstrably false. Among other results, 46 percent of the signers of the letter believe that the CRA was one of three top causes of the crisis compared to 12 percent of the "other" economists. I conclude that the BLF exhibit symptoms to cognitive dissonance.

There are a variety of lines of evidence against the CRA hypothesis, (some in the paper, more here and here) most strikingly the fact that "Only 6 percent of high-priced loans to low-income borrowers or in low-income neighborhoods by lending institutions that fall under the CRA legislation were made in their CRA assessments areas." Far more money was put at risk elsewhere, most of it by institutions not covered by the CRA. "The CRA did it" is an economic denialist narrative, every bit as much as "sunspots did it" is a global warming denialist narrative. Both are easily refuted by data — data which denialists simply choose to ignore.

Still, aside from the denialists who will ignore this new study, there are some who could benefit — journalists, for one, who are constantly exposed to floods of denialist claims about the economy, the torrent of blame that Republicans constantly heap on Democrats, despite the well-established fact that Democrats are overwhelmingly better for the economy. Thus, at the very least, this study provides a very different, and refreshingly fact-oriented, framework for thinking about economic policy.

The paper has two distinct purposes, Zandi explained. First, “to assess the policy response, in its totality, to the great recession,” a reprise of their earlier work but with the passage of time, “a lot more data points and better tools, better models.” Second “to tease out from our results ... what we’ve learned” both to prevent future crises to the extent possible, and beyond that to ensure “that policymakers take the right lessons from what we’ve just experienced, so that they can respond to that crisis in a more effective way, and ensure that we don’t suffer the same kind of economic pain that we did.”

As the paper explains, the policy response had three distinct aspects: financial stabilization (epitomized by TARP), fiscal policy (the stimulus and other programs) and monetary policy (most notably, quantitative easing), but the combination of these policies was much more successful than any of them would have been in isolation. “The policy response is more than the sum of the parts,” Zandi said, and in the report, they wrote “Fiscal and monetary policy interactions are large, that is, fiscal stimulus measures enhance the power of monetary/financial stimulus measures substantially — and vice versa.”

On the first aspect, Zandi said, “The most important point coming out of this effort is that stabilizing the financial system — in a sense bailing out the banking system and the financial system more broadly — was a necessary condition for stabilizing the economy, and jump-starting an economic recovery. Without that effort, without stabilizing Wall Street, so to speak, it would have taken a lot longer for Main Street to find the bottom and to get up and running.”

On the second aspect, fiscal policy, Zandi said, “lots of moving parts here, very controversial, but I think our work clearly shows that the fiscal stimulus efforts, the temporary increase in government spending, cuts in taxes, were very effective.” Most notably, “The Recovery Act, the most controversial stimulus, passed in February of ’09 was very instrumental in ending the recession, jump-starting a recovery. The recession ended only a few months after the Recovery Act, in June of ’09, and the first job increases began a year later, in February 2010, so I don’t think that’s any accident.”

Some of other policy efforts may have been more of a mixed bag, but Zandi said it was a “very important point, that when you’re in crises, it’s important to try lots of things. Some things will work, some things won’t, at least as well. But it is important and vital to be creative in the policy response.” Indeed, this is precisely the attitude that FDR took in digging the country out of the Great Depression.

As for the third aspect, monetary policy, most notably zero interest rates, and quantitative easing [QE], it was “also very controversial,” Zandi said, “but I think, again, our work shows quite

clearly that QE was very much a net positive for the economy.” He acknowledged there were “certainly some downsides, and the script on this is still being written,” but countered “At least up to this point in time it’s clear that it did help to lower long-term interest rates, support asset prices and support economic growth, and we go through that in some detail.”

Zandi concluded by noting “There were some efforts that fell short of expectations,” including “policy leading up to the crisis,” and housing policy in response to it. But considered as a whole, he clearly considered it a remarkable success.

Blinder then took up the second main purpose of their study, the question about lessons learned. He began with a warning: “If you’re in a key policy maker’s chair when something like this or remotely like this happens, you’re faced with titanic levels and varieties of uncertainty. So it’s not just like there’s a menu you pick up, and chose, this is what you do in circumstance 27.”

But if not a menu, he did have advice, starting with “The biggest, biggest lesson,” to draw: “It makes sense for policymakers to err on side of too much, rather than too little. So, that’s a bigger stimulus rather than a smaller stimulus, that’s more QE rather than less QE, and a whole variety of things like that, knowing that you don’t know the perfection point, the exact amount that will be just enough to cure the problem, and not too much to create some other problems. The benefits to risks are very asymmetric.”

As a corollary, he said, it was “a big mistake ... to do a thing today that will make it harder for the next round, the net group of policymakers to cope with the next crisis.”

He then went on to “focus on some of wrong lessons people would like us to learn from this and emphasize that they’re wrong,” noting that “often the correct lesson is just the opposite.” He took on five such lessons.

Blinder began with notion that moral hazard — letting people off the hook for bad decisions — is to be avoided at all costs. He began by saying, “Everybody agrees that moral hazard is a potential problem when you bail people out, and would rather not do it. There’s no dispute about that. But the question is how big are those costs?” He went on to say, “A really important lesson is not to think of moral hazard as show-stopper — that is, ‘Thou shalt not go where moral hazard lurks,’ but rather as trade-off — ‘Yes, it’s a bad thing, we wish we didn’t have to do it, but under extreme circumstance there may be good reasons to live with the moral hazard.’ I think that’s a very important lesson.”

The “second wrong lesson” Blinder took on was “the anti-Keynesian message that fiscal stimulus doesn’t do any good for the economy,” a view that Blinder called “almost impossible for me to understand how people maintain” it.

In particular, he said, “I was never able to understand in real time — this is going back to say 2009 ’10, ’11 — and I certainly can’t understand in retrospect John Boehner’s famous in some quarter’s phrase of ‘job-killing government spending.’” To the contrary, he pointed out, “When the government spends money, as Keynes said in the 1930s, it’s doing one of two things,

basically. It's hiring people itself, to do work, or it's hiring private contractors, buying things from private firms, who in turn have to hire people to produce whatever it is they produce. How that could kill jobs is beyond me.

“This is not to say you can't argue over specifics — this or that provision of the stimulus package, for example, but the notion that it's a job-killer is just about as wrong as it could be,” Blinder said. “Keynes had that more or less right in the 1930s.”

The third argument Blinder took up was that “The Federal Reserve ... was going beyond its legal authority, pushing the law to and beyond its breaking point and maybe even poaching into the realm of Congress, doing quasi-appropriations ... putting public money at risk.” In response, he said, “If you read the Federal Reserve Act as it was written then, especially the famed Section 13.3, there's no doubt that the Fed stayed within legal authority. Many people in Congress were shocked to see how much legal authority the Fed actually had, but it stayed within its legal authority, that's for sure.”

The fourth lesson that should never be learned, Blinder said, was that super-expansionary policies “such as zero interest rates and the tremendous expansion of the balance sheet via QE” are dangerous and “will eventually be inflationary.” There's nothing new in this charge, he pointed out. “Critics were saying that in 2009, 2010, 2011, dot dot dot, they're still saying it today. There's been no sign of inflation and as all of you know — no sign of higher inflation — and as all of you know the Fed is now trying, actually, actively, to make inflation higher than it is.”

Finally, Blinder criticized the belief that “The Fed now faces a massive and perhaps impossible exit problem [from its super-expansionary policies]. How does it get out?” Here, he pointed out, “One of the missing points in this debate is people forgetting that the Fed has as many bites at this apple as it thinks it needs.” It doesn't need to “embark on a policy, like one big policy, like the fiscal stimulus that passed in 2009,” instead, “The Fed is going to have many, many incremental policy tightenings over a protracted period of time, probably measured in years. And any time it feels it's made a mistake, it can always slow down or even reverse something it's already done.” Summing up, Blinder said, “So the false lesson to learn is that the Fed in its haste to avoid a Great Depression 2.0 got us into an even bigger problem, and they have no idea how to get us out of it. I just think that's wrong.”

In the question period, I asked if individual criminal prosecutions couldn't have been a much more effective way to deal with the moral hazard issue, and both authors agreed. “It was a big mistake on the part of the Justice Department, mainly, not to do more prosecutions of individuals,” Blinder said. “I want to hasten to say doing dumb things is not criminal, but misrepresentations can be criminal, depending on details,” he noted, “and the main point — so I very much want to agree with you — is that if you fine a gigantic bank, whatever, a billion dollars, five billion dollars, you're basically punishing the shareholders of that bank, who almost certainly did nothing wrong. You are not punishing the guilty party.”

“So I think it was a big mistake,” he concluded, “and the next time we shouldn’t make that mistake, and to your precise question, yes, I think it would do much more good on the moral hazard front than just fining the bank.”

Altogether, they make an impressive case against the sorts of arguments made by Republicans and conservative critics of the activist response to the financial crisis. But of course Baker is right — this isn’t going to do a thing to change denialists’ minds. Still, it could help to blunt the impact their arguments have on others.

There are, however, two further important points to address, in light of this paper, and the issues it raises. The first is the issue of why facts just don’t seem to matter in this case. There are a number of different possible answers to this, depending on the level of analysis and the kind of tradition you come out of. But one of the most interesting ways of approaching the problem comes through the empirical work done by cognitive linguist Anat Shenker Osorio, much of it reflected in her book, *Don’t Buy It: The Trouble with Talking Nonsense About the Economy*. The denial Baker points to seems like just another example of this, and I asked Shenker Osorio for some comment.

“We’ve all heard the terminology of “laissez faire” or, in broad strokes, let the economy do its own magical thing,” Shenker Osorio said. “This is more than an economic orientation, it’s a whole thought structure — peddled and promoted by a right wing that benefits from it. We’re led to believe the economy exists independently out in nature — the weather, the water, the very essence of life. This way of thinking is what leads to unconsciously comparing the economy to a body — saying it’s ‘unhealthy’ or on ‘life support.’ And naming your plan a ‘Recovery’ Bill.”

Such language can be so pervasive, you don’t even notice it’s there — like a fish unaware of the water around it. But it’s also wildly misleading, she points out.

“So,” she continued, “the debate about stimulative measures comes into sharp focus when viewed from the lens of how you perceive the economy. If you consider it an independent, organic, entity — you may favor quick ‘life saving’ measures — but you’d oppose long term government action. Or, as conservatives would name it, ‘intervention.’” Which is enough to cut off any further thought on the subject.

“If, however, you view the economy accurately as the aggregate of the decisions people make and actions we take, then you understand there’s a continuous role for outside supervision. Or what we’d call government,” she concluded.

There’s a certain circularity here: conservatives with a well-established narrative framework have a powerful filter to screen out contradictory evidence. Liberals more grounded in the empirical tradition are cognitively prepared to see the sorts of facts that Zandi and Blinder deal with, and follow the argument they lay out. Each group sees what it’s predisposed to see — even though what they’re predisposed to see is not at all equivalent.

But there’s a second important point to address, one already introduced by Dean Baker — the question of what Zandi and Blinder’s work is really telling the rest of us, those who aren’t in

denial, who aren't caught up in the "thought structure" that Shenker Osorio describes. I've already argued that their study is showing journalists there are very sound reasons to reject conservative denialism, and that still seems like a very good service to perform. But what about getting beyond not learning the wrong lessons? What about the possibility of substantially improving our understanding of how things actually work — and what choices actually exist?

"It is important to understand the nature of the Blinder/Zandi exercise," Baker said. "They are asking the benefit of what we did as compared to doing nothing. (I'm actually surprised, doing nothing comes out better than I would have expected.)" Baker made this same point in response to their first study. "The question asked by the study is what would the world look like if the federal government had done absolutely nothing to counter the economic and financial downturn resulting from collapse of the housing bubble," Baker wrote then, "This counter-factual seems more than a bit unrealistic."

"It would be interesting to compare with a different policy mix," Baker told Salon. "Suppose we let the banks go under, then flood the system with liquidity (banks now under the control of the FDIC, and on their way back to being privately owned) and did an ambitious stimulus (focused on clean energy). This frees us of the albatross of a badly bloated financial sector, while providing the basis for growth in a sustainable way." This is only one possible alternative scenario.

There's been a lot of discussion of the ills besetting macro-economics in the wake of the Great Recession. But expanding the Zandi/Blinder exercise in the way that Baker suggests just might produce results that could get more than just economists talking about how to work our way beyond the cloud that still hangs over the entire field.

As Shenker Osorio said, "If, however, you view the economy accurately as the aggregate of the decisions people make and actions we take, then you understand there's a continuous role for outside supervision. Or what we'd call government." And getting a clearer picture of what fundamentally different alternatives are possible is absolutely crucial for developing more thoughtful, creative, and successful government.