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The Great Abdication

By PAUL KRUGMAN

Among economists who know their history, the mere mention of certain years evokes shivers. For example, three years ago Christina Romer, then the head of President Obama's Council of Economic Advisers, warned politicians not to re-enact 1937 — the year F.D.R. shifted, far too soon, from fiscal stimulus to austerity, plunging the recovering economy back into recession. Unfortunately, this advice was ignored.

But now I'm hearing more and more about an even more fateful year. Suddenly normally calm economists are talking about 1931, the year everything fell apart.

It started with a banking crisis in a small European country (Austria). Austria tried to step in with a bank rescue — but the spiraling cost of the rescue put the government's own solvency in doubt. Austria's troubles shouldn't have been big enough to have large effects on the world economy, but in practice they created a panic that spread around the world. Sound familiar?

The really crucial lesson of 1931, however, was about the dangers of policy abdication. Stronger European governments could have helped Austria manage its problems. Central banks, notably the Bank of France and the Federal Reserve, could have done much more to limit the damage. But nobody with the power to contain the crisis stepped up to the plate; everyone who could and should have acted declared that it was someone else's responsibility.

And it's happening again, both in Europe and in America.

Consider first how European leaders have been handling the banking crisis in Spain. (Forget about Greece, which is pretty much a lost cause; Spain is where the fate of Europe will be decided.) Like Austria in 1931, Spain has troubled banks that desperately need more capital, but the Spanish government now, like Austria's government then, faces questions about its own solvency.

So what should European leaders — who have an overwhelming interest in containing the Spanish crisis — do? It seems obvious that European creditor nations need, on
to assume some of the financial risks facing Spanish banks. No, Germany won't
with the very survival of the euro at stake, a bit of financial risk should be a sm

But no. Europe's "solution" was to lend money to the Spanish government, and government to bail out its own banks. It took financial markets no time at all to figure out that this solved nothing, that it just put Spain's government more deeply in debt. And the European crisis is now deeper than ever.

Yet let's not ridicule the Europeans, since many of our own policy makers are acting just as irresponsibly. And I'm not just talking about Congressional Republicans, who often seem as if they are deliberately trying to sabotage the economy.

Let's talk instead about the Federal Reserve. The Fed has a so-called dual mandate: it's supposed to seek both price stability and full employment. And last week the Fed released its latest set of economic projections, showing that it expects to fail on both parts of its mandate, with inflation below target and unemployment far above target for years to come.

This is a terrible prospect, and the Fed knows it. Ben Bernanke, the Fed's chairman, has warned in particular about the damage being done to America by the unprecedented level of long-term unemployment.

So what does the Fed propose doing about the situation? Almost nothing. True, last week the Fed announced some actions that would supposedly boost the economy. But I think it's fair to say that everyone at all familiar with the situation regards these actions as pathetically inadequate — the bare minimum the Fed could do to deflect accusations that it is doing nothing at all.

Why won't the Fed act? My guess is that it's intimidated by those Congressional Republicans, that it's afraid to do anything that might be seen as providing political aid to President Obama, that is, anything that might help the economy. Maybe there's some other explanation, but the fact is that the Fed, like the European Central Bank, like the U.S. Congress, like the government of Germany, has decided that avoiding economic disaster is somebody else's responsibility.

None of this should be happening. As in 1931, Western nations have the resources they need to avoid catastrophe, and indeed to restore prosperity — and we have the added advantage of knowing much more than our great-grandparents did about how depressions happen and how to end them. But knowledge and resources do no good if those who possess them refuse to use them.

And that's what seems to be happening. The fundamentals of the world economy aren't, in themselves, all that scary; it's the almost universal abdication of responsibility that fills me, and many other economists, with a growing sense of dread.