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Block Those Metaphors

By PAUL KRUGMAN

Like it or not — and I don’t — the Obama-McConnell tax-cut deal, with its mixture of very bad stuff and sort-of-kind-of good stuff, is likely to pass Congress. Then what?

The deal will, without question, give the economy a short-term boost. The prevailing view, as far as I can tell — and that includes within the Obama administration — is that this short-term boost is all we need. The deal, we’re told, will jump-start the economy; it will give a fragile recovery time to strengthen.

I say, block those metaphors. America’s economy isn’t a stalled car, nor is it an invalid who will soon return to health if he gets a bit more rest. Our problems are longer-term than either metaphor implies.

And bad metaphors make for bad policy. The idea that the economic engine is going to catch or the patient rise from his sickbed any day now encourages policy makers to settle for sloppy, short-term measures when the economy really needs well-designed, sustained support.

The root of our current troubles lies in the debt American families ran up during the Bush-era housing bubble. Twenty years ago, the average American household’s debt was 83 percent of its income; by a decade ago, that had crept up to 92 percent; but by late 2007, debts were 130 percent of income.

All this borrowing took place both because banks had abandoned any notion of sound lending and because everyone assumed that house prices would never fall. And then the bubble burst.

What we’ve been dealing with ever since is a painful process of “deleveraging”: highly indebted Americans not only can’t spend the way they used to, they’re having to pay down the debts they ran up in the bubble years. This would be fine if someone else were taking up the slack. But what’s actually happening is that some people are spending much less while nobody is spending more — and this translates into a depressed economy and high unemployment.

What the government should be doing in this situation is spending more while the private sector is spending less, supporting employment while those debts are paid down. And this government spending needs to be sustained: we’re not talking about a brief burst of aid; we’re talking about spending that lasts long enough for households to get their debts back under control. The original Obama stimulus wasn’t just too small; it was also much too short-lived, with much of the positive effect already gone.

It’s true that we’re making progress on deleveraging. Household debt is down to 118 percent of income, and a strong recovery would bring that number down further. But we’re still at least several years from the point at which households will be in good enough shape that the economy no longer needs government support.

But wouldn’t it be expensive to have the government support the economy for years to come? Yes, it would — which is why the stimulus should be done well, getting as much bang for the buck as possible.

Which brings me back to the Obama-McConnell deal. I’m often asked how I can oppose that deal given my consistent position in favor of more stimulus. The answer is that yes, I believe that stimulus can have major benefits in our current situation — but these benefits have to be weighed against the costs. And the tax-cut deal is likely to deliver relatively small benefits in return for very large costs.

The point is that while the deal will cost a lot — adding more to federal debt than the original Obama stimulus — it's likely to get very little bang for the buck. Tax cuts for the wealthy will barely be spent at all; even middle-class tax cuts won't add much to spending. And the business tax break will, I believe, do hardly anything to spur investment given the excess capacity businesses already have.

The actual stimulus in the plan comes from the other measures, mainly unemployment benefits and the payroll tax break. And these measures (a) won't make more than a modest dent in unemployment and (b) will fade out quickly, with the good stuff going away at the end of 2011.

The question, then, is whether a year of modestly better performance is worth $850 billion in additional debt, plus a significantly raised probability that those tax cuts for the rich will become permanent. And I say no.

The Obama team obviously disagrees. As I understand it, the administration believes that all it needs is a little more time and money, that any day now the economic engine will catch and we'll be on the road back to prosperity. I hope it's right, but I don't think it is.

What I expect, instead, is that we'll be having this same conversation all over again in 2012, with unemployment still high and the economy suffering as the good parts of the current deal go away. The White House may think it has struck a good bargain, but I believe it's in for a rude shock.

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