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Deep Hole Economics

By PAUL KRUGMAN

If there's one piece of economic wisdom I hope people will grasp this year, it's this: Even though we may finally have stopped digging, we're still near the bottom of a very deep hole.

Why do I need to point this out? Because I've noticed many people overreacting to recent good economic news. What particularly concerns me is the risk of self-denying optimism — that is, I worry that policy makers will look at a few favorable economic indicators, decide that they no longer need to promote recovery, and take steps that send us sliding right back to the bottom.

So, about that good news: various economic indicators, ranging from relatively good holiday sales to new claims for unemployment insurance (which have finally fallen below 400,000 a week), suggest that the great post-bubble retrenchment may finally be ending.

We're not talking Morning in America here. Construction shows no sign of returning to bubble-era levels, nor are there any indications that debt-burdened families are going back to their old habits of spending all they earned. But all we needed for a modest economic rebound was for construction to stop falling and saving to stop rising — and that seems to be happening. Forecasters have been marking up their predictions; growth as high as 4 percent this year now looks possible.

Hooray! But then again, not so much. Jobs, not G.D.P. numbers, are what matter to American families.

And when you start from an unemployment rate of almost 10 percent, the arithmetic of job creation — the amount of growth you need to get back to a tolerable jobs picture — is daunting.

First of all, we have to grow around 2.5 percent a year just to keep up with rising productivity and population, and hence keep unemployment from rising. That's why the past year and a half was technically a recovery but felt like a recession: G.D.P. was growing, but not fast enough to bring unemployment down.

Growth at a rate above 2.5 percent will bring unemployment down over time. But the gains aren't one for one: for a variety of reasons, it has historically taken about two extra points of growth over the course of a year to shave one point off the unemployment rate.

Now do the math. Suppose that the U.S. economy were to grow at 4 percent a year, starting now and continuing for the next several years. Most people would regard this as excellent performance, even as an economic boom; it's certainly higher than almost all the forecasts I've seen.

Yet the math says that even with that kind of growth the unemployment rate would be close to 9 percent at the end of this year, and still above 8 percent at the end of 2012. We wouldn't get to anything resembling full employment until late in Sarah Palin's first presidential term.

Seriously, what we're looking at over the next few years, even with pretty good growth, are unemployment rates that not long ago would have been considered catastrophic — because they are. Behind those dry statistics lies a vast landscape of suffering and broken dreams. And the arithmetic says that the suffering will continue as far as the eye can see.

So what can be done to accelerate this all-too-slow process of healing? A rational political system would long since have created a 21st-century version of the Works Progress Administration — we'd be putting the unemployed to work doing what needs to be done, repairing and improving our fraying infrastructure. In the political system we have, however, Senator-elect Kelly Ayotte, **delivering** the Republican weekly address on New Year's Day, declared that "Job one is to stop wasteful Washington

spending.”

Realistically, the best we can hope for from fiscal policy is that Washington doesn't actively undermine the recovery. Beware, in particular, the Ides of March: by then, the federal government will probably have hit its debt limit and the G.O.P. will try to force President Obama into economically harmful spending cuts.

I'm also worried about monetary policy. Two months ago, the Federal Reserve announced a new plan to promote job growth by buying long-term bonds; at the time, many observers believed that the initial \$600 billion purchase was only the beginning of the story. But now it looks like the end, partly because Republicans are trying to bully the Fed into pulling back, but also because a run of slightly better economic news provides an excuse to do nothing.

There's even a significant chance that the Fed will raise interest rates later this year — or at least that's what the futures market seems to think. Doing so in the face of high unemployment and minimal inflation would be crazy, but that doesn't mean it won't happen.

So back to my original point: whatever the recent economic news, we're still near the bottom of a very deep hole. We can only hope that enough policy makers understand that point.



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