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Op-Ed Columnist

# The Phantom Menace

**By PAUL KRUGMAN**

A funny thing happened on the way to a new New Deal. A year ago, the only thing we had to fear was fear itself; today, the reigning doctrine in Washington appears to be “Be afraid. Be very afraid.”

What happened? To be sure, “centrists” in the Senate have hobbled efforts to rescue the economy. But the evidence suggests that in addition to facing political opposition, President Obama and his inner circle have been intimidated by scare stories from Wall Street.

Consider the contrast between what Mr. Obama’s advisers were saying on the eve of his inauguration, and what he himself is saying now.

In December 2008 Lawrence Summers, soon to become the administration’s highest-ranking economist, called for decisive action. “Many experts,” he warned, “believe that unemployment could reach 10 percent by the end of next year.” In the face of that prospect, he continued, “doing too little poses a greater threat than doing too much.”

Ten months later unemployment reached 10.2 percent, suggesting that despite his warning the administration hadn’t done enough to create jobs. You might have expected, then, a determination to do more.

But in a recent interview with Fox News, the president sounded diffident and nervous about his economic policy. He spoke vaguely about possible tax incentives for job creation. But "it is important though to recognize," he went on, "that if we keep on adding to the debt, even in the midst of this recovery, that at some point, people could lose confidence in the U.S. economy in a way that could actually lead to a double-dip recession."

What? Huh?

Most economists I talk to believe that the big risk to recovery comes from the inadequacy of government efforts: the stimulus was too small, and it will fade out next year, while high unemployment is undermining both consumer and business confidence.

Now, it's politically difficult for the Obama administration to enact a full-scale second stimulus. Still, he should be trying to push through as much aid to the economy as possible. And remember, Mr. Obama has the bully pulpit; it's his job to persuade America to do what needs to be done.

Instead, however, Mr. Obama is lending his voice to those who say that we can't create more jobs. And a report on Politico.com suggests that deficit reduction, not job creation, will be the centerpiece of his first State of the Union address. What happened?

It took me a while to puzzle this out. But the concerns Mr. Obama expressed become comprehensible if you suppose that he's getting his views, directly or indirectly, from Wall Street.

Ever since the Great Recession began economic analysts at some (not all) major Wall Street firms have warned that efforts to fight the slump will produce even worse economic evils. In particular, they say, never mind the current ability of the U.S. government to borrow long term at remarkably low interest rates — any day now, budget deficits will lead to a collapse in investor confidence, and rates will soar.

And it’s this latter claim that Mr. Obama echoed in that Fox News interview. Is he right to be worried?

Well, spikes in long-term interest rates have happened in the past, most famously in 1994. But in 1994 the U.S. economy was adding 300,000 jobs a month, and the Fed was steadily raising short-term rates. It’s hard to see why anything similar should happen now, with the economy still bleeding jobs and the Fed showing no desire to raise rates anytime soon.

A better model, I’d argue, is Japan in the 1990s, which ran persistent large budget deficits, but also had a persistently depressed economy — and saw long-term interest rates fall almost steadily. There’s a good chance that officials are being terrorized by a phantom menace — a threat that exists only in their minds.

And shouldn’t we consider the source? As far as I can tell, the analysts now warning about soaring interest rates tend to be the same people who insisted, months after the Great Recession began, that the biggest threat facing the economy was inflation. And let’s not forget that Wall Street — which somehow failed to recognize the biggest housing bubble in history — has a less than stellar record at predicting market behavior.

Still, let’s grant that there is some risk that doing more about double-digit unemployment would undermine confidence in the bond markets. This risk must be set against the certainty of mass suffering if we don’t do more — and the possibility, as I said, of a collapse of confidence among ordinary workers and businesses.

And Mr. Summers was right the first time: in the face of the greatest economic catastrophe since the Great Depression, it’s much riskier to do too little than it is to do too much. It’s sad, and unfortunate, that the administration appears to have lost sight of that truth.