[The Return of Depression Economics and the Crisis of 2008, Paul Krugman, W.W. Norton, 191 pages]

Krugman's Nanny State

By David Gordon

AT FIRST SIGHT, Paul Krugman appears to have written exactly the book we need. Cries of recession go up everywhere. Nearly every day brings an account of a fallen financial giant or a major industry facing bankruptcy. Lenin's famous question—though not, one hopes, his answer—inevitably arises: what is to be done?

Krugman seems ideally qualified to answer. He is an economic theorist of great distinction, the winner of the Nobel Prize for Economics in 2008. Moreover, unlike the vast majority of his fellow theorists, the popular *New York Times* columnist writes for the public in simple and clear prose. Agree with him or not, you know that Krugman will not try to bamboozle you with jargon.

The Return of Depression Economics begins promisingly. Economists, Krugman tells us, work by constructing models: "The only way to make sense of any complex system, be it global warming or the global economy, is to work with models—simplified representations of that system which you hope help you understand how it works." Accordingly, he endeavors to give readers a simple model to enable us to grasp his prescription for our current disorders: a system devised by a group of parents to establish a babysitting pool.

> During the 1970s the Sweeneys were members of ... an association of young couples ... who were willing to baby-sit each other's children. This particular co-op was unusually large, about 150 couples, which meant not only that there were plenty of potential baby-sitters but also that managing the organization ... was not a trivial matter. ... the Capitol Hill co-op dealt with the problem by issuing scrip: coupons entitling the bearer to one hour of baby-sitting. When babies were sat, the baby-sitters would receive the appropriate number of coupons from the baby-sittees.

This sounds foolproof, but an imbalance overthrows the system. In the winter, most parents want to accumulate coupons: that way, they are able to go out in the summer without having to worry about babysitting. In winter, almost everyone wants to babysit, but few people want to go out then. The attempt to accumulate coupons fails.

Fortunately, a simple solution unblocks the impasse: "The supply of coupons was increased. The results were magical: with larger reserves of coupons couples became more willing to go out, making opportunities to baby-sit more plentiful, making couples even more willing to go out, and so on."

This charming tale, Krugman thinks, helps us to understand economic crises and what to do about them. Just like the babysitters trying to amass coupons, an attempt by everyone to hold money will fail. If the demand to hold money is high enough, a "liquidity trap" ensues. Investment will fall into a tailspin, no matter how low the rate of interest. The government must therefore pump in more money, as John Maynard Keynes prescribed. In the bad old days, benighted economists such as Joseph Schumpeter thought that failing businesses should be allowed to collapse in a depression. Now we know better, writes Krugman: "Before World War II, policymakers, quite simply, had no idea what they were supposed to be doing. Nowadays the whole spectrum of economists, from Milton Friedman leftward, agrees that the Great Depression was brought about by a collapse of effective demand and that the Federal Reserve should have fought the slump with large injections of money."

Krugman's parable of the tiny tots omits an important fact, however. Issuing more coupons did indeed solve his problem, but another answer would have done at least as well. When people found themselves unable to satisfy their demand for coupons, they could have offered to babysit for fewer coupons. They would thus bid up the price of coupons, and the price of baby-sitting would fall. If quantity of a good demanded exceeds supply offered at a given price, elementary economics tells us that the price will need to go up.

Just as before, the application of this solution to economic depressions is obvious. If people are not buying enough, prices need to be lowered to make purchases appealing. True enough, everyone cannot cut costs successfully at the same time. But if some people do lower prices, this will induce others to buy. The free-market economist W.H. Hutt, one of Keynes's foremost critics, showed in detail how this takes place in his *Keynesianism: Retrospect and Prospect*. Resort to increased government spending, as Keynes prescribed, is not necessary.

Krugman is of course aware of this, but he does not get around to mentioning it until about 60 pages after he presents us with the babysitting model: "The answer, as any economist should immediately realize, is to get the price right; to make it clear that points earned in the winter will be devalued if held until the summer. ... This will encourage people to use their baby-sitting hours sooner, and hence create more baby-sitting opportunities."

When he applies this point to the economy, though, Krugman does not mention the price system. Instead, he mounts his hobbyhorse—the need for government intervention: "But what in the baby-sitting economy corresponds to our coupons that melt in the summer? The answer is inflation, which causes the real value of money to melt over time."

Yet why can't people adjust prices by themselves without the heavy hand of government? Krugman is too good an economist to ignore this question. This time we have to wait for another 100 pages before the explanation. "Briefly, the source of the theoretical disputes [in economics] was this," Krugman writes, "shortfalls of overall demand would cure themselves if only wages and prices fell rapidly in the face of unemployment. In the story of the depressed baby-sitting co-op, one way the situation could have resolved itself would have been for the price of an hour of baby-sitting in terms of coupons to fall ... and the co-op would have returned to 'full employment' *without any action by its management*." (Italics mine.)

Krugman thinks, however, that in a depression prices and wages would not fall rapidly enough to restore full employment. Austrian economists such as Ludwig von Mises, Friedrich Hayek, and Murray Rothbard disagree. Yet even if these economists are right, Krugman can still argue his point. Suppose that market price adjustments make Keynesian spending unnecessary. It does not follow that government intervention should be rejected. Why rely on the market when we can more easily "prime the pump"?

Here we can appeal to Krugman himself, who has been keen to emphasize that if we do not face depression, government spending will cause inflation. In an earlier book, *The Great Unraveling* (2003), he warned of the dangers of deficit spending when the economy is in good condition, rightly excoriating the Bush administration for its massive defense spending. Keynes, he noted, warned of the dangers of inflation as well as the perils of unemployment. The correct balance between too much government spending is, in the Keynesian view, very difficult to achieve. Why, one might then ask, rely on the government at all?

There is a deeper issue at stake here. Even if the government could be relied on to provide the right dose of spending, Krugman's Keynesianism does not answer the most basic question: why does the economy face collapse at all? If, in Krugman's terms, everyone wants to hold money and no one wants to invest, how did we get into this predicament?

Once more we can find the answer in what Krugman tells us, though he does not draw the correct conclusion from his remarks. He explains, "At some point goldsmiths discovered that they could make their sideline as keepers of coin even more profitable by taking some of the coin deposited in their care and lending it out at interest ... on any given day some of the depositors would show up and demand their coin back, but most would not. So it was enough to keep a fraction in reserve; the rest could be put to work. And thus banking was born."

As the Austrian economists have explained, under a centralized banking system, fractional reserves permit the central bank to bring about a massive expansion of credit. This induces investors to start projects that, when the credit expansion ends, collapse. As Krugman points out, bank credit expansion led to investment bubbles in Asia during the 1980s: "Well, it turns out that Japan's investment bubble was only one of several outbreaks of speculative fever around the world during the 1980s. All of these outbreaks had the common feature that they were financed mainly by bank loans." Yet we face a similar situation in America today, where risky subprime mortgage loans created a bubble in the housing market that has collapsed.

In the Austrian view, the collapse of these malinvestments constitutes the depression. The issue is not a sudden loss of spirit by investors but an adjustment made necessary by unsound financing. In other work, Krugman has raised an objection to this account. Why, he asks, should a liquidation of certain bad investments lead to a general crisis for the economy?

Again, Krugman answers his own question. Today, we have not just fractional reserve banking, but many other credit creators. "The set of institutions and arrangements that act as 'non-bank-banks' are generally referred to as either the 'parallel banking system' or as the 'shadow banking system.'" These institutions have financed so much investment, in the housing market and elsewhere, that a major collapse creates tremendous problems of adjustment.

For Krugman, the remedy is of course more government. The shadow banking system must be placed under strict government supervision and Krugman's "guess is ... that there will eventually have to be more assertion of government control—in effect, it will come closer to a full temporary nationalization of a significant part of the financial system." He makes clear that he does not want a permanent takeover, just a temporary government intrusion to fix the system. But with the American economy spiraling toward greater and greater catastrophe—and government intrusion temporarily unable to reverse the problems—is it not time instead to abandon Keynesian mismanagement and return to sound money, making speculative credit expansion impossible? ■

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[The Art of the Public Grovel: Sexual Sin and Public Confession in America, Susan Wise Bauer, Princeton University Press, 352 pages]

Forgive Me For Getting Caught

By Peter W. Wood

AMERICA'S characteristic scoundrel is the con man. Herman Melville gave us a wonderful anatomy of this vulnerability in his 1857 novel, *The Confidence-Man: His Masquerade*. The steamship *Fidele* heads down the Mississippi with a cross-section of Americans aboard, many of whom fall victim to a practitioner who entangles them in their own vanities. He is no ordinary con man. He is able to transform himself into a crippled ex-slave, a widower in mourning, a transfer agent for a coal company, a solicitor for an asylum for widowed and orphaned Seminoles, and more. His goal is not limited to fleecing his marks. One character warns, "Money, you think, is the sole motive to pains and hazard, deception and deviltry, in this world. How much money did the devil make by gulling Eve?"

Americans are susceptible to con men because our society depends to an extraordinary degree on establishing trust among strangers. We are a commercial, physically mobile people who have little to rely on in the way of established community order. Most of us live, work, and play among relative strangers. We move into neighborhoods where we know no one; we change jobs and acquire whole new cohorts of colleagues; we join churches where we commit to brotherhood with people we have never before laid eyes on. But the rapidity with which we establish connections to strangers and turn them into acquaintances and then friends comes at a price: it makes us vulnerable to liars, to people who counterfeit good intentions or who, at the extreme, fake their entire identities.

Liars who get exposed and get forgiven, liars who get exposed and don't get forgiven: this is the terrain of Susan Wise Bauer's argumentative new book *The Art of the Public Grovel: Sexual Sin and Public Confession in America*. The subject is a departure for Bauer, who is best known for a history of the ancient world and books aimed at homeschoolers. But there is nothing of the classical virtues, such as stoicism, in *The Art of the Public Grovel*. The tone of this volume, from the title through to the last page, is cynical distaste for America's appetite for public repentance.

Bauer zeroes in on sexual hypocrites: people who pretend to uphold standards but whose lives tell another story. Her gallery consists of Grover Cleveland, Aimee Semple McPherson, Ted Kennedy, Jim Bakker, Jimmy Swaggart, Bill Clinton, and Cardinal Law, with cameo appearances from Jimmy Carter, Ted Haggard, Mark Foley, and David Vitter. A mix of politicians and clergy, people who—unlike, say, Hollywood celebrities—have some stake in being seen as possessing personal rectitude. What happens when they are exposed as fakes?

This is rich material, but Bauer aims to do more than rake through it. She has a thesis: that American society as a whole has absorbed the ethic of public confession that was born in the Protestant Great Awakenings and came to fruition in the popular revivals. Men such as Charles Finney (1792-1875), who popularized the practice of having groaning sinners come to the head of the congregation to confess their sins, and Dwight L. Moody (1837-1899), who streamlined the altar call by having congregants come forward to confess "faith" rather than sin, gave America a taste for publicly enacted repentance. Moody's elision of two kinds of confession proved particularly useful. It became possible to "confess" without admitting any particular transgression. If Bauer is right, when Bill Clinton declared, "I have sinned" without ever mentioning a particular sin, he was drawing on the well of rhetorical ambiguity dug by American evangelicals.

Bauer's argument, however, is more intriguing than it is convincing. To get to Clinton's moral triangulations, she walks us though a series of cases in which people didn't confess and yet succeeded in avoiding serious consequences for their transgressions.

Faced with scandalous accusations in the middle of his 1884 presidential campaign— "Ma, Ma, where's my Pa?"—that he had "seduced a helpless woman, made her pregnant, and then forced her to put the baby in an orphanage," Grover Cleveland improvised a response that, as Bauer sees it, was built on an implied confession to members of the clergy. Cleveland also made clear his willing acceptance of financial responsibility for the child, he avoided tit-for-tat attention to the sexual indiscretions of his Republican rival Sen. James Blaine, and he proceeded in the face of continuing allegation to deny nothing.

His ace, according to Bauer, was a prominent Protestant minister, the Rev. Kinsley Twining, who announced that there had been "no adultery, no breach of promise, no obligation of marriage," and that Cleveland had been "singularly honorable." Decoded, this meant the woman, Maria Halpin, was to be seen as the culpable party. Cleveland manfully shouldered his responsibilities without complaint, making his silence seem heroic. The clergy gave Cleveland cover that he could not have provided for himself.

Bauer recounts the "Ma, Ma, where's my Pa?" scandal seemingly in the hope of spotting an early connection between Protestant notions of confession and how a capable public figure can escape opprobrium for unworthy behavior. But Cleveland's actions seem less a prefiguring of Bill Clinton's maneuvers than a template for Barack Obama's Houdini-like escape from his decades-long involvement with Jeremiah Wright, Bill Ayers, and ACORN. Obama, like Cleveland, made an effective political strategy out of a shrug.