management as a form of 'conflict resolution' in which third parties set out to prevent or end violent conflict between other states. . . . Some conflicts are stubbornly resistant to mediation by outsiders, and there may well be cases . . . where military action is the only realistic option for advancing the prospects for a political settlement and eventual lasting peace" (p. 204).

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We must not let the nasty mediators get in the way of Impetuous Leader, as he blasts and bombs to insure eventual peace. And it gets even better. A crisis atmosphere is in many cases desirable. Otherwise, the leader cannot get what he wants: "In a larger perspective, one should bear in mind that crises can have their positive side. They present opportunities not always available to policy makers to mobilize the country behind certain policies and to overcome bureaucratic obstacles to firm action. . . . [Crises] may also open avenues for skilled leaders to strengthen alliances, bolster the legitimacy of their regimes, and enhance their international prestige" (pp. 204–05). Carnes Lord, whatever his virtues, has not given much help to those who endeavor to acquit Straussians of bellicose tendencies. ■ **MR**

Krugman Is Not Always Wrong

The Great Unraveling: Losing Our Way in the New Century

PAUL KRUGMAN
NORTON, 2003
XXIX + 426 PGS.

Keynesian economics has few virtues, but Paul Krugman's book, the bulk of which collects many of his controversial columns for the *New York Times*, shows that even a Keynesian can on occasion have valuable things to say. Most people equate Keynesianism with deficit spending, but this is not in all circumstances correct. Keynes recommended deficit spending only in depressions. In times of prosperity, Keynes wanted balanced budgets, or even budget surpluses.

Paul Krugman, a devout Keynesian, fully embraces the latter view. He accordingly mounts a strong, and in my view very effective, criticism of the Bush administration for its massive deficits. Since we are not now in a depression, deficits result in grave harm to the economy. In his criticism of Bush, Krugman draws much needed attention to a principal source of the deficit, excessive spending on defense. He warns of the malign consequences of Bush's misguided Iraq venture.

Unfortunately, Krugman's wisdom has severe limits. His response to deficits is to demand that taxes be raised. The thought that somewhere, somehow, a rich person is escaping heavy taxes chokes him with rage. He never addresses the stifling effects on investment to which his policy would lead. Except for spending on defense, he seems averse to the true remedy for deficits, i.e., massive reductions in government spending. But with a Keynesian, we cannot ask for everything. We should be thankful for what he has given us.

Krugman's key insight is that large deficits impede investment, and thus economic growth, by their effect on the monetary rate of interest: "Has the sudden return of federal deficits [in late 2001] had an impact on long-term interest rates? Of course it has. Just a few months ago everyone expected the federal government to pay off its debt, drastically reducing the supply of bonds; now it turns out that it will be borrowing money. Inevitably this depresses bond prices, which is the same as raising long-term interest rates" (p. 71).

Given this effect, our economy confronts a grave problem. Social Security and Medicare payments will make increasing demands on the economy. The prospect of constantly increasing deficits to pay the expenses of these programs threatens disaster. (Sometimes Krugman sounds like John Attarian, whose book on Social Security is reviewed elsewhere in this issue.)

Our author presents the problem in his customary hard-hitting style: "The U.S. government is best viewed as a big insurance company that also happens to have an army. The giant retirement programs—Social Security and Medicare—already dominate the federal budget;

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they'll become much more expensive a decade from now [2000]. If we have to pay those bills, and also pay interest on a big national debt, something will have to give" (p. 135). The difficulties that will confront the retirement programs of course stem from the large number of "baby boomers" who will have to be supported.

In a few places, though, Krugman retreats from his own best thoughts about the crisis. He tells us at one point that solving the Social Security problem "isn't all that difficult;" all we need are some "affordable injections of money" (p. 189). Even if benefit payments in the future exceed tax revenues, the Social Security system will take care of things through a "multitrillion-dollar 'trust fund' held in government bonds" (p. 201). What is wrong with government bonds? Are they not genuine assets? I find it difficult to reconcile Krugman's comments here with his analysis elsewhere of the crisis that threatens Social Security. With my customary generosity, I propose that we simply ignore these lapses.

Krugman is after all a Keynesian and cannot be expected to get everything right.

Krugman's analysis has so far been completely on target (aside from the passages we have agreed to ignore); but he is after all a Keynesian and cannot be expected to get everything right. He proceeds to a blatant leap in logic. Faced with heavy deficits, he rightly says, we cannot have both high government spending and tax cuts. From this, he wrongly concludes that we cannot have tax cuts.

How can we cut taxes, he asks, if we want to reduce the deficit? He fails to give adequate weight to the elementary point that if government expenses are cut sufficiently, lower taxes and less debt are entirely compatible.

But why cut taxes? From an economic point of view is not the answer obvious? Lower taxes encourage investment. Krugman sees that deficits stifle investment, through their effect on the interest rate: How can he fail to grasp the more direct negative effect high taxes have on investment? Perhaps he thinks that the rich save but do not invest. Is this not Keynesian dogmatism at its worst?[1]

He does address the issue briefly at one point. He says, "Now you could try to justify tax cuts tilted toward the top by claiming that a rising tide lifts all boats, and that cutting taxes for the rich will make the economy grow faster. . . . Given the extraordinary boom of the Clinton years, it's hard to claim that excessive taxes have been a drag on economic growth" (p. 150).

Krugman has here fallen into a gross fallacy. He reasons that if the economy was prosperous when taxes were relatively high for the rich, it cannot be the case that reducing taxes will promote prosperity. Of course this does not follow. Perhaps the economy under Clinton would have done even better had tax rates been cut. Sound reasons of theory lead us to expect beneficial results from tax cuts; and pending a refutation of these arguments, we should not abandon them.

Further, Krugman conflates two different issues. On the one hand, he

[1] I owe this point to Joseph Salerno.

asks a good question: why should tax cuts benefit only the rich? Why not institute cuts that are of greater benefit to those in less fortunate circumstances? He conflates this question, on the other hand, with another: why cut taxes for the rich at all? Krugman again and again denounces tax cuts for the wealthy, viewing them as part of a revolutionary rightist plot to overthrow the modern welfare state. He wants to "soak the rich," but he never tells us why such taxation is desirable.

If Krugman learns of the Mises Institute, I fear for his health.

To his credit, Krugman does not ignore entirely the most economically beneficial way to lessen the deficit. In particular, he calls attention to vast and unnecessary spending on defense. "And while there is much talk of hard choices, the administration seems loath to make any choices at all when it comes to defense spending. Does a subsidiary of the Carlyle Group have a 70-ton artillery piece . . . ? We'll buy it. Do two competing contractors offer advanced fighters designed to fight a nonexistent next generation of MiGs? We'll take both" (p. 239).

One part of the defense budget, in particular, threatens us with economic ruin; and Krugman is well aware of it. The Iraq War has already cost billions of dollars and will continue to drain our resources indefinitely: "the heavy costs of war, occupation, and rebuilding—for we won't bomb Iraq, then wash our hands of responsibility, will we?—are not in doubt" (p. 389).

Unfortunately, Krugman's skepticism about government spending has its limits. Any fundamental challenge to the welfare state he sees as part of a right-wing conspiracy; and, once he makes this claim, he sees no need for further analysis. He points out in shocked tones that if "you read the literature emanating from the Heritage Foundation, which drives the Bush administration's economic ideology, you discover a very radical agenda: Heritage doesn't just want to scale back New Deal and Great Society programs, it regards the very existence of these programs as a violation of basic principles" (p. 6). If Krugman learns of the Mises Institute, I fear for his health.

For Krugman, the welfare state is simply a given: to question its justification is heresy. He asks: "Why don't we just leave medical care up to individuals? Basically, even in the United States there are limits to how much inequality the public is prepared to tolerate. It's one thing if the rich can afford bigger houses or fancier vacations than ordinary families; Americans accept such differences cheerfully. But a society in which rich people get their medical problems solved, while ordinary people die from them, is too harsh even for us" (p. 208).

Here Krugman's obvious resentment against the rich makes him miss a basic distinction. If, in a free market, the rich have access to better medical care than the poor, it hardly follows that the poor get no medical attention. Of equal value as an argument would be the claim that since the rich can better afford than the poor caviar and champagne, the poor will starve or receive bad food.

Because of his refusal to address questions of basic principle, Krugman cannot solve the problem he has posed so well. To deal with extremely high deficits requires drastic cuts in government programs. To declare welfare immune from fundamental revision is to destroy all chance for a resolution of the problem. And Krugman makes matters even worse. He is not slow to propose his own plans for increases in spending.

Is not foreign aid a very good thing? We have so little of it now: a substantial increase, our author suggests, is in order. "Right now, the U.S. is the Scrooge of the western world—the least generous rich nation on the planet" (p. 380). Why not double our foreign aid budget? Doing so involves such a small amount—only "a dime a day for the average citizen" (p. 381). I shall leave it to those more mathematically gifted than I to do the arithmetic, but the annual figure for the U.S. population will be a not insignificant amount. Somehow the deficit is no longer a consideration; or, more likely, Krugman thinks a tax increase on the rich will take care of things.

There is yet another area in which Krugman's crusade against deficits falls flat. As a Keynesian of the highest standing, he knows what to do as soon as the economy experiences the slightest downturn. The government must increase its spending, and deficits are the order of the day. Although, as Krugman hastens to assure us, these are short-term deficits designed to cope with a crisis, do they not make much more difficult the aim of avoiding substantial and long-lasting government debt?

Here the author's obvious resentment against the rich makes him miss a basic distinction.

Krugman will of course answer that the dictates of sound economics require that we deal with recession through increases in spending. But has he ever seriously considered the Austrian alternative to Keynes? In a column written in October 2002, he says that we are in "a classic overinvestment slump, of a kind that was normal before World War II" (p. 97). Do not Austrians have something to say about overinvestment? ■ **MR**

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