

Rolling Stone

What Obama Must Do

A Letter to the New President

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Dear Mr. President:



Like FDR three-quarters of a century ago, you're taking charge at a moment when all the old certainties have vanished, all the conventional wisdom been proved wrong. We're not living in a world you or anyone else expected to see. Many presidents have to deal with crises, but very few have been forced to deal from Day One with a crisis on the scale America now faces.

So, what should you do?

In this letter I won't try to offer advice about everything. For the most part I'll stick to economics, or matters that bear on economics. I'll also focus on things I think you can or should achieve in your first year in office. The extent to which your administration succeeds or fails will depend, to a large extent, on what happens in the first year — and above all, on whether you manage to get a grip on the current economic crisis.

The Economic Crisis

How bad is the economic outlook? Worse than almost anyone imagined.

The economic growth of the Bush years, such as it was, was fueled by an explosion of private debt; now credit markets are in disarray, businesses and consumers are pulling back and the economy is in free-fall. What we're facing, in essence, is a yawning job gap. The U.S. economy needs to add more than a million jobs a year just to keep up with a growing population. Even before the crisis, job growth under Bush averaged only 800,000 a year — and over the past year, instead of gaining a million-plus jobs, we lost 2 million. Today we're continuing to lose jobs at the rate of a half million a month.

There's nothing in either the data or the underlying situation to suggest that the plunge in employment will slow anytime soon, which means that by late this year we could be 10

million or more jobs short of where we should be. This, in turn, would mean an unemployment rate of more than nine percent. Add in those who aren't counted in the standard rate because they've given up looking for work, plus those forced to take part-time jobs when they want to work full-time, and we're probably looking at a real-world unemployment rate of around 15 percent — more than 20 million Americans frustrated in their efforts to find work.

The human cost of a slump that severe would be enormous. The Center on Budget and Policy Priorities, a nonpartisan research group that analyzes government programs, recently estimated the effects of a rise in the unemployment rate to nine percent — a worst-case scenario that now seems all too likely. So what will happen if unemployment rises to nine percent or more? As many as 10 million middle-class Americans would be pushed into poverty, and another 6 million would be pushed into "deep poverty," the severe deprivation that happens when your income is less than half the poverty level. Many of the Americans losing their jobs would lose their health insurance too, worsening the already grim state of U.S. health care and crowding emergency rooms with those who have nowhere else to go. Meanwhile, millions more Americans would lose their homes. State and local governments, deprived of much of their revenue, would have to cut back on even the most essential services.

If things continue on their current trajectory, Mr. President, we will soon be facing a great national catastrophe. And it's your job — a job no other president has had to do since World War II — to head off that catastrophe.

Wait a second, you may say. Didn't other presidents also face troubled economies? Yes, they did — but when it came to economic policy, your predecessors weren't actually running the show. For the past half century the Federal Reserve — a more or less independent institution, run by technocrats and deliberately designed to be independent of whoever happens to occupy the White House — has been taking care of day-to-day, and even year-to-year, economic management. Your fellow presidents were just along for the ride.

Remember the economic boom of 1984, which let Ronald Reagan run on the slogan "It's morning again in America"? Well, Reagan had absolutely nothing to do with that boom. It was, instead, the work of Paul Volcker, whom Jimmy Carter appointed as chairman of the Federal Reserve Board in 1979 (and who's now the head of your economic advisory panel). First Volcker broke the back of inflation, at the cost of a recession that probably doomed Carter's re-election chances in 1980. Then Volcker engineered an economic bounce-back. In effect, Reagan dressed up in a flight suit and pretended to be a hotshot economic pilot, but Volcker was the guy who actually flew the plane and landed it safely.

You, on the other hand, have to pull this plane out of its nose dive yourself, because the Fed has lost its mojo.

Compare the situation right now with the one back in the 1980s, when Volcker turned the economy around. All the Fed had to do back then was print a bunch of dollars (OK, it

actually credited the money to the accounts of private banks, but it amounts to the same thing) and then use those dollars to buy up U.S. government debt. This drove interest rates down: When Volcker decided that the economy needed a pick-me-up, he was quickly able to drive the interest rate on Treasury bills from 13 percent down to eight percent. Lower interest rates on government debt, in turn, quickly drove down rates on mortgages and business borrowing. People started spending again, and within a few months the economy had gone from slump to boom. Economists call this process — from the Fed's decision to print more money to the resulting pickup in spending, jobs and incomes — the "monetary transmission mechanism." And in the 1980s that mechanism worked just fine.

This time, however, the transmission mechanism is broken.

First of all, while the Fed can still print money, it can't drive interest rates down. Why? Because those interest rates are already about as low as they can go. As I write this letter, the interest rate on Treasury bills is 0.005 percent — that is, zero. And you can't push rates lower than that. Now, you might think that zero interest rates would lead to an orgy of borrowing. But while the U.S. government can borrow money for free, the rest of us can't. Fear rules the financial markets, so over the past year and a half, as the interest rates on government debt have plunged, the interest rates that Main Street has to pay have mostly gone up. In particular, many businesses are paying much higher interest rates now than they were a year and a half ago, before the Fed started cutting. And they're lucky compared to the many businesses that can't get credit at all.

Besides, even if more people could borrow, would they really want to spend? There's a glut of unsold homes on the market, so there's very little incentive to build more houses, no matter how low mortgage rates go. The same goes for business investment: With office buildings standing empty, shopping malls begging for tenants and factories sitting idle, who wants to spend on new capacity? And with workers everywhere worried about job security, people trying to save a few dollars may stampede into stores that offer deep discounts, but not many people want to buy the big-ticket items, like cars, that normally fuel an economic recovery.

So as I said, the Fed has lost its mojo. Ben Bernanke and his colleagues are trying everything they can think of to unfreeze the credit markets — the alphabet soup of new "lending facilities," with acronyms nobody can remember, is growing by the hour. Any day now, the joke goes, everyone will have a Visa card bearing the Fed logo. But at best, all this activity only serves to limit the damage. There's no realistic prospect that the Fed can pull the economy out of its nose dive.

So it's up to you.

Rescuing The Economy

The last president to face a similar mess was Franklin Delano Roosevelt, and you can learn a lot from his example. That doesn't mean, however, that you should do everything

FDR did. On the contrary, you have to take care to emulate his successes, but avoid repeating his mistakes.

About those successes: The way FDR dealt with his own era's financial mess offers a very good model. Then, as now, the government had to deploy taxpayer money in order to rescue the financial system. In particular, the Reconstruction Finance Corporation initially played a role similar to that of the Bush administration's Troubled Assets Relief Program (the \$700 billion program everyone knows about). Like the TARP, the RFC bulked up the cash position of troubled banks by using public funds to buy up stock in those banks.

There was, however, a big difference between FDR's approach to taxpayer-subsidized financial rescue and that of the Bush administration: Namely, FDR wasn't shy about demanding that the public's money be used to serve the public good. By 1935 the U.S. government owned about a third of the banking system, and the Roosevelt administration used that ownership stake to insist that banks actually help the economy, pressuring them to lend out the money they were getting from Washington. Beyond that, the New Deal went out and lent a lot of money directly to businesses, to home buyers and to people who already owned homes, helping them restructure their mortgages so they could stay in their houses.

Can you do anything like that today? Yes, you can. The Bush administration may have refused to attach any strings to the aid it has provided to financial firms, but you can change all that. If banks need federal funds to survive, provide them — but demand that the banks do their part by lending those funds out to the rest of the economy. Provide more help to homeowners. Use Fannie Mae and Freddie Mac, the home-lending agencies, to pass the government's low borrowing costs on to qualified home buyers. (Fannie and Freddie were seized by federal regulators in September, but the Bush administration, bizarrely, has kept their borrowing costs high by refusing to declare that their bonds are backed by the full faith and credit of the taxpayer.)

Conservatives will accuse you of nationalizing the financial system, and some will call you a Marxist. (It happens to me all the time.) And the truth is that you *will*, in a way, be engaging in temporary nationalization. But that's OK: In the long run we don't want the government running financial institutions, but for now we need to do whatever it takes to get credit flowing again.

All of this will help — but not enough. By all means you should try to fix the problems of banks and other financial institutions. But to pull the economy out of its slide, you need to go beyond funneling money to banks and other financial institutions. You need to give the real economy of work and wages a boost. In other words, you have to get job creation right — which FDR never did.

This may sound like a strange thing to say. After all, what we remember from the 1930s is the Works Progress Administration, which at its peak employed millions of Americans building roads, schools and dams. But the New Deal's job-creation programs, while they

certainly helped, were neither big enough nor sustained enough to end the Great Depression. When the economy is deeply depressed, you have to put normal concerns about budget deficits aside; FDR never managed to do that. As a result, he was too cautious: The boost he gave the economy between 1933 and 1936 was enough to get unemployment down, but not back to pre-Depression levels. And in 1937 he let the deficit worriers get to him: Even though the economy was still weak, he let himself be talked into slashing spending while raising taxes. This led to a severe recession that undid much of the progress the economy had made to that point. It took the giant public works project known as World War II — a project that finally silenced the penny pinchers — to bring the Depression to an end.

The lesson from FDR's limited success on the employment front, then, is that you have to be really bold in your job-creation plans. Basically, businesses and consumers are cutting way back on spending, leaving the economy with a huge shortfall in demand, which will lead to a huge fall in employment — unless you stop it. To stop it, however, you have to spend enough to fill the hole left by the private sector's retrenchment.

How much spending are we talking about? You might want to be seated before you read this. OK, here goes: "Full employment" means a jobless rate of five percent at most, and probably less. Meanwhile, we're currently on a trajectory that will push the unemployment rate to nine percent or more. Even the most optimistic estimates suggest that it takes at least \$200 billion a year in government spending to cut the unemployment rate by one percentage point. Do the math: You probably have to spend \$800 billion a year to achieve a full economic recovery. Anything less than \$500 billion a year will be much too little to produce an economic turnaround.

Spending on that scale, at a time when the weakening economy is driving down tax collection, will produce some really scary deficit numbers. But the consequences of too much caution — of a failure on your part to do enough to stop the economy's nose dive — will be even scarier than the coming ocean of red ink.

In fact, the biggest problem you're going to face as you try to rescue the economy will be finding enough job-creation projects that can be started quickly. Traditional WPA-type programs — spending on roads, government buildings, ports and other infrastructure — are a very effective tool for creating employment. But America probably has less than \$150 billion worth of such projects that are "shovel-ready" right now, projects that can be started in six months or less. So you'll have to be creative: You'll have to find lots of other ways to push funds into the economy.

As much as possible, you should spend on things of lasting value, things that, like roads and bridges, will make us a richer nation. Upgrade the infrastructure behind the Internet; upgrade the electrical grid; improve information technology in the health care sector, a crucial part of any health care reform. Provide aid to state and local governments, to prevent them from cutting investment spending at precisely the wrong moment. And remember, as you do this, that all this spending does double duty: It serves the future, but it also helps in the present, by providing jobs and income to offset the slump.

You can also do well by doing good. The Americans hit hardest by the slump — the long-term unemployed, families without health insurance — are also the Americans most likely to spend any aid they receive, and thereby help sustain the economy as a whole. So aid to the distressed — enhanced unemployment insurance, food stamps, health-insurance subsidies — is both the fair thing to do and a desirable part of your short-term economic plan.

Even if you do all this, however, it won't be enough to offset the awesome slump in private spending. So yes, it also makes sense to cut taxes on a temporary basis. The tax cuts should go primarily to lower- and middle-income Americans — again, both because that's the fair thing to do, and because they're more likely to spend their windfall than the affluent. The tax break for working families you outlined in your campaign plan looks like a reasonable vehicle.

But let's be clear: Tax cuts are not the tool of choice for fighting an economic slump. For one thing, they deliver less bang for the buck than infrastructure spending, because there's no guarantee that consumers will spend their tax cuts or rebates. As a result, it probably takes more than \$300 billion of tax cuts, compared with \$200 billion of public works, to shave a point off the unemployment rate. Furthermore, in the long run you're going to need more tax revenue, not less, to pay for health care reform. So tax cuts shouldn't be the core of your economic recovery program. They should, instead, be a way to "bulk up" your job-creation program, which otherwise won't be big enough.

Now my honest opinion is that even with all this, you won't be able to prevent 2009 from being a very bad year. If you manage to keep the unemployment rate from going above eight percent, I'll consider that a major success. But by 2010 you should be able to have the economy on the road to recovery. What should you do to prepare for that recovery?

Beyond the Crisis

Crisis management is one thing, but America needs much more than that. FDR rebuilt America not just by getting us through depression and war, but by making us a more just and secure society. On one side, he created social-insurance programs, above all Social Security, that protect working Americans to this day. On the other, he oversaw the creation of a much more equal economy, creating a middle-class society that lasted for decades, until conservative economic policies ushered in the new age of inequality that prevails today. You have a chance to emulate FDR's achievements, and the ultimate judgment on your presidency will rest on whether you seize that chance.

The biggest, most important legacy you can leave to the nation will be to give us, finally, what every other advanced nation already has: guaranteed health care for all our citizens. The current crisis has given us an object lesson in the need for universal health care, in two ways. It has highlighted the vulnerability of Americans whose health insurance is tied to jobs that can so easily disappear. And it has made it clear that our current system is bad for business, too — the Big Three automakers wouldn't be in nearly as much trouble if they weren't trying to pay the medical bills of their former employees as well as

their current workers. You have a mandate for change; the economic crisis has shown just how much the system needs change. So now is the time to pass legislation establishing a system that covers everyone.

What should this system look like? Some progressives insist that we should move immediately to a single-payer system — Medicare for all. Although this would be both the fairest and most efficient way to ensure that all Americans get the health care they need, let's be frank: Single-payer probably isn't politically achievable right now, simply because it would represent too great a change. At least at first, Americans who have good private health insurance will be reluctant to trade that insurance for a public program, even if that program will ultimately prove better.

So the thing to do in your first year in office is pass a compromise plan — one that establishes, for the first time, the principle of universal access to care. Your campaign proposals provide the blueprint. Let people keep their private insurance if they choose, subsidize insurance for lower-income families, require that all children be covered, and give everyone the option to buy into a public plan — one that will probably end up being cheaper and better than private insurance. Pass legislation doing all that, and we'll have universal health coverage up and running by the end of your first term. And that will be an achievement that, like FDR's creation of Social Security, will permanently change America for the better.

All this will cost money, mainly to pay for those insurance subsidies, and some people will tell you that the nation can't afford major health care reform given the costs of the economic recovery program. Let's talk about why you should ignore the naysayers.

First, let's put the costs of the economic-recovery program in perspective. It's possible that reviving the economy might cost as much as a trillion dollars over the course of your first term. But the Bush administration wasted at least twice that much on an unnecessary war and tax cuts for the wealthiest; the recovery plan will be intense but temporary, and won't place all that much burden on future budgets. Put it this way: With long-term federal debt paying the lowest interest rates in half a century, the interest costs on a trillion dollars in new debt will amount to only \$30 billion a year, about 1.2 percent of the current federal budget.

Second, there's good reason to believe that health care reform will save money in the long run. Our system isn't just full of holes in coverage, it's also grossly inefficient, with huge bureaucratic costs — such as the immense resources that insurance companies devote to making sure they don't cover the people who need health care the most. And under a universal system it will be much easier to use our health care dollars wisely, to spend money only on medical procedures that work and not on those that don't. Since rising health care costs are the main source of the grim, long-run projections for the federal budget, the truth is that we can't afford not to move forward on health care reform.

And let's not ignore the long-term political effects. Back in 1993, when the Clintons tried and failed to create a universal health care system, Republican strategists like William

Kristol (now my colleague at *The New York Times*) urged their party to oppose any reform on political grounds; they argued that a successful health care program, by conveying the message that government can actually serve the public interest, would fundamentally shift American politics in a progressive direction. They were right — and the same considerations that made conservatives so opposed to health care reform should make you determined to make it happen.

Universal health care, then, should be your biggest priority after rescuing the economy. Providing coverage for all Americans can be for your administration what Social Security was for the New Deal. But the New Deal achieved something else: It made America a middle-class society. Under FDR, America went through what labor historians call the Great Compression, a dramatic rise in wages for ordinary workers that greatly reduced income inequality. Before the Great Compression, America was a society of rich and poor; afterward it was a society in which most people, rightly, considered themselves middle class. It may be hard to match that achievement today, but you can, at least, move the country in the right direction.

What caused the Great Compression? That's a complicated story, but one important factor was the rise of organized labor: Union membership tripled between 1935 and 1945. Unions not only negotiated better wages for their own members, they also enhanced the bargaining power of workers throughout the economy. At the time, conservatives warned that wage gains would have disastrous economic effects — that the rise of unions would cripple employment and economic growth. But in fact, the Great Compression was followed by the great postwar boom, which doubled American living standards over the course of a generation.

Unfortunately, the Great Compression was reversed starting in the 1970s, as American workers once again lost much of their bargaining power. This loss was partly due to changes in the world economy, as major U.S. manufacturing corporations started facing more international competition. But it also had a lot to do with politics, as first the Reagan administration, then the Bush administration, did all they could to undermine the ability of workers to organize.

You can make a start on reversing that process. Clearly, you won't be able to oversee a tripling of union membership anytime soon. But you can do a lot to enhance workers' rights. One is to start laying the groundwork to pass the Employee Free Choice Act, which would make it much harder for employers to intimidate workers who want to join a union. I know it probably won't happen in your first year, but if and when it does, the legislation will enable America to take a huge step toward recapturing the middle-class society we've lost.

Truth & Reconciliation

There are many other issues you'll need to deal with, of course. In particular, I haven't said a word about environmental policy, which is ultimately the most important issue of all. That's because I suspect that it won't be possible to pass a comprehensive plan for

dealing with climate change in your first year. By all means, put as much environmentally friendly investment as possible — such as spending to enhance energy efficiency — into the initial recovery plan. But I'm guessing that 2009 won't be the year to introduce cap-and-trade measures to reduce greenhouse gas emissions. If I'm wrong, that's great — but I'm not counting on big environmental policy moves right away.

I also haven't said anything about foreign policy. Your team is well aware of the need to wind down the war in Iraq — which is, by the way, costing about as much each year as the insurance subsidies we need to implement universal health care. You're also aware of the need to find the least bad solution for the mess in Afghanistan. And I don't even want to think about Pakistan — but you have to. Good luck.

There is, however, one area where I feel the need to break discipline. I'm an economist, but I'm also an American citizen — and like many citizens, I spent the past eight years watching in horror as the Bush administration betrayed the nation's ideals. And I don't believe we can put those terrible years behind us unless we have a full accounting of what really happened. I know that most of the inside-the-Beltway crowd is urging you to let bygones be bygones, just as they urged Bill Clinton to let the truth about scandals from the Reagan-Bush years, in particular the Iran-Contra affair, remain hidden. But we know how that turned out: The same people who abused power in the name of national security 20 years ago returned as part of the team that, under the second George Bush, did it all over again, on a much larger scale. It was an object lesson in the truth of George Santayana's dictum: Those who refuse to learn from the past are condemned to repeat it.

That's why this time we need a full accounting. Not a witch hunt, maybe not even prosecutions, but something like the Truth and Reconciliation Commission that helped South Africa come to terms with what happened under apartheid. We need to know how America ended up fighting a war to eliminate nonexistent weapons, how torture became a routine instrument of U.S. policy, how the Justice Department became an instrument of political persecution, how brazen corruption flourished not only in Iraq, but throughout Congress and the administration. We know that these evils were not, whatever the apologists say, the result of honest error or a few bad apples: The White House created a climate in which abuse became commonplace, and in many cases probably took the lead in instigating these abuses. But it's not enough to leave this reality in the realm of things "everybody knows" — because soon enough they'll be denied or forgotten, and the cycle of abuse will begin again. The whole sordid tale needs to be brought out into the sunlight.

It's probably best if Congress takes the lead in investigations of the Bush years, but your administration can do its part, both by not using its influence to discourage the investigations and by bringing an end to the Bush administration's stonewalling. Let Congress have access to records and witnesses, and let the truth be told.

That said, the future is what matters most. This month we celebrate your arrival in the White House; at a time of great national crisis, you bring the hope of a better future. It's

now up to you to deliver on that hope. By enacting a recovery plan even bolder and more comprehensive than the New Deal, you can not only turn the economy around — you can put America on a path toward greater equality for generations to come.

Respectfully,

Paul Krugman