NATIONAL PRESS CLUB LUNCHEON WITH PAUL KRUGMAN

SUBJECT: PAUL KRUGMAN, COLUMNIST FOR THE NEW YORK TIMES AND ECONOMICS PROFESSOR AT PRINCETON UNIVERSITY, WILL ADDRESS THE COUNTRY'S ECONOMIC CRISIS

MODERATOR: SYLVIA SMITH, PRESIDENT, NATIONAL PRESS CLUB

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**SYLVIA SMITH:** (Sounds gavel.) Good afternoon. My name is Sylvia Smith. I'm the Washington editor of the Ft. Wayne *Journal Gazette* and president of the National Press Club.

We're the world's leading professional organization for journalists. And on behalf of our 3,500 members worldwide, I'd like to welcome you and our guests in the audience today. I'd also like to welcome those of you who are watching on C-SPAN or listening on XM Satellite Radio.

We're celebrating our 100th anniversary this year, and we've rededicated ourselves to the future of journalism through informative programming, journalism education, and fostering a free press worldwide. For more information about the National Press Club, please visit our website at www.press.org.

We're looking forward to today's speech, and afterward, I'll ask as many questions from the audience as time permits.

I'd also now like to introduce our head table guests and ask them to stand briefly when their names are called. From you're right, Katherine Skiba of *U.S. News & World Report*; Myron Belkind, retired AP and the newly elected secretary of the Club; Mark Hamrick of AP Broadcast and our membership secretary; Renu Ryasan(?) of Kiplinger; Melissa Charbonneau, the vice chairwoman of the Speakers Committee.

Skipping over our speaker for just a minute, Bob Cardin of Cardin Communication, and the Speakers Committee member who organized today's event. Thank you so much, Bob. Donna Leinwand of *USA Today* and the president-elect of the Club; Andrew Schneider of Kiplinger, Washington editor; and Timothy Burger of Bloomberg. Welcome, everyone. (Applause.)

There are few, if any, columnists more influential than *The New York Times*'s Paul Krugman. *The Washington Monthly* has called him, "The most important political columnist in America." Adding considerable heft to his reputation, the Nobel committee awarded Krugman the 2008 Nobel Prize for Economics for his analysis of the economies of scale on international trade.

Plus, he does what really smart people rarely do; Krugman communicates in a way that is accessible to people without degrees in economics. He does that without being condescending or dumbing down his thoughts. And his many readers are grateful. We hope he'll give us a flight plan out of our mess today, or at least enlighten us.

Paul Krugman grew up in Long Island and received his undergraduate degree at Yale and his doctorate in economics at MIT. In addition to his perch at *The New York Times*, Krugman is a professor of economics and international affairs at Princeton University. He's the author of several books including *Conscience of a Liberal*, also the title of his blog, and *Return of the Depression Economics and the Crisis of 2008*.

Krugman's been a harsh and unrelenting critic of the Bush Administration's economic and foreign policies. He blames much of the economic troubles on President Bush, Alan Greenspan, and some of the more notable architects of deregulation, including former Republican Senator Phil Gramm.

While Krugman is certainly a liberal by temperament and definition, he has at times traveled the political spectrum. He worked for a short period for the Reagan Administration as a staff member for the Council on Economic Advisors. Who might have guessed that? Please help me give a warm National Press Club welcome to Paul Krugman. (Applause.)

**DR. PAUL KRUGMAN:** Well, thank you. By the way, I'd like to take exception to being called a harsh critic of the Bush Administration's economic and foreign policies. I've also been a harsh critic of its environmental policies, it's judicial-- (Laughter.) Anyway.

By the way, that thing about the Reagan Administration, yes, I was there as a technocrat at the Council. I was the chief international staffer. Chief domestic staffer was a guy by the name of Summers, Larry Summers. Don't know what happened-- Anyway.

So I'm here to talk, at least obviously what's on everybody's minds is the crisis. And I have a new book, a new book which is a much revised version of an old book, which is also about the crisis. It's called *The Return of Depression Economics and the Crisis of 2008*. And I'm going to structure these remarks around what that book is about, and where we are right now in the economy, which are, I think, more or less the same thing.

So let me start, maybe in an odd place. Trying to think about this talk, I realized that what was in my mind, among other things when I wrote *Depression Economics* in its first version was a talk I'd heard many years before from Alice Rivlin, former OMB chair, at Brookings now I believe, who talked about how in policy there were hard problems and easy problems. And easy problems were ones where you might have a political hitch trying to figure out how to get the necessary votes to pass what needed to be done in Congress, but you did know what to do. It was not fundamentally, conceptually hard.

So something like finding enough money to repair the highways is an easy problem. Hard problems are things where we really don't have good answers. We don't know really what we should be doing, or we have some things we might try, but we don't really know how to bring these things under control. So something like reducing the crime rate is a hard problem. We did it, be actually still don't know how we did it. So it's one of the things that is really difficult.

In economics or macroeconomics, in managing the economy as a whole, we had a traditional division between hard problems and easy problems. Stagflation is a hard problem, when you've got high inflation and you're trying to bring it down, but you really don't want to have high unemployment in the process. We don't know how to do that. Stagflation was a hard problem. No one in economics is puzzled by the fact that it was very expensive and difficult to bring the high inflation of the late 1970s down. That was known to be a hard problem.

On the other hand, just plain old-fashioned recession, just plain lack of demand, there's not enough spending to keep people fully employed, that's supposed to be an easy problem. We thought we knew, you know, just have the Fed print some more money, maybe just have some Federal spending. But mostly we thought that pretty much Uncle Alan or Uncle Ben or their equivalent can deal with ordinary recession type problems quite easily.

Demand is easy. And that's not just the way people talk. Occasionally they put it in print, so. I actually begin the current edition of *Depression Economics* with a quote from Robert Lucas, the very gritty economist, Nobel Laureate from some years back, who gave as his presidential address to the American Economic Association, he started it by saying, "The problem of depression prevention has been solved. This is not a problem." And basically the lecture goes on to say, "We should be worrying about long-run growth because we know how to handle downturns. That's not a problem."

But actually, about ten years ago, I and a fair number of other people began to have some real doubts about whether the problem of depression prevention had been solved. And that came initially out of the experiences of Asian economies in crisis, looking at the problems of Indonesia, Thailand, Malaysia, South Korea, and above all, Japan, and saying, you know, "Maybe this thing is not so easy to deal with."

There was a little nest actually turns out at Princeton of economists who were deeply concerned, who looked at, in particular, Japan and said, "You know, that could be us. Maybe the problems that they're having in Japan are not so much because of fundamental specific Japanese problems, but maybe they suggest a vulnerability that could be in all of our economies." That little nest of economists included me of course, Lars Svensson who's now at the Riksbank in Sweden, Mike Woodford, and the guy by the name of Ben Bernanke. We all looked at those problems and thought that, "You know, this may be an omen. What has happened in these Asian economies could possibly happen to us as well."

And, of course, now it has. Hence the new addition of the book and hence my great concern at the situation we're in. So let me tell you what I call Depression Economics, what it is that is the issue here.

Now, the normal way that we deal with any slump, the normal way we deal with a downturn is for the Central Bank, Federal Reserve, or the European Central Bank, or the Bank of Japan to deal with it by-- essentially by printing money. Now, it's not quite that-- That's not literally what they do. They credit the accounts of participating banks and buy short-term government debt in return, but open market-- You basically push money out there, push down the interest rates on short-term government debt, whether it's Treasury bills or their equivalent in other countries. And that's normally enough to get things moving, lower interest rates, the things that the Fed controls most directly, translated to lower interest rates on things that matter to the private sector.

So when you cut interest rates, when you cut the target Fed funds rate, that eventually works through to a cut in mortgage interest rates, cut in corporate bond rates, investment increases. There's more spending. As people, there's more spending, there's more income, and so on, all down the line. It doesn't work instantly, doesn't work with high accuracy. So you're always, when you're doing that kind of policy, a little bit in the position of having a thermostat that responds a little bit slowly to the temperature in the room. And hence the temperature does fluctuate, but nothing really major.

And for a long time, we believed that we had this thing pretty well down. In fact just a few years ago, Ben Bernanke gave a speech called "The Great Moderation" basically arguing that because Central Bankers like himself had figured this stuff out, we had things reasonably well under control, not that we'd abolish the business cycle, but that we'd reduced it to a kind of acceptable-- The wiggles were small enough that we could handle them now.

What happened in Asia in the late '90s really shook that belief amongst some of us. On the one hand, you had a number of countries that found that they could not apply the usual medicine. They could not go and cut interest rates to try and fight their way out of a recession because their currencies were plunging. And their plunging currencies exposed them to all kinds of financial difficulties. They had companies that had borrowed in dollars or in Yen. They had a lot of balance sheet exposure. And as a result, they were actually finding themselves forced into raising interest rates to try to defend their currencies rather than cutting to fight the recession, and therefore experiencing, in some cases, real Depression-level collapses in output. So Indonesia was probably the worst peacetime slump in any reasonably large economy since the 1930s.

And we saw those things happening. Japan had a somewhat different problem, but Japan had a real estate and stock bubble, which burst. And in the wake of that, they did-- They didn't have any inhibitions about cutting interest rates, and so they went and they cut interest rates… and they cut interest rates, and they cut interest rates, all the way to zero.

And it wasn't enough. Japan found itself in something economists have known about for a long time, but had managed to sort of push out of their memory, which is the liquidity trap. It's a confusing name, but it basically means that once you got the interest rate down to more or less zero, increasing the amount of money in circulation doesn't matter because money-- People are already have as much liquidity, as much cash as they want. Money is more or less equivalent to just other stores of value. Can't push the interest rate below zero, because if interest rates are below zero, you do better by putting the stuff in your mattress.

So what you do, if you push out more cash is you just alter a basically meaningless division of the amount of short-term stuff between money and zero interest paper. Has no effect on the real economy. You have no traction, at least from ordinary monetary policy.

Now their liquidity trap was a big issue in the 1930s, the concern that--the sense that monetary, that the Federal Reserve at that point had had no ability to manage the economy. But, as I like to say, economists have managed to convince themselves with the passage of time that such things can't happen, didn't happen, and furthermore, would never happen again, that we were not going to find ourselves--

I can remember not long ago, we would look at the Great Depression, look at 1935 and say, "Wow, look at that." At that point, the interest rate on three-month Treasury bills was down to just 0.14 percent. Imagine that. Yesterday, it was .005. So if you want to know how much we've recreated Depression conditions--

So we've got a crisis now. And I'm not going to talk a lot about how we got into that crisis. That's been many things. Just to say that, some people say that what we're seeing here is like nothing we've ever seen before. I think it's actually more accurate to say that it's like everything we've seen before, all at once. There's a real kind of sum of all fears quality.

So the 1930s began-- What made the Great Depression 'great' was not the stock market crash, but the banking failures of the early 1930s. Well, we've essentially replicated that experience, not with traditional conventional banks. If your definition of a bank is something that lives in a big marble building and has an FDIC-insured sign in the window, then they're fine. Well, okay, a few-- you know, about two or three get seized by the FDIC every Friday. But that's all right. They're continuing to operate.

The trouble is that, something doesn't have to look like a traditional bank to be in the banking business. And so it turns out, we had grown over the years this very large parallel banking system, shadow banking system, whether you want to call it — investment banks, hedge funds, asset-backed commercial paper, money market funds, auction rate securities — all of these things that were basically doing what a bank does, which is to promise one set of people ready access to their money with many only a short delay, and promise to another set of people long-term financing. And most of time, it works. That's what a bank does. A bank says, “We have your money here whenever you want it.” But at the same time, it lends out most of it long-term.

Well, that works because ordinarily most people don’t want their money at the same time. But if people lose confidence in the soundness of a particular bank or of the system as a whole, then you have a bank run, and all hell breaks loose. We protected against bank runs with deposit insurance, and then regulations on banks, capital requirements, reserve requirements, and so on. But we grew up this other system, which is the shadow banking system, things that do bank-like activity, but were not called banks, were not depository institutions, were not regulated like banks. And that system has largely collapsed.

And for what it’s worth, that system was bigger on the eve of the crisis than the conventional banking system. Tim Geithner, Treasury Secretary Designate, gave a speech last summer in which he sort of tracked it through. And it was at least $10 trillion dollars of stuff. And of course it hasn’t all disappeared, but it has shrunk massively in what is basically a 21st Century version of the bank runs that ushered in the Great Depression.

Currency crises, the kinds of things that had happened to South Korea, Indonesia, and later, Argentina, well, we’ve got those, too. We tend to think of the financial crisis as being the product of the U.S. housing bubble, subprime, and then the consciousness of the burst of the housing bubble and the subprime turning into toxic waste. And that is a large part of the story. But there were other bubbles, other misalignments, that have also gone bad in the last year and a half.

And if we’re going to look, I think probably the second biggest, after the U.S. housing market, the second biggest source of a shock in the world today is the problems of the European periphery, the problems of countries that attracted very large inflows of capital in the last few years, out of the belief that, well, they were all going to be members of the Eurozone pretty soon, and they were safe, and, hey, it’s all Europe, and what can go wrong?

And if you look at the size of the trade deficits run by some of these countries relative to their economies, they actually dwarfed what happened in Southeast Asia in the run-up to the ‘90s crisis. And now they’re all experiencing crises that are more or less-- are very close cousins of the crises that took place in Southeast Asia and then in Argentina some years ago. It’s actually astonishing how blithely everybody rushed into a, almost complete recreation of the crises that we all worried about in the ‘90s. So, you know, my line now is that, Latvia is the new Argentina, and Ukraine is the new Indonesia. It’s really very similar.

And this is big stuff. Individually, these are not large economies. But take them all together, take in the bursting of the Spanish housing bubble, the British housing bubble, and you've got something which is a sort of second epicenter of the crisis, not much smaller than the one we've generated here.

So we've got these sum of all fears sort of coming together, all of these crises. Freeze-up in the credit markets, huge increase in the spreads between the interest rates at which the government can borrow, which, at the short end, are now zero, and the interest rates that the private sector has to pay. All of that puts a lot of downward pressure on spending, very large shrinkage in private demand. Current numbers are just-- You know, numbers, giving you some indication of where the economy's moving right now are generally quite frightening. Basically I fire up my computer every morning, take a look at the latest economic numbers and generally say something I can't print in *The Times*, because it's just really, really bad stuff, day after day.

Okay, what do you do? Because that's where we are now. What are the possible options and what do we think is going to happen? As I said, there was a group of us at Princeton, not just there, but-- A number of economists were worrying about this. A number of people looked at Japan in the '90s and said, "Gee, this looks a lot like us, big, advanced, sophisticated countries, stable government, and yet they're having a lot of trouble. What can we do to avoid-- If we're starting to look Japanese, what can we do to avoid a similar experience?"

Ben Bernanke, of course, did quite a lot. And if you look at what policy responses have been so far, to me at least it looks a lot like we're moving down a checklist. So one of the things, staffers at the Fed had argued for some time, that the Japanese might have been able-- Actually, they were a little stronger. They said, "The Japanese would have been able to avoid their lost decade if they had responded aggressively with interest rate cuts very early instead of gradually working their way down to that zero interest rate."

So the Fed has done that, very fast, rapid interest rate cuts. That quite clearly has not worked. It probably has mitigated. Probably the crisis would have been even worse if the Fed had been less quick to respond. At least to the credit of the Fed, they kept their eye on the ball. It's astonishing right now to realize that, not that long ago, the European Central Bank was actually raising interest rates, because they had managed to convince themselves that inflation was the problem, not the possibility of a second Great Depression.

But in any case, that has not been enough. Conventional monetary policy is now at its limit. The normal thing the Fed does is to work at the short end, and only on government securities. So it buys Treasury bills and pushes interest rates down. We're now at the ZIRP point, that zero interest rate policy. So we're now ZERP-ed. And that's not going to work.

Well, okay. That was Bernanke, 2002. So we move up to Bernanke and Reinhart, 2004, which is changing the composition of the Central Bank's balance sheet, otherwise known as having the Fed buy a lot of stuff which isn't quite as safe as buying short-term-- as buying Treasury bills in the hope that essentially by the Fed itself becoming a major lender, it can loosen up the markets. And it's doing that on an awesome scale. So the Federal Reserve had about $800 billion dollars worth of assets not long ago, all of it pretty much short-term U.S. government debt. It's now up to two and a half trillion, I believe. And it's buying commercial paper, essentially lending to private business. It's buying mortgage backed securities from Fannie and Freddie, which is a little bit peculiar, because this is one sort of kind of part of the U.S. government, the Federal Reserve, buying stuff from another sort of kind of part of the U.S. government, now that Fannie and Freddie are in conservatorship. But still, it's not your normal kind of policy. And they'll clearly continue to push stuff out.

Actually my wife says that the logical limit, which will be reached within a few years is, we'll all have credit cards with the Federal Reserve logo on them. (Laughter.) But they're doing this enormous stuff.

What I think I would say-- And this is-- Does it work? I think the answer is, "Yes….but…" Particularly in the last few weeks, it does look as if they have achieved something with these policies. Mortgage rates have come down. Interest rates, on some private sector borrowing, have come down. Things are a little better. There's been a significant loosening, really since about the middle of October thanks to all of this incredibly aggressive Fed action.

But it's clearly not enough. The economy is headed downhill very fast now. At this point in fact, even if you got a significant loosening in the financial markets, we'd probably be heading downhill quite fast. It's kind of a black art to figuring out, not what's going to happen, but even what is happening right now, because official statistics lag. But for what it's worth, a reasonable guess is that we're bleeding jobs at the rate of around 600,000 a month, that the economy is shrinking at a rate of about six percent right now. This is a pretty steep nosedive going on in the economy. And of course it feeds on itself. As the economy sinks, businesses scale back their investment plans, because, you know, why add capacity if you're going to have a sharp drop in demand? Consumers scale back because, even if you have a job right now, who knows? And so we get all of this downward pressure.

What can you do? Well, what the textbook says is, fiscal policy. You can have the government deliberately promote spending. Now, we had attempted fiscal policy early this year which probably achieved something, though there was so much downward pressure in the economy that it's hard to tell. But it had two problems. One was that it was too small, around one percent of GDP, which looks trivial compared to the size of the problems. The other is, it was in the form of giving people money and hoping they'll spend it, which is a very dubious proposition right now. And we don't really know how much of it was spent. That's a very hard question to answer, but probably not too much, certainly not enough.

So what you really want to do now is the sure-fire thing is to spend directly. Have the government do infrastructure, have the government, of course, repair bridges, build roads, fix up schools, all of that having-- doing double duty. With luck, you end up with something of lasting value after it's all over. But in the meantime, you also are very definitely actually spending money and supporting the economy.

Problems. What I'd say is that the problem that I worry about greatly now-- Sorry. Let me back up for a second. Size — how big should this all be? And we're now hearing reports of $850 billion over two years from the incoming Administration, which is actually almost certainly not enough to really bring the economy back anywhere close to full employment. Although I can understand why they're reluctant to hit the big T and go up to a trillion.

Let me just give you my back of the envelope. Sorry, I'm going to get a little wonkish for a second here. We think that the multiplier-- right-- You spend-- You build a bridge. The people you hire to build the bridge then have more money and they go and buy more consumer goods. They go and buy-- That creates more jobs, and so on. But even when all of that is said and done, we think that a dollar of Federal spending probably creates only something like a dollar and a half of GDP, more than the amount you spend, but not vastly larger.

That means that if you do $200 billion of spending, that's probably $300 billion of GDP, which is two percent. And it takes about a two percent rise in GDP to shave one percent off the unemployment rate. So-- Sorry about that. Basically $200 billion for a year to reduce the unemployment rate in that year by one percentage point — that's a rough number.

We're probably on a track, absent policy intervention, to have an unemployment rate of between nine and ten percent by the end of this year. So you start to think about that, you see that $850 billion over two years is not a lot of money. It's actually well short of what we would probably need to get anywhere close to, let's say, a five percent unemployment rate.

Why not just go ahead and do more? Key problem right now is time and speed. Infrastructure spending is clearly, I'd say clearly the best thing we could do right now. The problem is, you can't just say, "Okay, let's start doing major environmental initiatives and spend the money starting next week." Takes time.

Takes time to get stuff going. So the question is-- The term (I'm sure everybody's heard it now) is shovel-ready. How much shovel-ready stuff do we have? And shovel-ready actually doesn't mean you can start next week. Shovel-ready generally means you can start within six months. And even so, there are limits. So I'm seeing numbers like, max, $150 billion dollars of shovel-ready.

Now maybe-- We've got some very smart people, very creative people coming in. Maybe they can find more of that. But the immediate problem is actually going to be, how can you get enough stuff going in time to slow this economy's nosedive? I will be shocked if, despite everything that the Obama people are trying to do, if they can stop the unemployment rate before eight percent. In fact, my guess is we'll hit nine percent before they finally are getting enough traction to turn it around, late this year. I mean, as you know, economic forecasts are not exactly precise. But it's going to be very difficult.

The problem immediately now is really one of speed, getting the stuff going. You can try other stuff. Some things are faster, aid to the unemployed, aid to state and local governments. One thing you can do quickly, if you can't start spending quickly, you can avert cuts in spending fairly quickly, so aid to state and local governments, all of that, we're hearing about. But it's going to be really, really hard.

How does this all end? I'm quite optimistic. I'm scared to death of next year. I'm quite optimistic about the year after that. Because then the stimulus will be coming online, and we will be getting a lot of boost. And the team coming into The White House does understand that. They understand the economy at least as well as anyone does. They understand the needs.

I start to get concerned, again, one you look further out. Because I take a look and say, well, okay, we do know how to boost the economy. If we do a lot of Federal spending, that will boost the economy. We can't do it-- Our immediate problem is how to do it fast enough.

What I don't know is what the endgame looks like. Eventually you want the private economy to step back in. You want to withdraw this. Eventually we have to start worrying about servicing the debt we've run up in the course of the stimulus program. But I don't have a clear story about which part of the private sector takes up the slack after the Federal government-- after the stimulus is done. Hopefully we'll get a better read on that, a little bit further out. But that is going to be a big issue.

The Great Depression was ended by a large public works program known as World War II. What we really don't, still don't understand very well is, why, when the war was over the Depression didn't come back. We actually don't know that very well. That's a question that I think we're going to want to think about quite a lot in its modern guise as we look forward.

Scary times. You know, professionally, there is a part of me that says, you know, this is the crisis I always wanted to live through, because this is what, you know, economists study. But, of course, as an actual human being, it's horrific. It is awesomely dangerous. Though I think we clearly are back in Depression economics, I don't think we're actually talking about another Depression.

But there's only one reason for that. It's not that the things that made the Great Depression happen are impossible in the modern world. In fact, exactly those things, in a 21st Century version, are happening right now. The only thing that will prevent us from having another Great Depression is that I think we learned something from the last time we had this experience, and that we have some idea of how to avert the worst. So everything right now hinges on whether we understand this stuff, even as well as I think we do, and whether the tools that are at-hand are enough to pull as back from the brink. I think so. Not quite as confident of that as even I would have been a year ago. Scary times. Let's wish ourselves the best of luck. Thanks. (Applause.)

**MS. SMITH:** We might have to extend this lunch for another hour. We've got so many questions here. The questioner says, someone suggested stimulus checks to people written in disappearing ink so that they have to spend it within 30 days. Can't deposit it in a bank or anything. What do you think of an idea of something like that?

**DR. KRUGMAN:** Actually the Germans have proposed exactly that, I mean, not disappearing ink, but time-dated stimulus-- But the trouble is, people are-- It's still fungible, right? I mean, give me a check that will disappear in a month, and I will spend it, and, you know, substitute spending from that check with spending I would have done from other funds. So only people who are liquidity-constrained-- I'm trying to think of a way to say that in English, and I can't-- are going to--

Now, you know, there's an issue. It might be that we're being too rational about this, that people really would spend it faster. But no, that's really an issue. I understand that in Germany, people are protesting against the proposal, saying, "I should have the right to save it if I want." But yeah, it's not as easy. There are other proposals that we issue, time-dated currency which depreciates in value so that we can have negative interest rates. But anyway, never mind.

**MS. SMITH:** If we have a huge stimulus package, and if somebody even uses the T-word, trillion, does it really matter what it's spent on? I mean, you said that shovel-ready projects are important. But Alice Rivlin had warned against it being misspent. Can you really misspend a government stimulus package?

**DR. KRUGMAN:** Yeah, I mean, other things equal, it should be spent well if you can. But no, this is where-- Sorry?

**MS. SMITH:** What's that mean, "Spend it well"?

**DR. KRUGMAN:** Yeah, I mean, it should be on stuff, if you can, on stuff that is actually valuable. So we really do have bridges falling down and we should fix them, and all that. But no, I mean, this is-- My great idol, in case people haven't figured this out from my writings, is John Maynard Keynes. Keynes wrote, talking about the reluctance to spend, you know, on projects and all the complaints that people had. He said, "We can solve this by burying bottles full of cash in coal mines, and then letting the private sector dig them up." And he said it would be better to spend it on something useful, he said, but, you know, if that's the only thing people accept, let's do that.

No, I mean, to a large extent-- There's a political concern, which is, if you're going to be a Democratic, progressive, big-spending administration, you had probably be very, very careful that the thing is squeaky-clean. So the WPA was amazingly clean. And that was by design. There were multiple layers of oversight to make sure that the money was-- that whether or not the projects were good, at least there was no corruption, hardly any corruption. There were desperate attempts to find corruption, and they weren't very successful.

That's going to slow up the projects. But I'm afraid that has to be done. I think in the real-- You know, from a straight economic point of view, better to give a lot of money to Tony Soprano and get it out there fast-- I'm from New Jersey. But in the real world, they do-- I'm not sure that the quality of the projects is as critical as Alice thinks it is. But I think that the quality of the oversight is.

**MS. SMITH:** Do you think there are any of those Depression era programs, WPA and the arts program, everything, could they be brought back? Or is it just a different time that we're in?

**DR. KRUGMAN:** You know, I've actually wondered about-- If we would throw one-tenth of one percent of this thing at culture, what wonderful things could happen. But I have a suspicion it just can't be done in this modern world, that the culture wars are just too intense for us to do that. But the WPA? You know, I don't think. People are not going to be-- The WPA had a kind of-- an ethos around it, and was billed as something more than just a quick emergency measure. I don't think people are ready for that. I mean, right now, we just do stuff that looks useful and will get the demand out there. So it's going to be straightforward things, like fixing bridges, like my pet project, though I don't know how-- I've been getting conflicting reports on how shovel-ready it is. But I want that second rail tunnel under the Hudson for personal reasons.

So that sort of thing, upgrade-- So I think it's going to be much more prosaic than the WPA was.

**MS. SMITH:** How about defense spending in the context of this? Do you think that's a good idea? Not so?

**DR. KRUGMAN:** You know, it doesn't really matter from the point of view of stimulus what kind of spending it is. So yeah, I mean, as I said, World War II ended the Great Depression. It was the massive spending on weaponry that actually did it.

Now, I don't think there's actually an urgent need for us-- You know, if there are defense priorities that really should be done and are shovel-ready, fine. But I suspect that that's not the case. And I don't think-- In any case, I think given the mood of the country to say, "Well, we're going to do this on a defense buildup," is probably not the best idea.

**MS. SMITH:** We need to ask you to comment on the news of the day. Which is better — an orderly bankruptcy for the auto industry? The emergency loans that were announced today?

**DR. KRUGMAN:** Those are not either/or. I'm sure there are lawyers in the room who would know better than I, whether or not it actually has to be a Chapter 11. But, you know, what's going to happen almost surely for the auto industry is in fact an orderly bankruptcy, a packaged, pre-packaged bankruptcy. It's going to be-- They're going to have to find some way to abrogate a lot of contracts. They're going to have to find some way to put off a number of debt payments. But it has to come with-- DIP financing is non-existent. So it has to come from the Federal government. People won't buy cars from a company or will be reluctant to buy cars from a company that might not exist. There have to be warranties from the Federal government.

So there's a whole bunch of stuff that has to surround a bankruptcy proceeding. And the reason for this emergency loan is, you can't do that in a matter of days. There's no way that kind of package can be put together now, especially with lame duck Administration, lame duck Congress. So the whole purpose of this loan is to kick the can down the road. But that's productive in this case. You push it back, and so in early next year, the next Administration and the new Congress can put together a more lasting solution. So I think this is not a contradiction.

And, you know, will the big fix for the auto industry that probably will come in February, whatever, will that actually work? Or will that just postpone the death a little while? And the answer is, we don't know the answer to that. But the one thing you don't want to do is, out of sheer inability to get your act together, let that industry just go under right in the middle of this horrifying downturn. That's a massive anti-stimulus program you don't want to implement.

**MS. SMITH:** You make the point that in economic slumps, it's almost a patriotic duty for the rich to spend, spend, spend. In the off chance there are any rich members of the National Press Club, what kind of consumption gets the most bang for the buck, so to speak, if the underlying goal is to help the economy?

**DR. KRUGMAN:** You know, I just don't think this is the way you make policy, by urging people to spend as their patriotic-- which we-- You know, after 9/11, I thought that was-- although I understood the point. But, you know, there was-- President Bush and also former President Clinton actually both went out there urging people to keep spending. And actually I probably shouldn't, but there was this ad that was all over, particularly on the airport TVs from the Travel Agents Association with President Bush saying, "Do your business around the country," which obviously doesn't quite have the same connotation elsewhere that it does in New Jersey. But anyway. (Laughter.)

But that just had a bad-- Even though it made economic sense, it just had, for me, a morally bad feel. Times of stress, you don't call on people to not make sacrifices. And, you know, I just thought, this is not the job of the individual consumer. That said, I guess-- What you want to do is you want to think of, what has got the lowest import content as possible, right? You want to spend on haircuts and personal services and not go buy lots of poison toys and tainted seafood from China.

You can see why it's a good thing I'm not in the government. (Laughter.)

**MS. SMITH:** The questioner says, your blog recently posed the question, "Do we need a middle class?" If not, aren't we arguing for trickle-down economics?

**DR. KRUGMAN:** Yeah, for those who don't read my blog, the question was, just for the-- It was really a quite narrow question. If we're asking, do you need to have a reasonably equal distribution of income in order to have sufficient consumer demand to sustain the economy-- And lots of people say you do, but I think the math is wrong. If you actually ask, "Can you have a society which has sufficient consumer demand where a lot of that consumer demand consists of people buying lavish dinners and staying at luxury hotels," yes, you can. In fact, we did, you know, for many years before the 1930s. And, to some extent, we did that through much of the '80s and '90s. It's a question of sufficient demand.

That's not saying that a society that doesn't have a middle class, which is more or less what we are now, is a good society. I think it's terrible in many ways. But just the mechanical-- The argument, that shear Keynesian demand economics require is that you have a relatively equal distribution of income, isn't right. I mean, in some sense-- It's a subject, in some ways, maybe I shouldn't even be raising, because-- But there is a tendency for people to think that just to stimulate the economy, we have to have greater equality in this country. And I think that's not right. Economics is not a morality play. What's just is not necessarily what you have to do in order to simply make the machine work.

**MS. SMITH:** How would you rate the news media's handling and coverage of the financial crisis?

**DR. KRUGMAN:** Oh boy. There's been a lot of good reporting, I have to say. I think I've probably found more articles that I've found really illuminating on this than pretty much any previous era, which is partly just because there's a lot of interesting stuff happening. But I think there has been a lot of good reporting.

My sense is actually that the quality of economics reporting-- I'm not quite sure I can say about business, but the quality of economics reporting, I believe has gone up quite a lot in the last decade, that just the general quality of thinking, understanding of the issues is better. So I'm actually not that negative on-- You know, this is not like the run-up to the Iraq war. There has not been a major dereliction.

What is true is that on the specific issue of housing, this is-- If you read Dean Baker, the Center For Economic Policy Research, has a regular blog at The American Prospect basically reporting on economic and business issues, mostly on economic issues. And he makes the point that, throughout the run-up in housing prices, basically the only people who got quoted in most news stories were people from the National Realtors Association, people who were essentially sell side for the housing industry.

And now that the housing bubble has burst, still, for the most part, the only people who get quoted are people who are sell side for the housing industry. On the specific issue of housing, it is almost like Iraq. Apparently, no, you're not taken seriously on national security unless you are wrong about Iraq. And you're not taken seriously on housing unless you are wrong about the bubble. And why that's true, I don't quite understand. But that is a major hole in the coverage.

**MS. SMITH:** Questioner asks, what do you see as the risk of protectionism at the level seen during the Great Depression? Is there a danger of a rerun of the Smoot-Hawley tariff and retaliatory tariffs by other countries?

**DR. KRUGMAN:** Okay. Point on history, Smoot-Hawley was passed before the Depression. So it's an interesting thing. It was not a response to. It was something-- And a lot of people say that protectionism, you know, caused or greatly deepened the Great Depression, which actually doesn't hold up when you do the economics carefully. That's another one of those, trying to make-- I'm against protectionism, but that's trying to make it more of a villain than it was.

I don't think there's a whole-- I think that this protectionist thing is greatly overstated. United States, Obama Administration, sure, it has protectionist wing of the Democratic Party. There always is. But there's actually, I think, a less outright protectionist sentiment now than there was in the 1980s. And yet we never did actually go heavily protectionist in the '80s.

And the reason is, that there are international agreements. And this incoming Administration is a very internationalist-minded group, believes in honoring treaties. He's not going to rip up the trade agreements we have. They might very well refuse to spend political capital on new trade agreements. If I was advising, I would say, you know, "Resurrecting the corpse of Doha is not a priority for this Administration." But really ripping up the agreements we've got, I just don't think is going to happen.

And I don't see-- There's remarkably little sign that anyone else is getting into protectionism either. I mean, I look at Latin America and look at some of the countries that had terrible crises. Look at Argentina which had the mother of all currency crises in 2002. And they, in many ways, returned to a populist economic stance. But they did not return to the inward-looking economic policies of the Peron era. So I think protectionism is not nearly as big a risk as people imagine in today's world.

**MS. SMITH:** Given the similarity of the current economic crisis to Japan's lost decade, how real is the risk that the Dow Jones and S&P 500 will suffer a similar fate to that of the Nikkei, which is now at 20% of its '89 peak?

**DR. KRUGMAN:** Yeah. Boy. I don't do stock price forecasts or windows. You know, the other thing I would say is that, as I recall-- it's been a long time since I looked at these numbers-- but if I recall, at its peak, the Nikkei had a price earnings ratio of about 60. So although we've had some pretty out of line stock prices, not like that. So I think it would be hard to say that we would-- You know, it would be hard to match that, you know, unless we really do slide into something even worse economically than I think. I think it would be hard to do that badly. Famous last words? I hope not.

**MS. SMITH:** What do you think the risk is of civil unrest abroad arising from the global financial crisis? And if anywhere, where?

**DR. KRUGMAN:** What do I know? Nobody knows. You know what? I was in the U.S. government. I got my first ever classified paper, was something from-- a CIA memo on the then global financial crisis, what we thought was-- You know, that was nothing compared with now. But anyway, it was-- and, you know, had all the warnings, "Secret ...(inaudible)."

And what it was, was a set of completely unhelpful speculations about possible unrest in Mexico and other places. And they have no idea. And I'm in the same position right now. We gather that the Chinese are extremely concerned that seeing their growth rate slip from, you know, 11% to 6% might cause major unrest. I have no idea whether they're right about that. If anybody knows what the hell is going on in Greece-- I just don't know.

**MS. SMITH:** What is the long-term effects of the economic meltdown? A lower standard of living? More government control over the economy?

**DR. KRUGMAN:** Yeah. Lower standard of living, if we recover, no, not at all. I mean, this is Keynes again. John Maynard Keynes wrote, as the Great Depression was occurring, that we have magneto trouble, he said, which is, more or less, alternator. But anyway, you know, we got a problem with the electrical system, but the engine, that doesn't mean that the whole car is broken. If we can fix this part, we'll be back and rolling again. And that's basically where we are right now. It's the fundamental productivity and so on, is not at all affected. This is a financial, fiscal screw-up. And if we can fix it, we will be back on-track.

More government control over the economy? More government intervention into the economy, for sure. You know, we're relearning the lessons our grandfathers learned. We're relearning that financial system has to have a lot of regulation and oversight. Because when banks go down, they can take the rest of the economy with them. And so you have to have certainly more financial regulation. And I suppose there's probably a change in our whole attitude, right? I think the era of Ronald Reagan's dictum, government is not the solution, government is the problem, has probably just ended. We've just seen that there are some things from which, in fact government has to be the solution. So we'll be more sympathetic towards government intervention.

But I do not expect to see, you know, large-scale-- Actually what's happening now is a lot of sort of backdoor nationalization of the financial system. In fact, when the TARP was announced, I couldn't resist, you know, putting on my best fake Russian accent, you know, "Commissar Paulson has seized the economy's commanding heights." But that was clearly not the intention, right? And even if-- I wouldn't be surprised if we see, you know, a pretty heavy hand of the Obama Administration on the financial system for the first year or two. But that will be temporary. It'll be like Sweden, which actually did nationalize a large part of its banking system, but then sold it back. Nobody wants to do that now.

**MS. SMITH:** How is it possible the SEC was so blind in the Madoff Ponzi scheme? And does the incoming SEC chairwoman have the chops to do whatever needs to be done?

**DR. KRUGMAN:** Well, the answer, I don't know. I don't know the new SEC chair. So I can't say. You know, the little bit I understand, yes, there were some connections. There were some personal ties. But, you know, never underestimate simple stupidity and obtuseness.

Look — there's a real-- There are a lot of things that have happened now where I think the combination of reluctance to rock the boat and just difficulty in getting past the incredulity factor have been a big issue. In areas that I don't know so well, I've had the same problem. I mean, my next door neighbor at the Woodrow Wilson School is the head of our law and public affairs program. And she was telling me several years ago, "You've got to do something. You've got to look into what's happening at the Justice Department. They're stuffing it full of people from bible schools." And I said, "Yeah, yeah." And of course, it was exactly true. That's exactly what was happening.

But because I didn't know that area, I found that just hard to believe. And there it was. You know, it was just hard to believe that this could be true. So it was probably just brushed off as a possibility.

**MS. SMITH:** Ouch. Is there another shoe to drop? And if so, what is it? Or are we barefoot, economically speaking?

**DR. KRUGMAN:** Yeah. I like that.

**MS. SMITH:** You may borrow it.

**DR. KRUGMAN:** Wow. You know, you keep on thinking that you've seen everything. But I think we still haven't seen the full hedge fund unwind. Some of those international crises have not yet come to full fruition, you know, with the-- We haven't seen the full bust-up in the European periphery yet.

There's probably something big I'm missing. Commercial real estate, a lot of that has been discounted, but probably not all of it. But god knows, there's probably something huge out there that we're not thinking about. Because that's the thing — when you have this kind of crisis, basically everything that can go belly-up, does. And so there will be some more things going.

**MS. SMITH:** If there ever was a point that we could have prevented the situation we're in now, what would it have been?

**DR. KRUGMAN:** Oh boy. You know, I think politically, it was never going to happen. Look — in a better world, people would have sat there, sort of late Fall of 1998 and said, "Okay, LTCM." LTCM, when it failed, that produced a freeze-up in the world financial system very much like what we had now more recently. There were several weeks when everything was really frightening.

I remember. I was at a briefing at the New York Fed in the middle of that. And they were terrified. I remember that someone asked, you know, "What can be done about this crisis?" And actually a senior monetary official said, "Pray." And then it ended, but we never quite knew how. You know, Greenspan and Rubin acted very confident. And somehow, the whole thing went away.

And in a better world, all of the great and good would have said, you know, "Between this Asian crisis and what happened with LTCM, obviously the world has gotten very dangerous in ways that we're not keeping track of. And what we really need to do is consider a very substantial expansion of regulation, very substantial-- You know, basically we need to have something like the way we regulate and safeguard commercial banks extended to a wide range of financial institutions." And that would have prevented the crisis we've had now.

But nothing like that was remotely on the plate at the time. You know, this was time when, you know, Phil Gramm was still pushing for ever more deregulation. This was a time when Alan Greenspan was viewed as a demigod. And he thought that there was never any need for more regulation. So if we say, economically, could we have done something ten years ago to have headed off this crisis, yes. Politically, psychologically, it was just never going to happen.

**MS. SMITH:** We're almost out of time. But before asking the last question, we have a couple important matters to take care of. First, let me remind members of future speakers. In January, we have a series of CEOs. On the eighth of January, we have the CEO of NASDAQ. On January 13th, we have the president and CEO of ConocoPhillips. And on January 15th, we'll have the CEO of AIG.

Second, I'd like to present our speaker with the coveted National Press Club coffee mug for his caffeine fix. (Applause.) And for my last question, what are you going to do with that $1.4 million dollars you got from the Nobel committee?

**DR. KRUGMAN:** First of all, last I looked, it was down to about $1.2 because of the rising dollar. We have no idea. Park it someplace extremely, extremely safe until we figure it out. [simultaneous conversation] It's--

**MS. SMITH:** ...(inaudible)

**DR. KRUGMAN:** No, that's one of the best congratulatory letters I had was, "Congratulations. Now if only you can find a bank to put it in." So I don't know what we're going to do, is the answer. Thanks.

**MS. SMITH:** Thank you so much. Thank you very much. (Applause.) Thank you, Dr. Krugman, and thank you for coming today. I'd also like to thank the National Press Club staff members, Melinda Cooke, Pat Nelson, JoAnn Booz and Howard Rothman for organizing today's lunch.

We're adjourned. (Gavel sounds.)

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