

Krugman: CRISES

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Here is Professor Krugman's presentation to the Allied Social Science Associations this coming Monday:[CRISES](#)

Krugman discusses several currency crises and compares them to the current U.S. deleveraging cycle. Here is an excerpt (picking up near the conclusion):

Plunging prices of houses and CDOs ... don't produce any corresponding macroeconomic silver lining. ... This suggests that we're unlikely to see a phoenix-like recovery from the current slump. How long should recovery be expected to take?

Well, there aren't many useful historical models. But the example that comes closest to the situation facing the United States today is that of Japan after its late-80s bubble burst, leaving serious debt problems behind. And a maximum-likelihood estimate of how long it will take to recover, based on the Japanese example, is ... forever. OK, strictly speaking it's 18 years, since that's how long it has been since the Japanese bubble burst, and Japan has never really escaped from its deflationary trap.

This line of thought explains why I'm skeptical about the optimism that's widespread right now about recovery prospects. The main argument behind this optimism seems to be that in the past, big downturns in the world's major economies have been followed by fast recoveries. But past downturns had very different causes, and there's no good reason to regard them as good precedents.

Living in a crisis-ridden world

Looking back at U.S. commentary on past currency crises, what's striking is the combination of moralizing and complacency. Other countries had crises because they did it wrong; we weren't going to have one because we do it right.

As I've stressed, however, crises often – perhaps usually – happen to countries with great press. They're only reclassified as sinners and deadbeats after things go wrong. And so it has proved for us, too.

And despite the praise being handed out to those who helped us avoid the worst, we are not handling the crisis well: fiscal stimulus has been inadequate, financial support has contained the damage but not restored a healthy banking system. All indications are that we're going to have seriously depressed output for years to come. It's what I feared/predicted in that 2001 paper: "[I]ntellectually consistent solutions to a domestic financial crisis of this type, like solutions to a third-generation currency crisis, are likely to seem too radical to be implemented in practice. And partial measures are likely to fail."

Maybe policymakers will become wiser in the future. Maybe financial reform will reduce the occurrence of crises: major financial crises were much rarer between the end of World War II and the rise of financial deregulation after 1980 than they were before or since. Meanwhile, however, the fact is that the economic world is a surprisingly dangerous place.

<http://www.calculatedriskblog.com/2010/01/krugman-crises.html>