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Money for Nothing

By PAUL KRUGMAN

For years, allegedly serious people have been issuing dire warnings about the consequences of large budget deficits — deficits that are overwhelmingly the result of our ongoing economic crisis. In May 2009, Niall Ferguson of Harvard declared that the "tidal wave of debt issuance" would cause U.S. interest rates to soar. In March 2011, Erskine Bowles, the co-chairman of President Obama's ill-fated deficit commission, warned that unless action was taken on the deficit soon, "the markets will devastate us," probably within two years. And so on.

Well, I guess Mr. Bowles has a few months left. But a funny thing happened on the way to the predicted fiscal crisis: instead of soaring, U.S. borrowing costs have fallen to their lowest level in the nation's history. And it's not just America. At this point, every advanced country that borrows in its own currency is able to borrow very cheaply.

The failure of deficits to produce the predicted rise in interest rates is telling us something important about the nature of our economic troubles (and the wisdom, or lack thereof, of the self-appointed guardians of our fiscal virtue). Before I get there, however, let's talk about those low, low borrowing costs — so low that, in some cases, investors are actually paying governments to hold their money.

For the most part, this is happening with "inflation-protected securities" — bonds whose future repayments are linked to consumer prices so that investors need not fear that their investment will be eroded by inflation. Even with this protection, investors used to demand substantial additional payment. Before the crisis, U.S. 10-year inflation-protected bonds generally paid around 2 percent. Recently, however, the rate on those bonds has been minus-0.6 percent. Investors are willing to pay more to buy these bonds than the amount, adjusted for inflation, that the government will eventually pay in interest and principal.

So investors are, in a sense, offering governments free money for the next 10 years; in fact, they're willing to pay governments a modest fee for keeping their wealth safe.

Now, those with a vested interest in the fiscal crisis story have made various attempts to explain away the failure of that crisis to materialize. One favorite is the claim that the Federal Reserve is keeping interest rates artificially low by buying government bonds. But that theory was put to the test last summer when the Fed temporarily suspended bond purchases. Many people — including Bill Gross of the giant bond fund Pimco — predicted a rate spike. Nothing happened.

Oh, and pay no attention to the warnings that any day now we'll turn into Greece, Greece I tell you. Countries like Greece, and for that matter Spain, are suffering from their ill-advised decision to give up their own currencies for the euro, which has left them vulnerable in a way that America just isn't.

So what is going on? The main answer is that this is what happens when you have a "deleveraging shock," in which everyone is trying to pay down debt at the same time. Household borrowing has plunged; businesses are sitting on cash because there's no reason to expand capacity when the sales aren't there; and the result is that investors are all dressed up with nowhere to go, or rather no place to put their money. So they're buying government debt, even at very low returns, for lack of alternatives. Moreover, by making money available so cheaply, they are in effect begging governments to issue more debt.

And governments should be granting their wish, not obsessing over short-term deficits.

Obligatory caveat: yes, we have a long-run budget problem, and we should be taking steps to address that problem, mainly by reining in health care costs. But it's simply crazy to be laying off schoolteachers and canceling infrastructure projects at a time when investors are offering zero- or negative-interest financing.

You don't even have to make a Keynesian argument about jobs to see that. All you have to do is note that when money is cheap, that's a good time to invest. And both education and infrastructure are investments in America's future; we'll eventually pay a large and completely gratuitous price for the way they're being savaged.

That said, you should be a Keynesian, too. The experience of the past few years — above all, the spectacular failure of austerity policies in Europe — has been a dramatic demonstration of Keynes's basic point: slashing spending in a depressed economy depresses that economy further.

So it's time to stop paying attention to the alleged wise men who hijacked our policy discussion and made the deficit the center of conversation. They've been wrong about everything — and these days even the financial markets are telling us that we should be focused on jobs and growth.