



How Paul Krugman Would Handle Debt

Nobel prize-winning economist and Princeton Professor Paul Krugman provided the Associated Press with some unpleasant commentary on the huge debt that Americans and their institutions owe now. Krugman argues that eventually default on these loans is inevitable. That would mean bankruptcies for individuals and corporations and defaults by governments — or, if the Krugman approach is followed, this would mean calculated government inflation of the money supply, which would make it easier to pay off debts.



Private debt is one matter. Bankruptcy was intended to be a remedy in the Constitution for individuals who could not pay their debts. Congress has tweaked with bankruptcy laws over the last two hundred years, but the principle itself is enshrined in the foundational text of a new country that rejected the debtors' prisons of the Old World.

Default of state and local debt obligations is a much more serious matter. Before that occurs, the public may wish to request an investigation into how financial malfeasance allowed this to happen. The obligations which wreck state and local governments are overwhelmingly the variety which, in the private sector, would be considered trusts with fiduciary obligations. How, for example, can public employee pension systems run out of money? If an insurance company suddenly found itself unable to pay claims against its policies, politicians and the public would be screaming for the scalps of those executives who failed the trust obligations. If a bank could not pay its depositors, the same scrutiny would be demanded.

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The problem with defaulting on public obligations runs deeper. Governments that fail to pay their debts and obligations lose the confidence of bondholders and other investors. The return on investment for future bonds, consequently, is higher — sometimes much higher — and this, in turn, must be paid for by the taxpayers (as coerced "investors" in the failing government.) Taxpayers, no matter what happens, end up paying the price, a fact that does not seem to faze Paul Krugman at all. Inflation (or deflated money), higher interest payments on debts, higher tax rates — all offer unpalatable options to an electorate already overtaxed.

The solution which seems to elude "experts" like Krugman is to dramatically reduce the scope and function of government. Related choices like tackling politically hot topics like public employee pension and entitlement reform also seem humdrum to these experts. Freezing discretionary spending, too, would at least send a signal of self-control to a nervous public. In the long run, as even Marxist Fidel Castro has discovered, public spending has to be curtailed: it cannot keep growing exponentially. One may think a Nobel Prize-winning economist might grasp that too ... or maybe not.

Perhaps it is Krugman's former association with the Fabian Society-dominated London School of Economics that is responsible for his viewpoint.



Written by [Bruce Walker](#) on September 28, 2010

Photo: US Nobel Prize of Economy winner Paul Krugman delivers his speech after he was awarded with the Global Economy Prize 2010 of the Kiel Institute in Kiel, Germany, on June 20, 2010: AP Images



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