

Book Review of The Age of Diminished Expectations: U.S. Economics Policy in the 1990s (Paul Krugman, MIT Press, 1990).

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**E Macroeconomics and Monetary  
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*The age of diminished expectations: U.S. economic policy in the 1990s.* By PAUL KRUGMAN. Cambridge, Mass. and London: MIT Press, 1990. Pp. xii, 204. \$17.95. ISBN 0-262-11156-X. *JEL 91-0407*

In this remarkable book, aimed at a general business audience, Paul Krugman analyzes a number of central trade and macroeconomic policy issues with exceptional clarity and a nice touch of humor. Using only simple direct prose and an occasional diagram, Krugman offers keen insights into problems such as the productivity slowdown, U.S.-Japanese trade relations, Third World debt, the Savings and Loan crisis, and corporate takeovers. The title derives from

Krugman's assertion that although the U.S. economy has not delivered much in recent years, there is little political support for trying to improve matters. Thus, we Americans live in an age of diminished expectations.

Originally commissioned by the *Washington Post* as a sort of primer for high-level business executives, the first run of the manuscript was not widely advertised and sold for an exorbitant price. But feedback from enthusiastic executives was so strong that the *Post* decided to offer the manuscript to a much wider audience, and the reasonably-priced MIT Press edition is the result. The tone of the book is perhaps more assertive than it might have been if directed at professional economists, but Krugman's gift for bringing economic analysis to bear on practical issues is so striking that any overconfidence is easily forgiven.

The text is nominally organized into five sections on Economic Welfare (productivity, income distribution, and employment), Chronic Problems (the trade deficit and inflation), Policy Problems (the budget deficit, Fed policy, the dollar, free trade, and Japan), Financial Follies (The Savings and Loan scandal, Third World debt and Corporate Takeovers) and "American Prospects" (forecasts for the general drift of the U.S. economy). But, in fact, the book essentially consists of sixteen economics lessons (policy vignettes) that can be read in almost any order. With each topic Krugman tersely summarizes some of the main academic views, sometimes offering a chart to summarize an important empirical fact, sometimes turning a sarcastic scapel on those he considers quacks.

A good example is the very first chapter which, fashionably enough, deals with productivity growth. In just a few short pages, Krugman manages to summarize the alternative explanations of the United States' productivity slowdown. He explains why mundane explanations such as a slowdown in investment fall short ("in fact, the American economy placed about as high a share of its resources into investment in the 1970s and 1980s as it did in the 1950s and 1960s"; p. 15). But he also cautions that it is dangerous for economists to resort to amateur sociology; one school of thought is debunked as the "thirty-something" theory. The chapter on income distribution (in the U.S.) beautifully lays out the facts about the growth of the under-

class during the 1980s, and considers problems with both conservative and liberal explanations. The chapters on trade, the dollar, and Third World debt are, of course, very good; Krugman has made important contributions in these areas. But curiously, some of the very best chapters deal with topics outside Krugman's academic writings. The chapter on corporate finance beautifully summarizes the academic debate on whether takeovers enhance efficiency; it is remarkable how simply and elegantly Krugman explains say, the Grossman and Hart takeover model. The chapter on the Savings and Loan crisis is as clear and concise as anything ever written on this topic.

Certainly, most informed readers will find one area or another where they personally disagree with Krugman's assertive conclusions. For example, in the chapter on free trade, Krugman argues that the benefits of free trade may be overblown, and that for the U.S. the costs of a trade war would likely be very small. The basic argument relies on the fact that the U.S., trade is small relative to GNP. The chapter is certainly provocative and many economists will be interested to learn just how much trouble international economists have had in empirically assessing the gains from trade. But the calculations here sound a little bit like arguments that the welfare effects of pollution on world agriculture are overblown because agriculture is only a small percentage of world GNP.

Though Krugman does not pontificate on the methodology of economic research, one can easily discern his favored approaches via revealed preference. Freshwater macroeconomists, in particular, are likely to be uncomfortable with some of the macroeconomics chapters, which might seem a bit salty even to some West Coast tastes. The Ricardian equivalence doctrine is portrayed as empirically irrelevant, merely a tool for apologists of the budget deficit. The section on the costs of disinflation confidently calculates that the Volcker disinflation produced a cumulative loss in output of 20 percent of GNP, without so much as mentioning alternative real business cycle theories of the 1980s.

Krugman's book is clearly directed at politicians as well as business readers, and one can only hope that his careful analytical style will

further raise the stature of economic analysis in the policy world. Of course, the final three chapters that forecast future prospects for the U.S. economy would hardly have been to former President Harry S. Truman's liking. Krugman hedges not only with both hands, but with both feet as well.

All in all, this is an extraordinary book, one which has material that should command the interest of undergraduates (many of the chapters would be good reading material for intermediate undergraduate courses), graduate students (who need to be reminded that there is more than math to our craft), businessmen, and professional economists. *The Age of Diminished Expectations* is something that virtually every economist should enjoy, and frankly it is so easy and pleasant to browse through that there is little excuse for avoiding the experience.

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