

## **In Defense of Deficits**

James K. Galbraith

*The Nation*, March 22, 2010

### **A big deficit-reduction program would destroy the economy two years into the Great Crisis.**

The Simpson-Bowles Commission, just established by the president, will no doubt deliver an attack on Social Security and Medicare dressed up in the sanctimonious rhetoric of deficit reduction. (Back in his salad days, former Senator Alan Simpson was a regular schemer to cut Social Security.) The Obama spending freeze is another symbolic sacrifice to the deficit gods. Most observers believe neither will amount to much, and one can hope that they are right. But what would be the economic consequences if they did? The answer is that a big deficit-reduction program would destroy the economy, or what remains of it, two years into the Great Crisis.

For this reason, the deficit phobia of Wall Street, the press, some economists and practically all politicians is one of the deepest dangers that we face. It's not just the old and the sick who are threatened; we all are. To cut current deficits without first rebuilding the economic engine of the private credit system is a sure path to stagnation, to a double-dip recession--even to a second Great Depression. To focus obsessively on cutting future deficits is also a path that will obstruct, not assist, what we need to do to re-establish strong growth and high employment.

To put things crudely, there are two ways to get the increase in total spending that we call "economic growth." One way is for government to spend. The other is for banks to lend. Leaving aside short-term adjustments like increased net exports or financial innovation, that's basically all there is. Governments and banks are the two entities with the power to create something from nothing. If total spending power is to grow, one or the other of these two great financial motors--public deficits or private loans--has to be in action.

For ordinary people, public budget deficits, despite their bad reputation, are much better than private loans. Deficits put money in private pockets. Private households get more cash. They own that cash free and clear, and they can spend it as they like. If they wish, they can also convert it into interest-earning government bonds or they can repay their debts. This is called an increase in "net financial wealth." Ordinary people benefit, but there is nothing in it for banks.

And this, in the simplest terms, explains the deficit phobia of Wall Street, the corporate media and the right-wing economists. Bankers don't like budget deficits because they compete with bank loans as a source of growth. When a bank makes a loan, cash balances in private hands also go up. But now the cash

is not owned free and clear. There is a contractual obligation to pay interest and to repay principal. If the enterprise defaults, there may be an asset left over--a house or factory or company--that will then become the property of the bank. It's easy to see why bankers love private credit but hate public deficits.

All of this should be painfully obvious, but it is deeply obscure. It is obscure because legions of Wall Streeters--led notably in our time by Peter Peterson and his front man, former comptroller general David Walker, and including the Robert Rubin wing of the Democratic Party and numerous "bipartisan" enterprises like the Concord Coalition and the Committee for a Responsible Federal Budget--have labored mightily to confuse the issues. These spirits never uttered a single word of warning about the financial crisis, which originated on Wall Street under the noses of their bag men. But they constantly warn, quite falsely, that the government is a "super subprime" "Ponzi scheme," which it is not.

We also hear, from the same people, about the impending "bankruptcy" of Social Security, Medicare--even the United States itself. Or of the burden that public debts will "impose on our grandchildren." Or about "unfunded liabilities" supposedly facing us all. All of this forms part of one of the great misinformation campaigns of all time.

The misinformation is rooted in what many consider to be plain common sense. It may seem like homely wisdom, especially, to say that "just like the family, the government can't live beyond its means." But it's not. In these matters the public and private sectors differ on a very basic point. Your family needs income in order to pay its debts. Your government does not.

Private borrowers can and do default. They go bankrupt (a protection civilized societies afford them instead of debtors' prisons). Or if they have a mortgage, in most states they can simply walk away from their house if they can no longer continue to make payments on it.

With government, the risk of nonpayment does not exist. Government spends money (and pays interest) simply by typing numbers into a computer. Unlike private debtors, government does not need to have cash on hand. As the inspired amateur economist Warren Mosler likes to say, the person who writes Social Security checks at the Treasury does not have the phone number of the tax collector at the IRS. If you choose to pay taxes in cash, the government will give you a receipt--and shred the bills. Since it is the source of money, government can't run out.

It's true that government can spend imprudently. Too much spending, net of taxes, may lead to inflation, often via currency depreciation--though with the world in recession, that's not an immediate risk. Wasteful spending--on unnecessary military adventures, say--burns real resources. But no government can ever be forced to default on debts in a currency it controls. Public defaults

happen only when governments don't control the currency in which they owe debts--as Argentina owed dollars or as Greece now (it hasn't defaulted yet) owes euros. But for true sovereigns, bankruptcy is an irrelevant concept. When Obama says, even offhand, that the United States is "out of money," he's talking nonsense--dangerous nonsense. One wonders if he believes it.

Nor is public debt a burden on future generations. It does not have to be repaid, and in practice it will never be repaid. Personal debts are generally settled during the lifetime of the debtor or at death, because one person cannot easily encumber another. But public debt does not ever have to be repaid. Governments do not die--except in war or revolution, and when that happens, their debts are generally moot anyway.

So the public debt simply increases from one year to the next. In the entire history of the United States it has done so, with budget deficits and increased public debt on all but about six very short occasions--with each surplus followed by a recession. Far from being a burden, these debts are the foundation of economic growth. Bonds owed by the government yield net income to the private sector, unlike all purely private debts, which merely transfer income from one part of the private sector to another.

Nor is that interest a solvency threat. A recent projection from the Center on Budget and Policy Priorities, based on Congressional Budget Office assumptions, has public-debt interest payments rising to 15 percent of GDP by 2050, with total debt to GDP at 300 percent. But that can't happen. If the interest were paid to people who then spent it on goods and services and job creation, it would be just like other public spending. Interest payments so enormous would affect the economy much like the mobilization for World War II. Long before you even got close to those scary ratios, you'd get full employment and rising inflation--pushing up GDP and, in turn, stabilizing the debt-to-GDP ratio. Or the Federal Reserve would stabilize the interest payouts, simply by keeping short-term interest rates (which it controls) very low.

What about indebtedness to foreigners? True, foreigners do us a favor by buying our bonds. To acquire them, China must export goods to us, not offset by equivalent imports. That is a cost to China. It's a cost Beijing is prepared to pay, for its own reasons: export industries promote learning, technology transfer and product quality improvement, and they provide jobs to migrants from the countryside. But that's China's business.