

Government Deficit Phobia

Keith Rankin, 16 May 2015

We learn early and often that 'deficits' are bad. We don't know why they are bad, but we sure know that they are. So Governments promise to put an end to their deficits, and Oppositions feel compelled to say "we too".

Mainstream media are obsessed with the idea that the Government's Budget surplus is important, but have no idea why, other than a kind of Freudian distaste for debt. They seek to hold Governments (and Oppositions for that matter) to account on this matter. The media neither know why nor whether deficits are bad, but they do know how to sniff out a broken promise.

With the Budget coming up this week, we are going to get a Budget deficit. So National is now playing down the issue it successfully framed the last election around; see [Lisa Owen interviews Finance Minister Bill English](#), Scoop, 2 May, re TV3's The Nation. Bernard Hickey, on the subsequent panel discussion, was right to note that the balanced budget is a political rather than an economic target.

The question that matters is, WHO should be running deficits? Who should this decade's massive amounts of unspent income be being advanced to? There are essentially six possible answers to this question about who should be running deficits:

1. Households withdrawing their savings to buy goods and services.
2. Businesses producing new goods and services.
3. Households buying homes or consumer durables.
4. Households and businesses buying assets that already exist.
5. The poor.
6. Governments.

All economists regard the first three as appropriate deficit options. The problems are: that many households do not withdraw their savings; that businesses collectively run more surpluses than deficits; and households also for the most part are choosing to run surpluses. (You run a surplus if your saving plus debt repayment exceeds your withdrawals plus new debts.)

The surplus-deficit game is a zero-sum game. As an accounting tautology, the total sum of surpluses must equal the total sum of deficits. So if 1-to-3 are surplus sectors, then the deficits must fall in sectors 4-to-6.

Governments become an obvious candidate to run deficits. But if governments are also choosing to run surpluses, then only sectors 4 and 5 are left to run the deficits that must exist.

The financial boom before the 2008 financial crisis was largely underpinned by lending to the poor. Sub-prime mortgages and credit cards come to mind. So do loan sharks, and pawn-broking more generally. These neo-Dickensian loans, that allowed people on low wages to participate in the consumer society, really just made up for low wages and benefits. Economies rocked when the poor ran large deficits. But the global financial crisis took place when the credit lines to the poor ran dry. Too many of the poor either wouldn't borrow, couldn't borrow, or couldn't service what they had borrowed.

Should governments prefer that the poor run deficits than that governments run deficits?

This decade the deficits are being incurred by sector 4. Here the deficits are disguised. Households taking on huge speculative debts are experiencing notional appreciations in the values of the assets (mainly land) that are being used as security. Deficits they are, nevertheless. People speculating on rising prices of assets they have title to are spending more than they are earning. Other people are running

deficits by making withdrawals in the form of house sales and spending the proceeds on ocean cruises and the like; but too few to stabilise asset prices.

Should governments prefer that asset speculators run deficits than that governments run deficits?

The reality is that neither the deficits of the poor nor the deficits of asset speculators are sustainable. However, they do eventually resolve, in part by bankruptcy, and in part by governments becoming deficieters of last resort (as occurred in and after 2008).

In Japan the government opts to take on this 'last resort' role permanently; it is the most appropriate sector to run persistent deficits. With public debt at well over 200% of GDP, Japan's government deficits have been the solution; its safety valve. Japanese are content to lend to their government, even at negative effective interest rates, and the government is content to spend incomes that financially conservative Japanese households will not spend. It's a perfect solution so long as both parties assent to that solution.

In Keynesian orthodoxy, governments run surpluses in boom years (such as this year). [Grant Robertson](#) was right to note that, by this criterion, there easily should be a cyclical Budget surplus in 2015. But times have changed. This decade the private sectors almost everywhere (as in Japan) are running structural surpluses, which means that governments are pretty much obliged to run deficits across the economic cycle (as in Japan). When governments resist this obligation then it is only the poor and the speculators who can oblige in their place.

Who should run budget deficits when businesses and normal thrifty households will not?
A:governments. B:the poor. C:property speculators. Lisa Owen or Corrin Dann should ask this question.

The present answer of the deficit-phobic New Zealand government is C.
