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Demand won’t be lifted by greater public spending

From Mr Daniel J. Aronoff.

Sir, Martin Wolf continues to fret over aggregate spending accounts and persists in his belief that, so long as private sector and foreign financial balances are negative, economic depression in high-income countries can only be averted by running a government deficit equal to the combined non-governmental surplus (“Why austerity alone risks a disaster”, Comment, June 29). He recognises that most high-income countries are near their fiscal capacity, but he can think of no alternative to tossing one last Hail Mary dose of stimulus in the hope it shocks the patient back to life.

It appears an article of faith to Mr Wolf that our market economies have become so enfeebled they will implode without massive and ongoing Keynesian stimulus. This is perhaps in part because he describes the economy as a central planner would – in terms of aggregates. If the US consumer won’t spend more, inevitably disaster will strike unless the government fills the breach.

But the miracle of the market has nothing to do with aggregates and everything to do with rules, incentives and complex interactions between companies, workers and consumers; the aggregates are a mere byproduct of market transactions. To invest the aggregate accounts with any more significance is to commit what Hayek termed “the fallacy of misplaced concreteness”.

Governments can reliably contribute to growth by removing distortions that impede economic activity, like requiring banks to deleverage – forcing their own bondholders to suffer losses if necessary – so that they are given incentives to expand lending; or removing mountains of regulations and government interventions that add to transaction costs and deter activity.

In any event, unsustainable deficits and zero interest rates have rendered aggregate demand management impotent and irrelevant.

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