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## ‘This time is never different’ for deficit spending

From Daniel J. Aronoff.

Sir, Martin Wolf (“Britain’s austerity is indefensible”, March 13) explains the predicament of Britain’s recessionary economy as a syllogism: a collapse in private spending causes a contraction in employment; an increase in public borrowing can offset the contractionary impact of private deleveraging; ergo, the government can reduce unemployment by expanding its deficit. Like many famous syllogisms, the logic is seductive, but flawed.

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Mr Wolf’s major premise – that a collapse of private spending is contractionary – is undoubtedly true. But the minor premise – that an increase in deficit spending is expansionary – may not be correct. Reinhart and Rogoff cite 800 years of evidence demonstrating that growth is negatively impacted when government debt rises above 90 per cent of gross domestic product. Britain is just about there. They point out that advocates of deficit spending (and other financially irresponsible behaviour) always argue that “this time is different”, but it never is. Moreover, the evidence supporting the claim for a large eurozone fiscal multiplier is contentious, to say the least. Therefore, the conclusion, that the government should increase its deficit, does not follow from the premises.

Keynes taught that the cause of unemployment lies in a failure of some market to clear. He looked to the financial market, but his logic extends to other markets. This suggests an approach to identifying policies to restore growth. We should look for market failures and try to fix them. One blatantly obvious

candidate is the debt overhang on bank balance sheets that restricts credit; another is the debt overhang on homeowners that restricts borrowing. Restructuring of these debts would very likely increase private spending and growth. There may be other markets where obstructions did not contribute to the financial crisis, but where clearing can aid recovery.

Some prominent economists, including at times Mr Wolf, have argued that the economy is in a liquidity trap, where desired saving exceeds investment at an ultra low interest rate. To deal with this condition may require massive fiscal expansion, because rates cannot drop further to clear the market. But if we take seriously the evidence of 800 years of financial history, that is a very dangerous course and should be undertaken only as a last resort, after all other options have been tried and failed. We are not there yet.

**Daniel J. Aronoff, President, The Landon Companies, Royal Oak, MI, US**

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