
Let's Not Panic Over the Deficit

By Editor Test *Wed, Jun 8, 2011*

"The current weak state of many economies argues against implementing budget cuts in the next couple of years," says a new pamphlet from the Peterson Institute for International Economics.

The new report on government debt by the Peterson Institute for International Economics turns out not to be as alarming as portrayed in a May 28 story in the *New York Times* entitled, "The U.S. Has Binged. Soon It Will Be Time to Pay the Tab."

After reading that story, I ordered the 50-page report to find out what it said, and whether I should start panicking. Personally, I'm against panic. And I think it makes people panicky to compare our national debt to a bar "tab." It isn't. It makes people think Uncle Sam is almost "broke." He isn't.

In terms of sensationalism, the book, entitled, "The Global Outlook for Government Debt Over the Next 25 Years," did not match the *Times* account. For a reality-check, I called the principle author, Joseph E. Gagnon, a Harvard-and-Stanford-trained former Federal Reserve official and senior fellow at the Peterson Institute. Gagnon told me that Morgenstern wrote a good story, but that her headline, with its emphasis on the word "soon," exaggerated his position.

"The major problems won't hit us for another five years, or I'd say five to 10 years. But financial markets are forward looking, and they could get worried. But even financial markets will give us two or three years.

"The situation is alarming in the sense that the problem is very large. [Gretchen Morgenstern] used the word 'soon,' but she also said, in quoting me, that we have some time to deal with it.

"I'm not against deficit spending, especially when you have huge unemployment. What we're doing now is fine. People who are not employed are not being productive, and the cost of that waste is higher than the cost of the deficit.

"Someone has to buy the government debt, but if you're buying the debt, you're not building a factory. Yes, the U.S. Treasury has the Federal Reserve to buy its debt, and any country with a central bank can do that. But there are limits to how much you can borrow."

Gagnon's booklet doesn't blame deficits on a "binge." Here's what it says: "The financial crisis of 2008 brought about the most rapid increase in global government debt since World War II. The International Monetary Fund projects that, between 2007 and 2011, net general government debt (as a percent of GDP) will rise from 51% to 70% in the euro area, from 42% to 73% in the U.S., from 38% to 74% in the U.K., and from 82% to 130% in Japan."

Indeed, the deficit spending that caused this "debt explosion" prevented a global depression by filling the vacuum of demand, and that investors fled to government debt because it was safe, Gagnon and co-author Marc Hinterschweiger go on to say.

Here's what Gagnon writes about the threat from our supposedly impatient Chinese creditors:

“Despite the talk in the U.S. and elsewhere of possible malign motives of Chinese or other debt holders, there is not reason to believe that foreign holders of a country's debt are more likely to sell in a panic than domestic holders. Were China to sell off some of its U.S. government debt out of pique or for political motivation, such a move would hurt China and its export sector even more than it might hurt the United States.”

The book says that if governments of advanced, demographically-aging countries fail to check their fiscal imbalances in the next 25 years—I would add that if their private sectors don't invest productively, put people to work and fortify their tax bases—then they're in for trouble. But the book concludes, “the current weak state of many economies argues against implementing budget cuts in the next couple of years.”

We're in deep deficit because of a financial crisis, imprudent tax cuts and pointless wars, not because we've “binged.” (If we've binged, it's by giving the medical and military industries a blank check for over 40 years). When I hear about government binging, I expect the mailman to whisk through my neighborhood in a tricked-out Hummer. Instead, every morning at 9:30, he arrives at my mailbox in the same battered little white Jeep. It's noisy, and probably needs a new muffler.

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