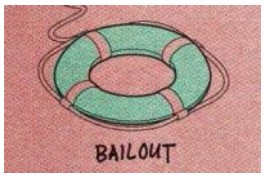
Published on *Adam Smith Institute* (http://www.adamsmith.org)

Article: Blame bailouts for huge budget deficits [1]

Written by **Vuk Vukovic** [2] | Friday 8 February 2013



Among Keynesian economists there is a resilient opinion on how the current large budget deficits shouldn?t be thought of as a serious problem to the economy, since they are ultimately a result of a depressed economy. Here's Paul Krugman:

> ?It?s true that right now we have a large federal budget deficit. But that deficit is mainly the result of a depressed economy ? and you?re actually supposed to run deficits in a depressed economy to help support overall demand. The deficit will come down as the economy recovers: Revenue will rise while some categories of spending, such as unemployment benefits, will fall.?

Disregard for a moment the key issue regarding this type of opinion - which is that in a depression a government is supposed to run large deficits in order to jump-start a recovery. Let's for now focus only on the argument that a deficit is a result of a depressed economy. What Krugman and the like have in mind when they make this claim is the following; because of the crisis and the credit crunch many businesses fail and consequentially unemployment rises. This creates pressures on the budget deficit, since revenues fall as many businesses are bankrupt and are not paying taxes (on both profits and employee taxes), and on the other hand many new unemployed put pressure on the expenditure side, as the government has to pay out more unemployment benefits.

This is all true. All the combined effects of the credit crunch will almost always result in an increased budget deficit. But they will never be so big to make the deficit rise above 10% of GDP as it did in the UK, Ireland or Spain (to mention only a few). Something else was at hand here.

This 'something else' was large government bailouts of fallen banks.

Continue reading. [3]

blog comments powered by Disqus [5]

Source URL: http://www.adamsmith.org/blog/tax-spending/article-blame-bailouts-for-huge-budget-deficits

Links:
[1] http://www.adamsmith.org/blog/tax-spending/article-blame-bailouts-for-huge-budget-deficits
[2] http://www.adamsmith.org/authors/vuk-vukovic
[3] http://www.adamsmith.org/research/articles/blame-bailouts-for-huge-budget-deficits
[4] http://disqus.com/?ref_noscript
[5] http://disqus.com