

[Deficit spending won't save us](#) [1]

Written by [Sam Bowman](#) [2] | Tuesday 22 May 2012



Scott Sumner had another [must-read post](#) [3] on his blog, [The Money Illusion](#) [4], last week. (Sumner is also the author of our report, [The Case for NGDP Targeting](#) [5].) Contrasting 'Country A' and 'Country B', he asked which one looked like it was implementing austerity and which one fiscal stimulus: Country A, with a deficit of 8.8% and 8.2% unemployment, or Country B, with a budget *surplus* of 2% and 7.3% unemployment.

One of the countries is the UK, and one is Sweden. But, according to arch-Keynesian Paul Krugman, 'Somebody has been practicing harsh spending-side austerity' and it's not Sweden. And, 'Given that public investment is, you know, productive, [Britain] is almost surely a case of self-defeating austerity.'

But, of course, the deficit sizes tell a completely different story. In fiscal terms, deficits are what matter in the Keynesian framework, because they reflect the 'extra' amount of money the government is adding to the economy. 'Austere' Britain is Country A, with a 8.8% deficit; 'stimulating' Sweden is Country B, with the 2% budget surplus. As Sumner asks,

If you are not a committed ideologue on either side, just look at the data provided up top. Does Country A really look like savage austerity? Does country B look like a country engaged in fiscal stimulus?

Sumner argues that Sweden's success is thanks to a Central Bank that provided monetary stimulus back in 2009. There's a large contingent of people who claim that the government's cuts are hurting the economy, but seem completely ignorant of the fact that, in the Keynesian model, monetary expansion should be able to completely offset fiscal contractions.

That's not a model I subscribe to, but the so-called 'Keynesians' who seem to think that there exists some kind of 'real' aggregate demand simply don't know what they're talking about. As Sumner says, 'If monetary stimulus makes fiscal stimulus unnecessary (and it does), then why would Britain want to do fiscal stimulus??'

There is another question here for the anti-austerity people to answer: if an 8% budget deficit isn't enough to stimulate the economy, how big does it need to get? We already have a bigger deficit than any of the Eurozone basket-cases but, even if we set aside reality for a moment, I'd love to hear how big the anti-cuts crowd think the deficit would need to get before we have some growth.

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