

We Need a Bigger "Deficit"

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* Nobel Memorial Prize recipient William S. Vickrey passed away on October 14, 1996. This previously unpublished paper appears here with the kind permission of Mrs. Cecile Vickrey.

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THE SO-CALLED "DEFICIT"

We are not going to get out of the economic doldrums as long as we continue to be obsessed with the unreasoned ideological goal of reducing the so-called deficit.

The "deficit" is not an economic sin but an economic necessity.

Its most important function is to be the means whereby purchasing power not spent on consumption, nor recycled into income by the private creation of net capital, is recycled into purchasing power by government borrowing and spending. Purchasing power not so recycled becomes non-purchase, non-sales, non-production, and unemployment.

A PRIVATE CAPITAL APPROACH TO FULL EMPLOYMENT

We have not had a satisfactory approach to full employment, except in wartime, since 1926. Over much of this century trends in the ratio of profitable private capital to national product have been downward, as a result of capital-saving innovation such as fiber optics, the trend to light industry away from steel mills and other heavy industry, and the increasing importance of services. Prospects are that for the foreseeable future the capacity of private industry to find profitable use for private capital will be not much greater than two years of gross domestic product.

On the other hand aspirations of individuals to acquire assets to provide for retirement and other purposes have been growing, due to longer life expectancy, higher retirement aspiration levels, the loosening of family ties, the development of expensive medical technologies, and other factors. Current aspirations appear to be moving towards three years or more of gross domestic product. This leaves a gap to be filled by government debt of about one year of gross domestic product.

GOVERNMENT DEBT TO FILL THE GAP THE PRIVATE SECTOR CANNOT FILL

If we aspire to a satisfactory level of full employment by 1998, whereby anyone not too finicky about the type of work could find a job at a living wage within 48 hours, this will, if we assume inflation to average about 3%, call for a gross domestic product of about 10 trillion dollars. To fill the gap between the asset aspirations of individuals at this level of income and the ability of the private sector to provide assets, the supply of government securities would have to rise to 10 trillion dollars, implying a level of income recycling by governments of about one trillion a year on the average over the next five years.

PAYING FOR THE DEBT THAT FILLS THE GAP

Once this level is reached, to continue in equilibrium the supply of government securities will need to grow *pari passu* with the gross domestic product, to correspond to the gap between the demand of the population for assets and the provision of assets by the private sector. Whatever interest charges on the debt are not financed out of this growth in the debt can more than be met out of savings in unemployment insurance payments, and the increased tax revenues derived from the larger national product at rates no greater than at present. A 10 trillion debt with a full employment economy will be far easier to deal with than a 5 trillion debt with an economy in the doldrums.

WHAT IF THE GAP IS NOT FILLED?

If governments fail to fill the gap and meet the demand for assets by issuing an adequate volume of securities, the attempt by individuals to acquire assets by non-spending will cause a reduction in sales, temporary investment in excess inventories, cutbacks in orders, unemployment, and reduced national income and product. This may

be partially offset by the bidding up of asset values, leading to a certain amount of additional spending out of capital gains, but the "saving" imbedded in these capital gains does not involve the creation of new capital or the employment of individuals in construction. The reduction in interest rates could in principle increase "deepening" types of investment in labor-saving technology, but after the initial stimulus the effect on employment tends to be negative. Little "widening" investment is likely to take place regardless of reduced interest rates if the market for the product is not there. There is a serious danger that the bidding up of asset prices could create a bubble of unsustainable values that is likely to collapse disastrously, as occurred in 1929 after the budget surpluses of the preceding years. Sooner or later a reduction in production and national income will set in until the reduction in income reduces the demand for assets to conform to the supply.

TANGIBLE REAL EFFECTS

Reducing the "deficit" may reduce the debt of the government, but it also reduces the supply of assets people want to acquire to take care of their security needs. Reducing the "deficit" does not improve the real heritage left for the future, rather it impairs that heritage by leaving a legacy of inexperienced workers, impaired infrastructure, and reduced investment in plants because of reduced demand for the products, to say nothing of the impact of unemployment on health, delinquency, crime, and broken homes.

The "deficit" is not even calculated on a businesslike basis. It makes no distinction between current account and capital account items. If GM, AT&T, and the nation's households had been compelled to "balance their budget" calculated in the way

the federal budget is calculated, we would now have many fewer automobiles, telephones, and houses.

INDIVIDUAL SAVING (ABSENT STRONG DEMAND) IS COUNTERPRODUCTIVE

Urging individuals to save more is counterproductive. Individual saving does not mean that funds are created out of thin air to put into savings accounts or the capital market; for most individuals savings is non-spending which becomes the non-income and reduced savings of the vendor. Funds are transferred from the bank account of the vendor to the account of the saver, there is no increase in total money in the bank, and no facilitation of investment, while reduced market demand will actually discourage investment. Savings are neither a prerequisite nor an inducement for investment. Rather, non-spending by reducing market demand lowers incentives to invest.

PROFITABLE INVESTMENT AND SAVING

On the other hand if a businessman can show good prospects for profitable investment he can nearly always get credit and proceed with the investment, which will constitute an increase in someone's wealth which is ipso facto savings. Supply does not create its own demand as soon as some of the income generated is saved, but investment does create its own savings, and more.

INFLATION AND FULL EMPLOYMENT

Eventually, in all likelihood, we will have to find some way of dealing with the threat of an unacceptably high rate of inflation that does not involve the maintenance of what Marxists used to call "the reserve army of the unemployed." For the moment, however, that threat seems sufficiently remote that we could proceed with the first steps

towards full employment and deal with that bridge when we come to it. There has been no dearth of plans for controlling inflation in ways that preserve the essence of free markets.

WE HAVE THE RESOURCES BUT REFRAIN FROM USING THEM

The administration is trying to bring the Titanic into harbor with a canoe paddle, while Congress is arguing over whether to use an oar or a paddle, and the Perot's and budget balancers seem eager to lash the helm hard-a-starboard towards the iceberg. Some of the argument seems to be over which foot is the better one to shoot ourselves in. We have the resources in terms of idle manpower and idle plants to do so much, while the preachers of austerity, most of whom are in little danger of themselves suffering any serious consequences, keep telling us to tighten our belts and refrain from using the resources that lie idle all around us.

ALEXANDER HAMILTON, WILLIAM JENNINGS BRYAN

Alexander Hamilton once wrote "A national debt, if it be not excessive, would be for us a national treasure." William Jennings Bryan used to declaim, "You shall not crucify mankind upon a cross of gold." Today's cross is not made of gold, but is concocted of a web of obfuscatory financial rectitude from which human values have been expunged.