J. Bradford DeLong: Debt Derangement Syndrome

Standard policy economics dictates that the public sector needs to fill the gap in aggregate demand when the private sector is not spending enough. After a decade of denial, the Global North may finally be returning to economic basics, **writes J.Bradford Delong**

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A state of 'high madness'

For the past decade, politics in the Global North has been in a state of high madness owing to excessive fear of government debts and deficits. But two recent straws in the wind suggest that this may at long last be changing.

Earlier this month, I read a Brexit-related column in The Sunday Times of London by the eminent and highly knowledgeable Ken Rogoff. He is perhaps best known for his declarations early in this decade that governments should not let their debt-to-GDP ratios rise above 90%. But here, Rogoff mused that it had "never been remotely obvious to [him] why the UK should be worrying about reducing its debt-GDP burden [currently 84%], given modest growth, high inequality and the … decline in … interest rates …"

This followed a Financial Times article late last month by the journalist Brendan Greeley, who reported receiving what he called "a panicked email" from the Committee for a Responsible Federal Budget (CRFB), a US think tank that once gave a fiscal responsibility award to Paul Ryan, the then-chair of the US House of Representatives Budget Committee. In its email, the CRFB warned against "mischaracterizations" of an address by my old teacher Olivier Blanchard to the American Economic Association, in which Blanchard essentially said that public debt is a tool governments should use when they need to.

Standard policy economics

What Rogoff and Blanchard are saying today is standard policy economics. In fact, I always found it hard to believe – and still do – that anybody can take exception to it. Whenever the private sector stops spending enough to keep unemployment low and jobs easy to find, the public sector needs to fill the gap in aggregate demand. The normal way to do this is for the central bank to buy bonds for cash, inducing those who then have the extra cash to boost their spending. But if and when interest rates approach rock bottom, the private sector's desire to spend extra cash rather than hold it ebbs. In that situation, monetary stimulus should be aided by fiscal stimulus: in other words, the government directly buys stuff.

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This may lead to fears that public debt would rise "too high," so that issuing more debt to finance additional government purchases would represent a bad deal, even if it boosted employment. But the deal would be bad only if the government had to borrow at a high interest rate, as was the case at the start of the 1990s. And the deal would be risky only to the extent that the government might have to roll over its debt at a high interest rate. Thus, the bond market would signal when the deficit needed to be cut, and the debt-to-GDP ratio placed on a downward trajectory.

Simple and obvious, or 'fringe'?

The principle that the cost of debt is measured by the interest rate charged would seem simple and obvious. And yet for the past decade – until now – public debate in the Global North has regarded this as a fringe, "ultra-Keynesian" belief.

I date the full flowering of this affliction to January 27, 2010. That evening, in his State of the Union Address, then-US President Barack Obama announced that it was time for the government to tighten its belt, that he was going to freeze government spending, and that he would veto bills passed by the then-majority-Democratic Congress that overstepped his red line. At the time, my first reaction was that issuing a veto threat against his two chief lieutenants, House Speaker Nancy Pelosi and Senate Majority Leader Harry Reid, was a unique way of building intra-party comity, and a previously unheard-of way of maintaining a functioning governing coalition.

Obama's former economic-policy staffers say that he was the Global North's most rational and best-behaved ruling politician in the first half of this decade. And they are right. But it is a powerful indicator of those debt-fearing times that Obama's address – delivered when the US unemployment rate was still 9.7% – went against John Maynard Keynes's 1937 observation that "the boom, not the slump, is the right time for austerity at the Treasury."

It is still not clear to me why the Global North fell into this fit of denial of basic economic principles. Clearly, the interest rate is a measure of the cost of debt and deficits. Equally clearly, austerity is inappropriate when unemployment is high. But with the likes of Rogoff and Blanchard weighing in, I now have hope that future economists will remember the sorry history of this past decade and prevent it from being repeated.

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