Worldwide Fiscal Crisis: Fact or Fiction?

John T. Harvey  
Texas Christian University and the Binzagr Institute for Sustainable Prosperity

Pundits and policymakers throughout the world are calling for drastic reductions in government budget deficits. Their fear is that the weight of accumulating debt will lead to disaster as it drives up interest rates, causes inflation, and forces defaults. What may appear to be reasonable policy today, they caution, will bring catastrophe in the not-too-distant future. The groundswell of fear is so great that it has generated grass-roots campaigns and political movements calling for budget balancing.

These are not the only voices, however. Just as vehement are those arguing that the real danger lies not in increasing, but reducing deficits and debt levels. They say that government spending is, by definition, private sector earning and that warnings regarding national bankruptcies are based on a flawed understanding of modern fiscal budgeting and financial markets. They point to the unemployment and stagnation created by austerity programs as evidence of what reducing spending and raising taxes really accomplishes.

Who is right and who is wrong is not just an academic matter but one of practical and fundamental importance. If the budget-balancers are correct, then the unemployment rates of 25% in Greece, 23% in Spain, 13% in Portugal, and 10% in Ireland are simply the short-run price paid for a stronger future. If they are wrong, however, then not only are millions of people suffering needlessly, but the very foundation of political democracy and international cooperation is being threatened.

The arguments put forward by the scholars invited to contribute to this issue lean heavily toward the latter view. In their opinion, we are headed toward disaster. L. Randall Wray opens the discussion by taking on just one of the many flaws he sees in the austerity movement’s argument, that is, the assumption that a sovereign nation with debt denominated in its own currency can be forced into bankruptcy. Not only is this patently false, he says, but there was a day not too long ago when this was common knowledge in the economics discipline. It is to our detriment that this simple wisdom has been lost. Wray offers a number of historical and contemporary examples to support his view.

Scott T. Fullwiler continues along these same lines, looking closely at what fiscal sustainability really means. Like Wray, he criticizes the mainstream view for ignoring real-world practices and institutions in their models. Fullwiler’s extremely well-researched alternative not only soundly rejects their approach, but builds a counter argument with roots in the accounting and monetary operations actually employed in modern economies. There are no helicopters in his explanation of the money-supply process.

William Mitchell’s paper, while entirely consistent with those of Wray and Fullwiler, looks more specifically at the European Union. Mitchell starts by reminding the reader of one of the original purposes of that economic experiment: peace on a continent that had seen centuries of warfare, including the most destructive conflict in human history. In that it has been enormously successful – but for how much longer? Mitchell argues that a fundamental revision is necessary if the EU is to survive, and that revision must be based on the idea that austerity is both economically ignorant and politically divisive.

Finally, the contribution from Juan Carlos Moreno-Brid, Noel Perez-Benitez, and Hector Juan Villarreal-Paez points out that the developed world is not the only place where government budgeting is at the center of debate. Developing states, too, must consider public sector revenue and expenditures, but under far more complex conditions. Although the positive impact on aggregate demand remains, financing is problematic when debt is denominated in someone else’s currency, there is a persistent trade deficit, and the exchange rate is pegged. It is for these reasons that Mexico cannot sustain continuous budget deficits in the same manner as the United States, thereby creating a series of painful choices. Either the constraints must be removed or Mexico and other similar developing states—and some developed—will continue to find
themselves struggling to maintain a sufficient level of aggregate demand.

The bottom line is that there is no fiscal debt crisis. That so many believe there to be one is a consequence of the economics discipline’s increasing irrelevance, particularly when it comes to macroeconomics and economic policy. As Wray observes, economists actually know less about government budgeting today than they did fifty years ago. This causes no direct problem for those standing in front of classrooms and publishing papers and earning tenure at universities around the world. Not so for the citizens of the affected countries, however. The world is faced with enough problems as it is without us fabricating one. It is high time that we put the myths to bed and started basing policy on fact and not fiction.

Author contact: j.harvey@tcu.edu

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