MARKETPLACE SHLOMO MAITAL

Do deficits matter?

IT'S ONLY money.

To an economist, that phrase is jarring. After all, money matters. Money makes the world go around, goes the song. But I often proclaim "it's only money" when I and my family attach excessive importance to shekels.

Words matter. Lives matter. Health matters. Of course money too matters – but only up to a point.

Israel's Finance Ministry recently announced that massive government spending during the 2020 pandemic generated a huge leak in the budget bucket – an alarming deficit of 11.7% of Gross Domestic Product, or 160.3 billion shekels ($50 billion), a sum that sharply increases what the government [hence, we the people] owes. You have to go back to the chaos and hyperinflation of 1984 to find a larger deficit; it was 14% of GDP in that tumultuous year.

Deficits often bring inflation, as they did in 1984. But there is little chance of that today when demand and supply are largely in low-level balance.

There is in fact a law that limits deficit spending. The 2020 deficit actually broke that law, but it was circumvented by the fiction of separating coronavirus emergency spending from general government outlays. And the deficit could have been even bigger; the coalition government approved 80 billion shekels in emergency pandemic spending but only managed to spend 68.6 billion shekels of it.

Counting everything, government spending in 2020 came to 487.5 billion shekels, up nearly 20% from 2019. One shekel in seven went for emergency outlays.

As always, the defense budget was bullet-proof, immune to cuts. It ha risen consistently every year and despite urgent civilian needs got an extra 'temporary' addition of three billion shekels (nearly a billion dollars) – that again appears in spending requests for 2021. Some 60% of the defense budget goes to wages.

The economy contracted by an estimated 3.3% in 2020, in contrast to the pre-pandemic forecast of 3% growth. Most of the net 6% contraction came from lower personal consumption, as unemployment and locked-down businesses drove many to tighten their outlays.

Do deficits matter? Should the government have spent more? Or less? Who will pay for the added debt? How does Israel compare to other countries? Let's explore these issues in depth.

History teaches us a lot about budget deficits. In the 1930's, in the midst of a wrenching global depression that drove unemployment rates to 25% in the US and Europe, British economist John Maynard Keynes recommended a very strange policy. Pay people to bury money, he said, and then pay others to find it and dig it up.

What in the world? This, from the world's smartest economist?

Keynes' point, made in an extreme fashion to get attention, was simple. When purchasing power evaporates in a major crisis, only governments can supply it and smash the doom loop of unemployment and contraction. Governments must inject money into the system, in any way shape or form. People will spend the money and the economy will revive itself as a result. Sure, digging up buried money creates no value. But spending the resulting cash will.

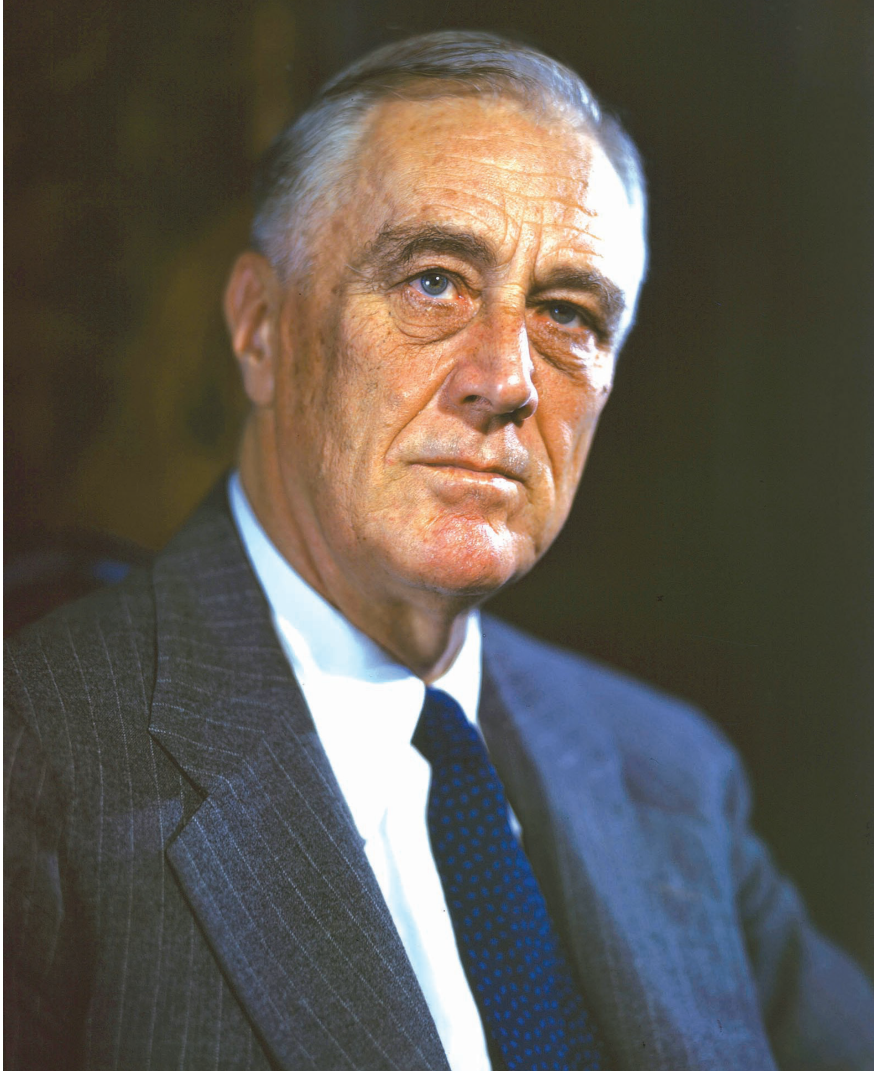
Despite Keynes, and despite US President Roosevelt's vaunted New Deal policy, it was only the massive defense spending generated by World War II that ended the Great Depression of the 1930's.

Today, governments understand what they did not see clearly during the Great Depression of the 1930's. Without massive bailouts, in 2020 many more people would have been destitute and hungry. And despite those bailouts, many still were. Yes, debt grows – but it can be repaid, once the economy gets going again and tax revenues rise. It's only money. Fact is, as Haaretz senior business editor Sami Peretz observed, despite Israel's deficit, our credit rating did not decline.

On the eve of the pandemic, in 2019, fortunately government debt was just below 60% of GDP. So a rise in debt to 70% is tolerable. On the other hand, in the great tradition of two-handed economics, there is a problem here.

Among the world's largest 20 economies, known as the Group of 20, countries are drowning in debt. The average G20 private and public debt together amount to 240% of GDP. Of that, five-eighths, or 150% of GDP, is private debt. With economies still struggling, and many in lockdown, in future people will have a hard time making their mortgage payments, unless the economy recovers fast.

Governments have printed money like there is no tomorrow. In the US, European Union and Japan, central banks have bought more than half of all government debt, issued since Feb. 2020 at the start of the pandemic. When central banks buy government bonds, they write big checks in local currency – this is known colloquially as printing money, though actual paper cash is not in fact printed.



President Franklin Delano Roosevelt (Original color transparency of FDR taken at 1944 Official Campaign Portrait session by Leon A. Perskie, Hyde Park, New York, August 21, 1944. Gift of Beatrice Perskie Foxman and Dr. Stanley B. Foxman. August 21, 1944)

According to the International Monetary Fund (IMF), governments may in future incur added debt when businesses go bust and their debt is assumed by government, in the wake of massive bailouts. Globally, public debt is now equal in size to GDP – the highest level in history. But overall, the IMF claims, "the massive fiscal support undertaken since the start of the COVID-19 crisis has saved lives and livelihoods".

Is there an upper limit to budget deficits? Maybe not. Take Japan for example. Ever since a huge stock market crash in 1990, Japan's central bank has propped up the economy by buying government debt and slashing interest rates. For over a decade, Japan's public debt has been far more than double its GDP (266% in 2020!). Yet Japan's currency and economy are stable.

Not every country can borrow as easily as Israel or other wealthy nations. Poor countries cannot. In emerging market nations, government have not been able to supply badly-needed financial support, because they lack access to credit.

Overall, can we then give Israel's fractious government high marks for its fiscal policy? Not according to Haaretz's Peretz. The so-called unity government never passed a budget, because Prime Minister Netanyahu insisted on an escape hatch to keep his rival Benny Gantz from succeeding him in November, as the coalition agreement calls for. If Israel's credit rating is indeed lowered, Peretz observes, it will be because the government (now a transition government) has no economic plan and never did pass a budget for 2020.

In the past Finance Ministry civil servants have been fiscal "Peters" holding their fingers in the crumbling dike of government spending. But no longer. There has been a wave of departures of talented professionals from the ministry. Former Director-General Keren Terner-Eyal, who worked with Finance Minister Israel Katz for years in the Transport Ministry, quit last October. This followed a barrage of criticism from Katz, who claims only elected officials should have any say.

Katz has now proposed appointing a new Director-General, Oded Shamir, a long-time Katz sycophant who is unlikely to oppose anything his boss demands, after the temporary Finance head Eran Yaakov resisted Katz's spending demands. With elections due in March, it is unlikely the fractious cabinet will officially approve Katz's proposed appointee.

Perhaps we can learn about emergency deficit spending from US President Roosevelt. In his campaign speech in Pittsburgh, in 1936, FDR had to explain his large budget deficits: "To balance our budget in 1933 or 1934 or 1935 would have been a crime against the American people. To do so we should either have had to make a capital levy that would have been confiscatory, or we should have had to set our face against human suffering with callous indifference. When Americans suffered, we refused to pass by on the other side. Humanity came first." Roosevelt won re-election in a landslide that year, with 61% of the popular vote and nearly all the electoral college ballots.

Humanity comes first, in times of great suffering. It is incumbent on Israel's political leaders to ensure that the deficit spending reaches those who truly need it most and that it is sufficient to mitigate their suffering. When good times return, the fiscal cleanup can begin in earnest. ■

The writer heads the Zvi Griliches Research Data Center at S. Neaman Institute, Technion and blogs at www.timnovate.wordpress.com