Governments are running an anti-productivity agenda

One of the most annoying and destructive narratives from mainstream economists in the last decade has been that government debt doesn't matter. It's commonly trotted out that as interest rates are so low, there's almost no cost in borrowing so governments should just go ahead and run deficits, spending freely. Those who make these arguments fail at the basic job of the economist, which is to point out not just the immediate and the seen, but the long term and the unseen. This task was laid out by Frederic Bastiat around 170 years ago in his famous Broken Window Fallacy.

Two articles this week got some decent coverage that made some of the obvious counterpoints. First, several high profile economists noted that deficits aren't free and that they are the old ripping off the young. At a minimum there's the interest to pay in the future and there's also the possibility that interest rates rise making the debt cost more than expected. The intergenerational issue is often overlooked, with this paper liking the passing on of debt to young people as a form of Ponzi scheme.

The second article makes the point that the advice of mainstream economists leads to outcomes like Lebanon. Lebanon has been running up debts and printing money, with low and middle income earners seeing their spending power evaporate as their currency collapses. This is one of the obvious examples that MMT's proponents like to ignore.

At a deeper level, the greatest problem of excessive government spending is that it replaces more efficient and productive private sector spending. As Milton Friedman pointed out, the most wasteful spending is when someone is using other people's money to buy things for other people, as they neither face the sting of the bill or the frustration of a dud purchase. There's no lack of examples across welfare, healthcare and particularly defence spending of this problem, with no shame shown in blatant pork barrelling.

Similarly, the last decade of central bank stimulus has also detracted from productivity. Cheap and easy debt encourages businesses to focus on M&A and optimising their capital structures, which produce short term share price bumps, rather than long term innovation and investment. Consumers are punished for saving (particularly after tax and inflation), so they borrow to buy property and spend freely. The current central bank obsession with increasing inflation ignores the basic fact that productivity growth reduces inflation (consumers can buy more goods and services for the same amount) and that's a great outcome that brings economic prosperity, which is one of the RBA's stated aims.

The abysmal outcomes on productivity for Western nations over the last 20 years are often lamented, but the obvious causes are ignored. We need savings to make the investments that will increase productivity. Using debt fuelled spending to drag forward consumption is counterproductive in the long term, it leads to stagnation not innovation.

Written by Jonathan Rochford for Narrow Road Capital on 10 July 2021. Comments and criticisms are welcomed and can be sent to info@narrowroadcapital.com

Disclosure