

Government deficits create private wealth

<https://www.taxresearch.org.uk/Blog/2024/08/04/government-deficits-create-private-wealth/>

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I have published the latest video in the Economic Truths series this morning. In it, I argue that it's widely claimed that our national debt threatens the well-being and stability of the UK, which is quite absurd when the national debt exactly equates to the value of private wealth that the government has injected into the UK's economy. Why is it that those talking about the national debt do not seem to know this stuff?

<https://www.youtube.com/watch?v=WLMIpRLRKc8>

The audio version of this video is here:

https://www.podbean.com/player-v2/?i=7ck5p-168cc44-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=8bbb4e&font-color=&logo_link=episode_page&btn-skin=ff6d00

The transcript is:

Government deficits create private wealth. That's what the government's own data tells us. The data I'm talking about is the information published on what are called the sectoral balances.

Now these things matter, although very few people seem to understand them. In every budget report there is a sectoral balance graph published and it looks like the chart I am now putting on the screen.

There it is. A pretty graph with four lines on it. The lines in question represent the four sectors of the economy. As you will see, the blue line is the government. The yellow line

is households. The purple line is the rest of the world. And the green line is business. And, according to a theory created in the 1990s, which I think is entirely valid, those four between them represent all the sectors of the economy that we need to consider when we are talking about what are called the sectoral balances.

And the sectoral balances represent which part of the economy is lending to which other part of the economy, or if you turn the thing on its head, which part of the economy is borrowing from which other part of the economy, because as a matter of fact every lender requires a borrower, and vice versa.

So, one of the things that is obvious about this chart - and the chart in question runs over the period from 2010 to 2029, although let's be clear that the greyed-out bit on the right-hand side is very obviously, as a consequence, a projection. What is very obvious about this projection. is that if you add all the numbers together, they come to nothing. And there's a good reason for that. If every borrower requires a lender, and vice versa, then all borrowing must equal all lending. And everything on this chart is denominated in sterling.

So, what we see - and let's look at one particular period - which is that in 2021 - households suddenly had massive savings and at the same time, the government had the most enormous deficit.

Why did the government have an enormous deficit in 2020/21? Well, that's very obvious. It was paying for the furlough scheme and everything else that supported the economy during the Covid era.

At the same time, businesses and households could not spend money. Businesses could not invest because there was nothing to buy. Households couldn't get out of their own homes to go and spend money. As a consequence, they saved enormously.

Now, did the government's deficit create the savings? Or did the savings create the deficit? That's a really good question because what is apparent is that we can look at this chart in both ways.

The way that most people want to look at it, who are at least enlightened when it comes to economics, is to suggest that government deficits create private wealth.

And that's very obviously true. If you look at this chart, whenever the government is running a deficit, the amount of private wealth goes up. People are owed money. Owning a debt is private wealth. Savings are debts from whoever you've deposited your money with. Therefore, private wealth has increased.

So, the idea that government deficits are somehow terrible for people is, in this one chart, shot to pieces. Because very clearly, government deficits aren't bad for people. Government deficits are great for people. They have more savings. So, what's the

problem?

There is, however, another way of looking at this, and that is that people's savings and savings by the rest of the world and savings by business create government deficits.

And actually, that's just as true. This chart represents what is called an accounting identity, something that has always to hold true. And if, as a matter of fact, the people of this country decide not to spend, the people who hold sterling from overseas decide to increase their sterling holdings, and business decides not to invest but save its funds instead, then the reality is that if all of those are in surplus - and you will notice that around the Covid era, that was true of all of them - then what happens is that the government has to run a deficit because somebody has to be the borrower of last resort. And the borrower of last resort in our economy is the government via the Bank of England and its central bank reserve accounts that it supplies to our commercial banking system.

So, the fact is that the deficit is not within the control of the government. The deficit is, instead, within the control of the private sector.

If the private sector decides to borrow to spend, the government has a small deficit.

If the private sector decides to save, the government has a big deficit.

So, whilst you can argue that deficits create private wealth, government deficits are also created by the decisions of the private sector to save. All of these things are true simultaneously.

But unless we understand that there is this, well, symbiotic relationship between all these elements within the economy, we can't understand the economy itself. Nor can we understand what a government deficit really means. And nor can we understand the nature of private wealth, which is, in no small part, related to the scale of the government's deficit.

This is core to your understanding of economics. This chart tells a truth. The fact is, this equation has to work, and therefore it's fundamental to understand it.

Government deficits create private wealth. But, private wealth decides whether the government has a deficit or not. This relationship is fundamental to economics.