Deficit Spending

Name

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Course

Date

**Deficit Spending**

**Introduction**

Deficit spending is a situation where the government’s expenditure outweighs its revenues, resulting in increased government debts. Deficit spending is viewed by economists as a necessary tool for the stimulation of fiscal policy. John Keynes, a British economist, is credited with the introduction of the concept of deficit spending. The government applies deficit spending in cases of recession where consumer income drops, resulting in low spending, and declining employment levels. In order to boost employment, the government increases its expenditures, which raise the level of aggregate demand, and hence prevent increasing the unemployment levels (Kohn & Mitchell, 2012). As a result, the key aim of deficit spending is the prevention or reversal of rising employment rates during a recession.

**Advantages**

Deficit spending increases money in people’s hands. Due to the effect of unemployment, people might find that they have less money to spend. The government could reduce taxation, therefore increasing the amount of income earned by businesses, a factor that will improve employment as the businesses will be able to increase the number of employed people. Government spending aimed at enhancing infrastructure results in increased employment. By increasing the amount of expenditure in infrastructure, the government leads to improved growth in those industries, a factor that increases employment in the targeted industries (Clemens & Miran, 2012). For instance, if the government increases its expenditures in the healthcare industry, more healthcare facilities will be built, a factor that will stimulate employment as employment positions within the healthcare facilities will be needed. Unemployment levels will consequently decline as some of the unemployed persons will get employed in the healthcare facilities. Lastly, deficit spending stabilizes financial markets by bailing out financial institutions. As portrayed by the recent subprime mortgage crisis of 2008, the government had to use money to bail out crumbling financial institutions to prevent them from being phased out of the market. As a result, the institutions could lend out money to individuals and business entities, therefore boosting employment levels and stimulating the economy.

**Disadvantages**

The government’s efforts at boosting unemployment levels and the economy could result in inflation. According to Ulbrich (2013), increased government spending could interfere with how the market works, and due to inflation, people would insist on getting higher wages, therefore weakening the economy. Secondly, increased spending increases the national debt, a factor that would result in financial burdens to future generations. Thirdly, economists indicate that there is a trade-off between unemployment and inflation. In the event that the government increases its deficit spending in order to reduce unemployment, inflation will increase due to an influx of money in the market. Any employment gains experienced are diluted by inflation, which consequently results in increased levels of unemployment as employers will not be able to pay high wages to workers, and as a result, some of the workers will be laid off. This indicates that the impact of increased government spending is only temporary as the markets will convert to the previous employment levels.

**Crowding-out effect**

The crowding-out effect is attributed to economists Bacon and Eltis, who analyzed the UK economy during the 1960s and 1970s. The crowding-out effect states that increases in public sector spending eliminates spending by the private sector. For instance, increases in government expenditure in infrastructure could result in an undesirable environment for private developers. Using the healthcare example given earlier, if the government improves the healthcare infrastructure by building more hospitals, private developers would not be dissuaded from investing in healthcare facilities as they cannot compete with public-funded investments. As a result, the actions of the government could have a negative on the private sector (Hassan & Nassar, 2015). The effect of such an occurrence would be depressing to the economy as the government would collect lower taxes from private entities as it has phased out some of the private developers from the market.

**Conclusion**

In summation, deficit spending hinders long-term economic growth. While the effects of deficit spending assist in short-term economic gains such as the increase in employment levels by boosting infrastructures and financial institutions, the market eventually reverts to its normal situations. For instance, investing in various types of infrastructure leads to the crowding-out effect as private investors are phased out of the market. While the government investments in infrastructure creates employment, the government also creates unemployment in the long-term as the private developers are forced to lay off some of their workers, and the government realizes cuts in taxes due to declining investment activities from private developers. In consequence, deficit spending hinders long-term economic growth as the government creates superficial market conditions that are eventually eliminated.

References

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