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Do deficits matter? We may be about to find out

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In this Jan. 21, 2018, photo, lights shine inside the U.S. Capitol Building as night falls in Washington, and Congress continues to negotiate during the federal government shutdown. The deal that ended the government shutdown also further cut taxes, adding billions more to the national deficit. The tax cuts were a little noticed element of the much discussed deal, which provided funding to keep government agencies operating for about three weeks and renewed a popular health insurance program for poor children. (AP Photo/J. David Ake)

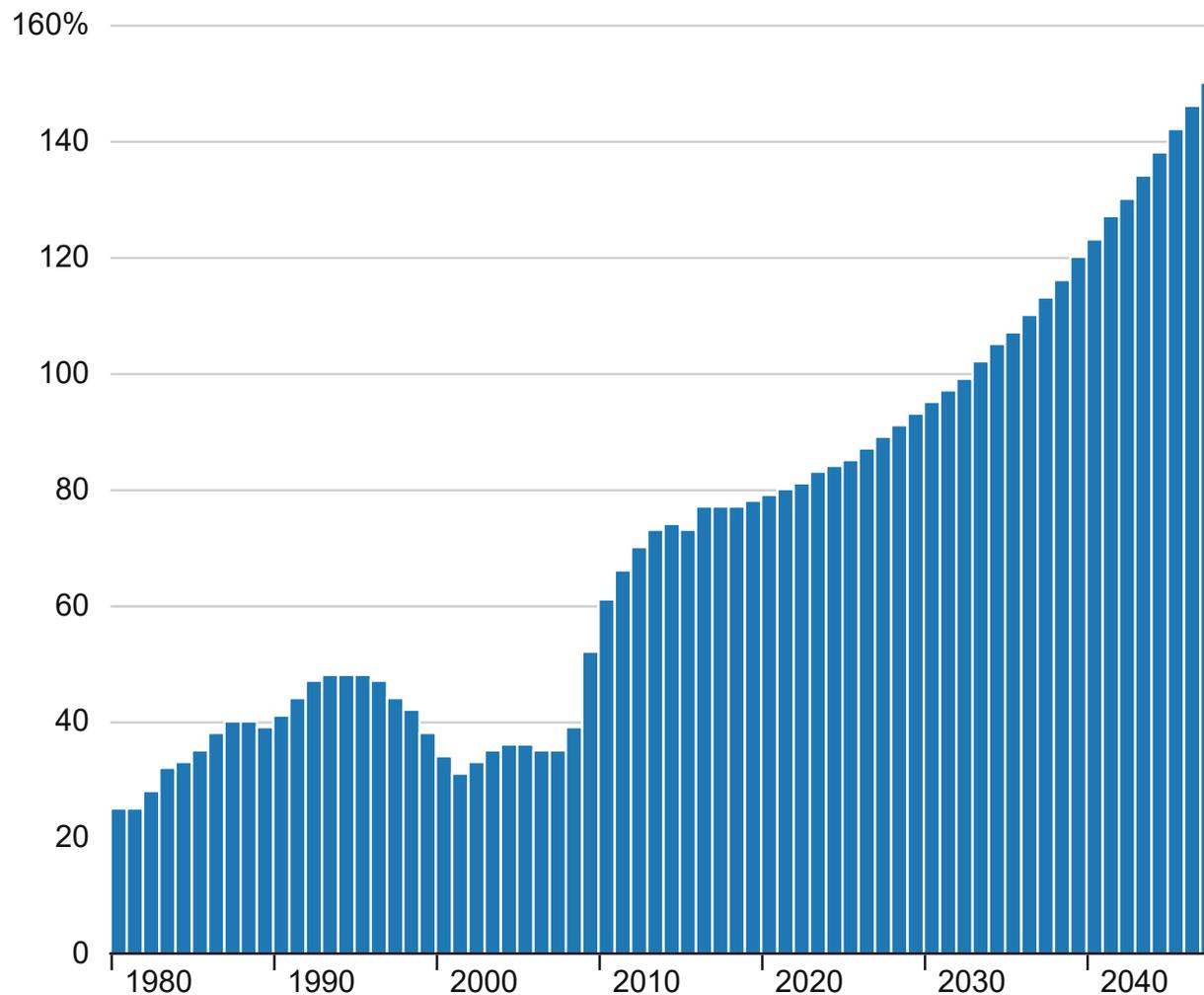
No accounting concept gets mentioned as often, or misunderstood as widely, as the federal budget deficit.

Over the decades, this simple revenue-minus-spending sum has been both praised and criticized for its effects on the economy, and cited frequently as a sign of the nation's moral decline.

One leading moralist, Ronald Reagan, used phrases like “runaway deficits” and “tidal wave of debt.” In proportion to gross domestic product, the national debt grew more than 50 percent during his eight years in the White House.

Federal debt as % of GDP

Includes CBO projections as of March 2017



SOURCE: Congressional Budget Office

The tidal wave has since doubled, but we didn't drown. The U.S. has mostly prospered in the last three decades, and our biggest stumbles, such as the housing bubble, can't be blamed on the federal budget.

Reagan's party seems to have stopped worrying about debt. In the last two months, a Republican Congress and Republican president have given us a tax bill that inflates deficits by \$1.5 trillion over 10 years and a budget agreement that boosts spending at least \$300 billion.

So, does the deficit matter?

The Committee for a Responsible Federal Budget, a nonpartisan policy group in Washington, argues that it does. It says the budget deal will push annual deficits over the \$1 trillion mark "indefinitely" and could result in a \$2 trillion deficit by 2027.

"Deficits make sense at certain times in the business cycle, or if you are making a one-off public investment," argues Maya McGuineas, the committee's president. "That's not why we are borrowing now. We are borrowing for political expediency."

She says inflating the deficit now will make it harder to ramp up borrowing when we hit hard times. Her group estimates that deficits for the next couple of years will be about 5 percent of GDP, a level usually reached only during recessions.

The entitlement problem, caused by the growing number of people who will be collecting Medicare and Social Security, also looms. “We should be getting our fiscal house in order,” McGuineas says. “Instead, this is a fiscal free-for-all where politicians of all stripes are willing to borrow and disregard the consequences.”

Deficit hawks’ problem is that they can’t point to any specific harm from past borrowing sprees. In theory, too much government debt pushes up interest rates and inflation, but evidence of that happening is hard to find.

“You can find high-debt countries that are relatively successful, and you can find high-debt countries that are not very successful,” says Rik Hafer, professor of economics at Lindenwood University.

He says the fact that long-term U.S. growth seems to have slowed, because of lower population growth and a slowdown in productivity, could make a big debt burden harder to bear.

Steven Fazzari, professor of economics at Washington University, is less worried. He thinks inflation fears are exaggerated, and he isn’t concerned about the nation’s ability to service its debt. “It’s not going to be a massive collapse,” he says.

As for worries about responding to the next recession, Fazzari thinks any future stimulus effort will be limited by politics more than finances. If we’re willing to borrow, markets are probably willing to lend.

“If you look at the history, there hasn’t been as big an effect on economic activity as the deficit hawks would suggest,” he adds. “Over the next five or 10 years, I don’t see anything that will change that.”

We’re clearly headed into uncharted debt waters, but Fazzari believes that if our political system can navigate them, so can our economy.