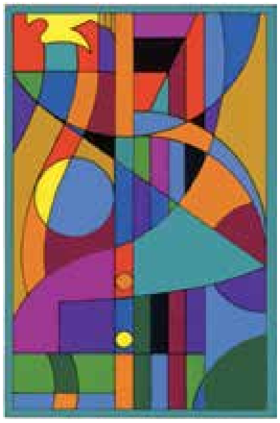

View from the Beltway

Deficits Don't Matter

By Owen Ullmann

At least not for now.

"Nobody cares."

That's what President Donald Trump's budget director and acting White House chief of staff, Mick Mulvaney, reportedly told congressional Republicans during a preview of the State of the Union address in February, when they asked why Trump would not devote a single word to a ballooning federal deficit without precedent during a time of strong economic growth.

He's right about that, politically, at least. Neither Trump nor Georgia gubernatorial candidate Stacey Abrams, who gave the Democratic response to the speech, mentioned the deficit. In fact, hardly any elected politician of either party talks about the deficit.

There was barely a ripple of comment in Washington when the total U.S. federal debt surpassed the $22 trillion mark in mid-February, or when the debt bumped up against the congressionally mandated debt ceiling on March 2. In addition, Trump, who promised as a candidate to reduce the national debt, showed no remorse for proposing a new budget plan on March 11 that foresees annual deficits of $1 trillion or more through at least 2022.

The issue was ignored during the 2018 midterm elections by candidates as well as voters, and the recent actions of both parties in Congress show they certainly don't care about the deficit now.

Balanced-budget fervor among Republicans persisted, prompting Reagan's successor, George H.W. Bush, to retreat from a seminal campaign pledge and endorse a tax hike.

While in control of both the House of Representatives and the Senate, Republicans enacted a $1.5 trillion tax cut projected to add $1 trillion to the deficit even after accounting for increased economic activity, and they gave a generous boost to the Defense Department. More recently, newly elected Democrats vowed to fight "PAYGO"—the pay-as-you-go rule requiring offsets for increased outlays—so lawmakers won't be hamstrung by the cost of social welfare programs they are eager to enact.

It seems the only time Washington's politicians care about the deficit is when they are attacking their opponents for being fiscally profligate. Republican conservatives created the Tea Party and House Freedom Caucus to counter President Barack Obama's Affordable Care Act and stimulus programs aimed at combating the Great Recession of 2007–2009. Democrats, for their part, have hammered Trump and congressional Republicans for enacting the massive tax cut in late 2017.

Republican disregard for deficits is hardly new. A balanced budget had long been GOP orthodoxy, in contrast to Democrats' belief in Keynesian stimulus policies, but President George W. Bush's administration shrugged off concerns about amassing red ink when

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it pushed through a major tax cut, turning a budget surplus inherited from President Bill Clinton into a massive deficit within a few years.

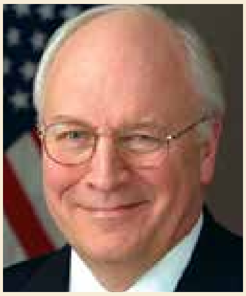
Did the widening deficit upset Bush and company? Hardly. Bush's former Treasury Secretary, Paul O'Neill, revealed in a 2004 book that he had warned Vice President Dick Cheney the swelling red ink risked derailing the economic expansion. "Reagan proved deficits don't matter," Cheney replied, according to *The Price of Loyalty: George W. Bush, the White House and the Education of Paul O'Neill* by journalist Ron Suskind. "We won the midterms. This is our due."

That viewpoint represents quite a change from bipartisan presidential policies twenty-five years earlier. President Jimmy Carter submitted a frugal 1979 budget with a small deficit because of pressure from Republicans and financial markets. Then, in 1980, Ronald Reagan won the presidential election by making a balanced-budget pledge a key plank of his campaign. Once in office, however, Reagan saw deficits explode because of his tax cuts, defense spending buildup, and a recession in 1981–1982.

Reagan lived with huge deficits throughout his presidency—to the dismay of his first budget czar, David A. Stockman—mainly because the red ink never produced the economic calamity Stockman and other deficit hawks had predicted would befall the nation.

Still, balanced budget fervor among Republicans persisted, prompting Reagan's successor, George H.W. Bush, to retreat from a seminal campaign pledge and endorse a tax hike along with spending cuts to put the federal budget on a path toward balance.

Bush's fateful tax increase—though relatively modest—provoked such anger among many of his party's anti-tax diehards that he lost his re-election bid in 1992 to Clinton. Bush's campaign was not helped by third-party candidate Ross Perot, whose overarching promise was to balance the budget.



Former Vice President **Dick Cheney:** *"Reagan proved deficits don't matter. We won the midterms. This is our due."*

MICHAEL VADON

Former Ohio Governor **John Kasich:** *"Do deficits matter or not?" "Because if they do… then the U.S. economy and all of us who depend on its well-being are in deep trouble unless we turn things around fast."*

Former IMF chief economist **Olivier Blanchard:** *"Put bluntly, public debt may have no fiscal cost. If the spending is well planned, the benefits are likely to exceed the costs."*

Former Treasury Secretary **Lawrence H. Summers,** *who presided over several balanced budgets: "Deficits should not cause policymakers much concern, at least for now."*

Former Fed Vice Chair **Donald Kohn:** *"It doesn't make sense to me that we can grow our debt-to-GDP ratio without some limits. The risk is too great."*

Maya MacGuineas *of the Committee for a Responsible Federal Budget: "I see the rise of free-lunch economics all around. We will eventually reach a tipping point. When we find out when that will be, it will be too late."*

Clinton pushed through a tax increase early in his presidency, and that, combined with a booming dot.com economy, produced budget surpluses at the end of his term—the first in three decades.

That's the last time any President or Congress made a good-faith effort to achieve a balanced budget, a fact that has infuriated old-time Republican budget hawks such as former Ohio Governor John R. Kasich, who was chairman of the House Budget Committee from 1995 to 2001.

In a column published in the *Washington Post* December 18, Kasich wrote: "Do deficits matter? Clearly, the White House and a substantial number of congressional Republicans can't decide. On one hand, they sound like cost-cutting deficit hawks when out on the stump or issuing tweets. But once the TV lights go off, they turn tables to support record spending and deficit-driven borrowing that have left us with an unprecedented burden of national debt."

"So, which is it? Do deficits matter or not?" Kasich asked. "Because if they do—and I count myself in that corner—then the U.S. economy and all of us who depend on its well-being are in deep trouble unless we turn things around fast."

"It's a mystery to me why political leaders and commentators who fashion themselves as conservatives could think or act otherwise," added Kasich, who lost the GOP nomination to Trump in 2016 and is eyeing a primary challenge in 2020. "When workers, businesses, and entrepreneurs use savings to pay for increased government spending and borrowing, that leaves them with less to invest in small businesses or initiatives; less for capital improvements and innovations that enhance productivity; and less to put aside for inevitable downturns or unforeseen events. The bottom-line result is less growth and innovation—and pressure to take on even more debt."

Kasich raises the traditional economic argument against deficit spending. Yet there appears to be scant evidence that deficits have harmed the U.S. economy over the past fifty years. During that time, the federal government has accumulated $15 trillion in publicly held debt, and net interest payments have exploded from $13 billion in 1969 to $325 billion in 2018, according to the Congressional Budget Office.

Even some traditional fiscal conservatives at the Fed acknowledge that the negative impacts of chronic deficits and mounting debt have dissipated.

Today the United States is on track to record the longest expansion in history come July, topping the tech-driven expansion of the 1990s. Unemployment is the lowest in fifty years and inflation—which deficit hawks had predicted would explode as a result of all the debt creation—has remained around 2 percent with no signs of rapid escalation in the near term. In addition, long-term Treasury yields have remained low, also defying the hawks' predictions of rising rates needed to attract lenders for all that debt.

It is true that productivity, business investment, and technological innovation all lag compared to the 1990s boom, but there is no direct evidence that the growing national debt is the culprit. Moreover, the financial crash of 2007–2009 can't be blamed on deficit spending. In fact, it was the huge Keynesian deficits and extraordinary monetary accommodation by the Federal Reserve that pulled the U.S. economy out of its free-fall following the collapse of the subprime market.

Casting even more doubt on the link between deficits and weak economic performances is a new, controversial assessment by respected French economist Olivier Jean Blanchard that says the growing U.S. debt poses no foreseeable risks.

Blanchard served as chief economist at the International Monetary Fund and is now a senior fellow at the Peterson Institute for International Economics. As the outgoing president of the American Economics Association, he contended in a speech to the group's annual conference in January that the U.S. economy's growth rate should exceed the real interest rate over the long term. "This implies that … the issuance of debt without a later increase in taxes may well be feasible," he said. "Put bluntly, public debt may have no fiscal cost."

"While interest rates on public debt vary a lot, they have on average, and in most decades, been lower than growth rates," he explained. If the future is like the past, the probability that the U.S. government can do a debt rollover—that is, issue debt and achieve a decreasing debt-to-GDP ratio without ever having to raise taxes later—is high."

Blanchard's address included a caveat: The fact that "debt rollovers may be feasible does not imply however that they are desirable" and could adversely impact capital accumulation unless there are "good reasons" to approve deficit spending. "If the spending is well planned, the benefits are likely to exceed the costs," he said.

That argument has emboldened economic progressives who have long argued that fiscal austerity is bad for the economy and that smart government deficit spending "investments" in people (such as education) and infrastructure (such as improved transportation) are more productive.

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Even some traditional fiscal conservatives at the Fed acknowledge that the negative impacts of chronic deficits and mounting debt have dissipated at a time when there are more investors than ever in an expanding global economy and U.S. debt is in greater demand than ever before as a safe haven.

"The U.S. dollar as a global currency and asset is a privilege that allows us to issue debt at lower rates," said one senior Fed official. "In the last ten years, the credit of other countries has been downgraded. That uncertainty has made U.S. bonds more important" to investors.

The "don't worry about deficits" crowd includes such fiscally responsible figures as Clinton Treasury Secretary Lawrence H. Summers, who presided over several balanced budgets. In an essay he wrote in the March/April 2019 issue of *Foreign Affairs* with Jason Furman, chair of Obama's Council of Economic Advisers, the pair argue that fiscal austerity solely to reduce the debt is bad policy. Rather, they advocate wise "investments" in areas such as health, education, and infrastructure that may result in larger deficits, so long as interest rates remain low and the debt does not grow too fast.

Furman and Summers note that real interest rates are extraordinarily low: 0.8 percent on a ten-year Treasury bond in 2018 compared to 4.3 percent in 2000. As a result, the cost of servicing a slightly higher debt is a bargain if the increased spending is a productive investment. They also contend there is no evidence that deficits are causing the country economic harm. Thus, they conclude, "Deficits, then, should not cause policymakers much concern, at least for now."

A more radical "deficits be damned" group embraces so-called Modern Monetary Theory, which believes governments that can issue debt in their own currencies don't have to worry about accumulating debt that constrains spending on worthwhile but expensive federal social programs. While they recognize that free-wheeling spending during boom times can spark inflation, they argue that the government can rein in inflation through tax increases that curb aggregate demand.

Underpinning these arguments is the belief that low inflation and interest rates are the new normal globally and will remain low thanks to continual technological breakthroughs and efficiency from globalization. After all, Japan has a debt burden greater than that of the United States but has serviced it for decades without any deleterious economic impact. Similarly, other developed nations with higher debt ratios than that of the United States also have managed to service them in the current low-inflation environment without major problems. So why worry about the growing U.S. debt?

While deficits certainly don't matter now either politically or economically, there must be some limit to how much U.S. debt can grow before it starts to matter again. As a percent of GDP, publicly held U.S. debt has grown from 28 percent in 1969 to 78 percent in 2018, according to the Congressional Budget Office, which projects it will exceed 90 percent within a decade unless major changes in tax and spending policies are enacted.

"It doesn't make sense to me that we can grow our debt-to-GDP ratio without some limits," said former Fed Vice Chair Donald Kohn, now a senior fellow at the Brookings Institution. "The risk is too great."

The risk is even greater when you consider total global debt—government, consumer, and business. It has exploded during this time of low interest rates to more than $250 trillion, or 300 percent of global GDP. We know China's debt is a ticking time bomb and countries around the world, from Argentina to Zimbabwe, are up to their eyeballs in debt. So long as interest rates stay low, there's no problem. But no economic trend—good or bad—lasts forever. When rates eventually start rising, we could see a string of defaults that precipitate a new financial crisis that drags the United States down.

Indeed, even Blanchard based his assessment on a continuing trend of low interest rates, which he acknowledged is not assured. As former Fed Chairman Alan Greenspan often warned, the biggest mistake economists make is projecting into the future trends that occurred in the past without accounting for unexpected events.

In addition to Kasich, another Cassandra warning about the dangers of following the "deficits don't matter" crowd is Maya MacGuineas, president of the Committee for a Responsible Federal Budget, a bipartisan, non-profit group whose mission is to sound the alarm and arouse the public anew about the dangers of deficits.

"The disappearance of fiscal policy reflects how broken our government has become," MacGuineas lamented. "Our debt ratio is the highest since World War II. We've never seen deficits this large when the economy is healthy."

"I see the rise of free-lunch economics all around," she said. "Republicans won't pay for their tax cuts and Democrats don't want to pay for their new spending. … We just keep loading on more debt and then we won't be able to respond to an economic setback or we'll have to make higher debt payments or invest in less infrastructure."

MacGuineas acknowledged that it's easy to roll over the burgeoning U.S. debt today, "but those favorable conditions can't last forever," she predicted. "We will eventually reach a tipping point. When we find out when that will be, it will be too late."

Mick Mulvaney and Maya MacGuineas are both right. Nobody cares—until we have to care. And nobody knows when that will be. ◆