Contemporary Issues

Understanding the Reagan Deficits

In recent years, few topics have been so much discussed, or so little understood, as the deficits in the federal budget. No one likes them, yet they persist and even grow. After making criticism of Jimmy Carter's budgetary shortfalls a centerpiece of his 1980 campaign, Ronald Reagan has presided over four successive $200 billion deficits—more than three times as large as Carter's.[1] Dire consequences of the giant deficits are regularly forecast, but just as regularly fail to materialize. Projections of future deficits fluctuate wildly. The president continues to favor a constitutional amendment mandating a balanced budget.

What is going on? Is it possible to pierce all the hue and cry, the claims and counterclaims, to understand the real economic and political issues at stake? I believe it is important at least to try, for only broad public understanding of the disputes over budget deficits can generate the political pressures necessary to bring about a governmental response that is both economically rational and socially humane.

In this respect, my emphases and conclusions stand in clear contrast to most of what is said about budget deficits by Ronald Reagan and his mainstream allies of the right and center. They recognize, consciously or unconsciously, that their political and economic agenda would be quickly rejected if its consequences were fully understood by the citizenry, and they therefore accept the necessity for fostering and maintaining confusion and misunderstanding.

For example, conservatives frequently argue that because of higher interest rates, increased government borrowing results in less borrowing for investment by private businesses, therefore in slower economic growth, and finally in lower future standards of living. To use the jargon of economics, the fear here is that government borrowing will have the effect of "crowding out" private borrowers from the available supply of credit—that unproductive spending by the government will displace productive investment by business.

The danger of crowding out is a genuine one, but it is important to recognize that its occurence is far from automatic. To see this, consider first the case of a $10 billion increase in the deficit caused by a $10 billion cut in business taxes. While business borrowing may then fall by $10 billion, and government borrowing increase by the same amount, it would be foolish to claim that private investment will fall by $10 billion—there is no need for businesses to borrow what the makers of our tax laws give to them as a gift.

Next, consider an increase in the government deficit during a period of depressed economic activity. Because the main determinant of business investment is the level of their expected future sales, rather than the cost and availability of credit—that is, because businesses tend to invest if, and only if, they foresee customers for an expanded level of output—the increased total spending levels that deficits bring about will tend to lead to *more* private investment, rather than less. Such "crowding in" is seldom mentioned by conservatives, whose theories tell them that the economy automatically and continuously operates at the full employment level.

Finally, consider the often conveniently overlooked point that what matters for economic growth and future living standards is not whether spending is done by business or by the government, but whether the spending consists of consumption or of investment. Much, but certainly not all, government spending consists of investments that contribute to the economy's future productive capacity: from roads, bridges, and sewers to support for education, job retraining, health care, and research. By the same token, some of the private borrowing displaced by government borrowing would have gone for consumer spending on such things as vacations, cars, and refrigerators.

In short, it is entirely possible that an increase in the deficit will have the result not of displacing private investment but of actually increasing the total amount of productive investment, public and private. In the specific case of the Reagan deficits, there is no persuasive evidence of any substantial "crowding out" of the private investment. Once again, the examination of a specific case reveals the reliance of conservative ideologues on slogans as inadequate and misleading.

A Reasonable Deficit or a Balanced Budget?

Another false conservative claim is that deficits necessarily impose unfair burdens on future generations of taxpayers. In fact, because much government spending consists of investments that will provide benefits in the future, it is entirely appropriate that costs also be pushed forward to future years. It is as reasonable for the government to borrow to build a road that will last for decades as it is for a business to borrow to build a factory or buy a machine that will be a productive asset for many years.

To the extent that ability to service the debt rises along with the debt itself, deficit spending does not lead to an increased net burden on citizens in the future. Keeping the burden of the national debt constant in relation to the ability to pay it does not require that the debt remain constant in dollar terms, but rather in relation to the overall size of the economy. Thus, the best summary measure of the burden that the national debt imposes on the economy is provided by the ratio of debt to GNP (gross national product, the broadest measure of the economy's total output). This ratio is unchanged when government debt grows at the same ratio as GNP. To make the same point more concretely, because successful government investments in areas such as physical infrastructure and education will lead to increased employment, income, and profits, these investments will themselves bring about the increased tax revenues needed to pay interest on the bonds issued to undertake them.

A rough calculation for fiscal 1986

The Reagan administration is using the deficit "crisis" it helped create to justify cutting domestic programs.

indicates that this standard allows room for a substantial annual deficit. If real (inflation-adjusted) GNP grows at 2.5 percent, and if inflation is held to 3.5 percent, total GNP measured in current dollars will grow by 6 percent for the year. Because the national debt was $1,828 billion at the end of 1985, a deficit of $110 billion (leading to a 6 percent growth in the outstanding debt) would leave the relative burden of the debt unchanged.[2]

The clear implication of this line of reasoning, and of the back-of-the-envelope calculations just summarized, is that the Reagan deficits have been excessive not because they exceeded zero, but because they have exceeded a reasonable level in the range of perhaps $100 billion per year. This is a reasonable level in the sense that it would have had the effect of keeping the burden of debt service roughly constant in relationship to the economy's ability to pay it. Moreover, an estimate of the amount by which Reagan's deficits have been excessive must be further reduced by a recognition of the benefits of deficit spending in times like the Reagan years of high unemployment.

A much more detailed analysis would be necessary if our goal were to make a serious estimate of the appropriate size of the federal deficit in any given year. Still, even the brief argument presented here is sufficient to show that the target of a balanced budget (zero deficit), which underlies much of the rhetoric in current debates and that the Gramm-Rudman-Hollings bill attempted to make federal law, is unjustified. Like much else in prevalent views on the deficit, the balanced budget fetish reflects conservative ideology rather than defensible economic analysis.

Reagan's Deficits and the Conservative Agenda

Why have we witnessed in recent years the spectacle of conservatives simultaneously raising both actual deficit-creating and rhetorical deficit-bashing to new heights? This seeming paradox can be resolved when both developments are seen in light of the overall conservative agenda that the Reagan administration has consistently tried to advance—an agenda aimed at promoting the interests of U.S. business vis-a-vis both domestic working people and foreign corporations. Two successfully implemented elements of this agenda have played major roles in contributing to the emergence of giant deficits—significantly lower taxes on the wealthy and on the corporations they own and control, and vastly increased military spending to support a heightened desire to assert U.S. power all over the world.

With respect to the part of their agenda that has sought to cut back on the whole range of domestic programs that redistribute income toward the poor, provide enhanced economic security for the rest of us, and promote human development, conservatives have achieved significant, but still only partial, success. The battle over what domestic programs will be cut back, and to what extent, has raged now for several years, and in this battle the president and his supporters have consistently invoked the existence of large federal deficits in arguing that we cannot afford even to continue present levels of funding. Indeed, a careful review of the statements of leading Reagan administration figures during the 1980s reveals a conscious intent to create enlarged deficits precisely so that they can be used in this way.[3]

Which Side To Be On

Those who share the conservative political and social values of the Reagan administration will wish to applaud the continued invocation of the potential dangers of budget deficits—both real and imagined—as part of the continuing campaign to promote business profitability at the expense of the great majority of the population by further hacking away at the welfare state. The rest of us will be more interested in helping to spread better understanding of some important propositions:

- that while deficits smaller than those of recent years are desirable, there is no valid case for moving all the way to a balanced budget;
- that the conservatives' proposed cure for the currently swollen deficits is worse than the disease; and
- that to the extent deficit reductions are desirable, the majority of Americans will be better off if these reductions are accomplished by increasing the taxes of those who are best able to pay them and by reversing the unprecedented growth of military spending in the 1980s, rather than by slashing worthwhile social spending.

Indeed, the very existence of the massive Reagan deficits and their persistence is powerful evidence of an intensive, ongoing struggle over these precise issues. For those familiar with the importance, potential, problems, and needs of public education, it is easy to know which side to be on.□

1. As I write (August 1986), it has become clear that the current year's deficit will be the highest yet. Official government estimates now forecast that it will be substantially greater than last year's record of $212 billion. "Current year" here refers to fiscal year 1986, the 12-month period ending 30 September 1986.

Unless otherwise noted, all deficit data cited in this article refer to fiscal years and are taken from the Statistical Appendix to the *1986 Economic Report of the President*, hereafter cited as *ERP 1986*.

2. Even if we were to accept, for the sake of argument, the claim that the recent large deficits have resulted in an excessive debt burden (as indicated by a debt:GNP ratio of 46 percent at the end of 1985), and that the 1981 debt:GNP ratio of 33 percent (the lowest of the post-World War II period) is the appropriate one, we would find that average annual deficits of $63 billion over the 1982–1985 period would have been necessary to maintain the 33 percent ratio (*ERP 1986*, p. 339).

3. The intention to create such "strategic deficits" has been persuasively documented by the Center for Popular Economics in their *Economic Report of the People*.

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