

That terrible trillion

By Paul Krugman
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As you might imagine, I find myself in a lot of discussions about U.S. fiscal policy, and the budget deficit in particular. And there's one thing I can count on in these discussions: At some point someone will announce, in dire tones, that we have a ONE TRILLION DOLLAR deficit.

No, I don't think the people making this pronouncement realize that they sound just like Dr. Evil in the Austin Powers movies.

Anyway, we do indeed have a ONE TRILLION DOLLAR deficit, or at least we did; in fiscal 2012, which ended in September, the deficit was actually \$1.089 trillion. (It will be lower this year.) The question is what lesson we should take from that figure.

What the Dr. Evil types think, and want you to think, is that the big current deficit is a sign that our fiscal position is completely unsustainable. Sometimes they argue that it means that a debt crisis is just around the corner, although they've been predicting that for years and it keeps not happening. (U.S. borrowing costs are near historic lows.) But more often they use the deficit to argue that we can't afford to maintain programs like Social Security, Medicare and Medicaid. So it's important to understand that this is completely wrong.

Now, America does have a long-run budget problem, thanks to our aging population and the rising cost of health care. However, the current deficit has nothing to do with that problem, and says nothing at all about the sustainability of our social insurance programs. Instead, it mainly reflects the depressed state of the economy — a depression that would be made even worse by attempts to shrink the deficit rapidly.

So, let's talk about the numbers.

The first thing we need to ask is what a sustainable budget would look like. The answer is that in a growing economy, budgets don't have to be balanced to be sustainable. Federal debt was higher at the end of the Clinton years than at the beginning — that is, the deficits of the Clinton administration's early years outweighed the surpluses at the end. Yet because gross domestic product rose over those eight years, the best measure of our debt position, the ratio of debt to G.D.P., fell dramatically, from 49 to 33 percent.

Right now, given reasonable estimates of likely future growth and inflation, we would have a stable or declining ratio of debt to G.D.P. even if we had a \$400 billion deficit. You can argue that we should do better; but if the question is whether current deficits are sustainable, you should take \$400 billion off the table right away.

That still leaves \$600 billion or so. What's that about? It's the depressed economy — full stop.

First of all, the weakness of the economy has led directly to lower revenues; when G.D.P. falls, the federal tax take falls too, and in fact always falls substantially more in percentage terms. On top of that, revenue is temporarily depressed by tax breaks, notably the payroll tax cut, that have been put in place to support the economy but will be withdrawn as soon as the economy is stronger (or, unfortunately, even before then). If you do the math, it seems likely that full economic recovery would raise revenue by at least \$450 billion.

Meanwhile, the depressed economy has also temporarily raised spending, because more people qualify for unemployment insurance and means-tested programs like food stamps and Medicaid. A reasonable estimate is that

economic recovery would reduce federal spending on such programs by at least \$150 billion.

Putting all this together, it turns out that the trillion-dollar deficit isn't a sign of unsustainable finances at all. Some of the deficit is in fact sustainable; just about all of the rest would go away if we had an economic recovery.

And the prospects for economic recovery are looking pretty good right now — or would be looking good if it weren't for the political risks posed by Republican hostage-taking. Housing is reviving, consumer debt is down, employment has improved steadily among prime-age workers. Unfortunately, this recovery may well be derailed by the fiscal cliff and/or a confrontation over the debt

ceiling; but this has nothing to do with the alleged unsustainability of the deficit.

Which brings us back to ONE TRILLION DOLLARS.

We do indeed have a big budget deficit, and other things equal it would be better if the deficit were a lot smaller. But other things aren't equal; the deficit is a side-effect of an economic depression, and the first order of business should be to end that depression — which means, among other things, leaving the deficit alone for now.

And you should recognize all the hyped-up talk about the deficit for what it is: yet another disingenuous attempt to scare and bully the body politic into abandoning programs that shield both poor and middle-class Americans from harm.