Debt bad, surplus good, right? Not necessarily, economists say

By JOHN LANTIGUA

During the grueling debt ceiling debate, the American public heard one talking point over and over: "If U.S. families are expected to live within their means, then the U.S. government should do so as well."

It makes a good sound bite, but taken literally, it doesn't make for good economics, many economists say.

Public and private finances "don't work the same way," said University of Central Florida economist Sean Snaith.

University of Miami economist Douglas Emery agrees.

"The politicians who say that probably know better, or maybe some of them don't," he said. "Everybody wants to use that analogy, but it isn't the same."

Although economists agree that the U.S. has a high amount of debt relative to its gross domestic product and must do something about it, government debt and deficit spending are not necessarily dirty words.

"They allow us to stabilize our economy and allow us to do things that create economic growth," Snaith said. "Debt in itself is not an evil. But excessive debt, burdensome debt, can be an extreme problem."

Conversely, a surplus, which sounds so alluring during an economic crisis, is not always so great, Emery said.

"When you are running a surplus, the government is taking more out of the economy than it is putting in. That is probably not a good thing," Emery said.

In other words, having money lying around for a rainy day might work for a family. But having tax money lying around is not a popular way to do things in government because it is someone else's money the government is sitting on. That eventually leads administrations to borrow.

Long history of U.S. debt
The U.S. has had national debt from the time of the Revolutionary War. The debt has risen during wars and has diminished during times of peace and economic prosperity.

But the Great Depression and World War II left the country with a national debt that exceeded GDP, which is the total value of goods and services produced during a year. The country has paid down some of that - it reached a low of 32.5 percent of GDP during Jimmy Carter's one term ending in 1981 - but it has never been paid off.

In fact, it has risen almost constantly since then, spiking to 53 percent of GDP under Ronald Reagan, 66 percent under George H.W. Bush and 84 percent under George W. Bush. President Obama has overseen another rise, to 93 percent between 2009 and 2010, much of it due to stimulus and bailout spending. Bill Clinton's administration was the only one since 1960 to run surpluses, and they were small.

The debt was $14.46 trillion as of late June, 98.6 percent of the $14.66 trillion 2010 GDP, which means it is approaching levels not seen since World War II.

Most of that debt is owed domestically. About $6 trillion is owed to the Social Security Administration and the Federal Reserve Bank. An additional $3.9 trillion is owed to U.S. investors, including pension funds and investment funds. The rest is owed overseas.

Public vs. private rules

The only way to reduce the debt is to reduce annual deficits, and the only way to do that is to reduce spending and/or increase revenues. Families reduce what they owe by the same means, but administrations play by different rules and are more comfortable with substantial debt than most households.

One reason: The government can borrow money at a much lower rate than individuals.

"We individuals are only going to be able to live and work a finite amount of time," UCF's Snaith said. "That inhibits our ability to borrow. Government is not nearly as limited. It goes on." And it borrows at lower interest.

Also, since so much U.S. debt is owned by the government itself or other Americans, that debt is not seen as extremely risky. Greece, on the other hand, owes most of its debt to foreigners and is in deep trouble.

The bet an administration makes is that the cost of borrowing the money will be less than the economic and political benefits that will accrue through not raising taxes and leaving money in the economy. So it doesn't sit on a surplus.

But government has large obligations it can't put off and often can't plan for, economists say, so it borrows.

"Government obligations are quite different than that of a household," Snaith said. "A government has to respond to large emergencies. It has to be able to launch a war on terrorism. It has to be able to form the Transportation Security Administration after 9/11. It has to respond to a natural disaster affecting many people."

Christopher Cotton, a University of Miami economist, focuses on the debts incurred to finance wars.
If not for those debts, "the U.S. might not exist today," he said.

A longer vision

A balanced budget sounds good at the household level, but Snaith questions whether it applies to public life.

"For a family it is prudent behavior, but it doesn't always supply a government the flexibility it will need to meet those emergencies," he said.

The government also must invest in the future in ways that go beyond what any family has to focus on, the economists said.

"Governments may not have high enough revenue to pay for things that can potentially increase long-run income," Cotton said: "infrastructure, security and education."

The ways those expenditures and government deficits are calculated are misleading and don't work the way family budgets do, said Florida Atlantic University economist William Stronge.

"A family finances a mortgage on a house and that's a capital expense," he said. "They pay it off, but they get the use of living in it as they do. They have that asset down the road. But the government invests in education and that is not seen as a capital expense. It's seen as a current expense and part of the deficit. It just doesn't work the same way.

"But investing in education is not like you're buying a six-pack," he said. "That's an expenditure that will pay off in time."

Another large difference exists between public and family finances.

If debt and the interest payments on it get too high, "a government can tax, whereas a family can't tax anybody," Stronge said.