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The Truth About Federal Deficits

Lester G Telser, *University of Chicago*

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The Truth about the Federal Deficit

L. G. Telser

The Federal budget in the news media seldom distinguishes among three categories: transfer payments such as Social Security and Medicare, current expenditures of various government programs such as payments for protection against foreign and domestic enemies, and outlays on capital goods such as aircraft carriers, roads, bridges, and the like. Government outlays on durables should rely on the same calculations that business and households use for their decisions about durable goods.

A business buys a truck if the present value of the income it expects from use of the truck can at least cover the cost of the truck. A well run business does not forego buying a truck because its cost cannot be covered by the excess of its current receipts over its current outlays.

A similar analysis applies to households contemplating purchase of a house. Although most home owners live in it themselves and do not expect their house to be a source of monetary income, there is an implicit monetary flow from ownership of a house. It is the rent the owner could get for it. A potential buyer of a house could calculate the present value of this flow of rent and decide whether or not to buy the house by comparing the present value of the rent to the price of the house. If the price is not above the present value, then there is a potential implicit monetary gain from buying and living in the house. Because a house is durable, a decision to buy should take this into account. The purpose of mentioning these monetary calculations is to point out that home ownership is analogous to a business rationale for ownership of any durable good. It is not to demean the psychic benefits from home ownership.

A public road is also a durable good owned by government. It lasts a long time and can yield a flow of useful services as long as it is maintained. The decision to construct a road could use the same logic as the construction of a long lasting physical commodity by a private business. It would waste valuable opportunities to require that such a public asset must be paid for out of current proceeds. To inveigh against deficit finance is to embrace a policy of waste.

Just as every sensible person treats outlays on durables with an eye on their yield over their life so too should their representatives in Congress and the White House

make it clear that they understand that government outlays on durables should also take into account the present value of the returns on these durables. This does not absolve the media from the same responsibility. Deficits are not inherently wasteful any more than outlays on any durable are inherently wasteful unless covered by current revenue.

This analysis says nothing about the desirability or rationale of government expenditures on the three categories: transfer payments, current expenditures on various government programs and outlays on durable public assets. For the government to employ idle workers imposes no cost on the economy. The true cost of a government project when there is unemployment is the benefit of one government project that sacrifices the benefit of another government project. Such sacrifice is inevitable because total real resources are limited even when there is unemployment.