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A Sustainable Budget Should Endure Any Storm

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IN the national debate over fiscal policy, an important question is what the long-run goal should be. Representative Paul D. Ryan, chairman of the House Budget Committee, has a plan to balance the federal budget in 10 years. When asked if he would do the same, President Obama demurred.

"My goal is not to chase a balanced budget just for the sake of balance," the president told George Stephanopoulos of ABC News. The White House press secretary, Jay Carney, said the president's goal was instead a "fiscally sustainable path."

Which raises two questions: What is fiscal sustainability? And how do we know when we have achieved it?

For you and me, the answer is pretty easy. As individuals, we have to balance our budgets over our lifetimes. In other words, in the long run, our spending is constrained by our earnings. If you ever tried to imitate the federal government, by spending more than you earned every year, your creditors would eventually catch on and pull the plug.

The federal government, however, is very different. Having survived now for more than two centuries, it has been granted the presumption of immortality by its creditors. As a result, there is no final day of reckoning on which all debts need to be repaid.

That means that the federal government can run budget deficits year after year, racking up ever-higher debt. And, indeed, that is pretty much what it has done throughout history. With the exception of a few years starting in the late 1990s, when the Internet bubble fueled an economic boom, goosed tax revenue and made President Clinton look like a miracle worker, the federal government has run a budget deficit consistently for the last 40 years. The debt that the federal government owes to the public has risen to about $12 trillion, from $341 billion in 1973.

It may be tempting to look at these facts and to conclude that there's no limit to what the federal government can borrow. But that would be a mistake. Even though the credit markets give the government more latitude than they give to ordinary individuals, the government still faces limits. It can borrow for a long time, perhaps even forever, but it can't go nuts about it.

A metric that economists often use to evaluate a government's fiscal position is the ratio of the government debt to the nation's gross domestic product. G.D.P. measures the total income in the economy and thus reflects the government's tax base. The higher the debt-to-G.D.P. ratio, the more a government will struggle to service its outstanding liabilities.

As a nation, the United States was born with a debt-to-G.D.P. ratio of about 42 percent, thanks to loans that were taken out to finance the American Revolution. In fact, throughout the nation's history, the most common cause of increases in the debt-to-G.D.P. ratio has been the expenses associated with military conflict.

The Civil War increased the ratio from 2 percent in 1860 to 34 percent in 1865. World War I increased it from 3 percent in 1914 to 31 percent in 1919. And World War II increased it from 44 percent in 1941 to 109 percent in 1946, the highest level in history.

The second most common cause of increases in the debt-to-G.D.P. ratio has been deep economic downturns. In 1933, during the Great Depression, the ratio was 44 percent, up from 16 percent in 1929. The recent financial crisis and deep recession have had a similar effect. The debt-to-G.D.P. ratio has increased to 77 percent, from 36 percent in 2007.

SO what does President Obama mean when he talks about fiscal sustainability? He doesn't mean running a surplus and repaying the debts that have been incurred on his watch, as people who spend more than they earn would have to do. Nor does he mean balancing the budget, as Representative Ryan suggests. Rather, the president seems to mean keeping the debt-to-G.D.P. ratio stable at this new, higher level. That is certainly what the last budget he submitted proposed to do.

Achieving this goal is much easier than balancing the budget. Because G.D.P. grows, the government debt can continue to grow as well, just not too fast. Stabilizing the debt-to-G.D.P. ratio requires that future budget deficits be smaller than they have been over the last few years, but they can still be sizable.

Yet this goal, hard to reach as it might be in the current political environment, is still too modest. The problem is that budget projections are based on forecasts, and such forecasts exclude the extreme events that have historically driven up government debt.

Military and economic catastrophes are, by their nature, unpredictable. While we can't plan on one, prudence requires that we take their possibility into account. In normal times, when we are lucky enough to enjoy peace and prosperity, the debt-to-G.D.P. ratio shouldn't just be stable; it should be falling. That has generally been the case throughout our history, and it should become the case again as we look forward.

The bottom line is that President Obama is right that sustainability is a reasonable benchmark for evaluating long-run fiscal policy. But the standard he applies when evaluating it appears too easy. It will leave us too vulnerable when the next catastrophe strikes.