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DEFICIT

WHY SHOULD I CARE?

Marie Bussing-Burks

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Deficit: Why Should I Care?

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To Phyllis and Bill

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About the Author

Marie Bussing-Burks holds Master of Business Administration and Doctorate of Arts in Economics degrees. She is an Assistant Professor of Economics in the College of Business at the University of Southern Indiana.

Bussing-Burks is the author of five other books: *Starbucks: Corporations that Changed the World, Money for Minors: A Student's Guide to Economics, Influential Economists, Profit from the Evening News: Using Leading Economic Indicators to Make Smart Money Decisions,* and *The Young Zillionaire's Guide to Taxation and Government Spending*. In addition, she has more than 30 magazine, newspaper, and journal articles to her credit.

About the Technical Reviewer

Todd Knoop is a Professor of Economics and Business at Cornell College and the author of two books: *Recessions and Depressions: Understanding Business Cycles* and *Modern Financial Macroeconomics: Panics, Crashes, and Crises*. He also has a forthcoming book on financial markets in emerging market economies and has published articles in the *Canadian Journal of Economics*, *Economic Inquiry*, and *Southern Economic Journal*. He holds a Doctorate from Purdue University.

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It has been a pleasure working with all who have assisted with the writing of this book. I appreciate the assistance in investigating the largest economic concern of the time: the rising deficits and $14 trillion plus national debt.

Introduction

The United States is experiencing a host of serious economic problems, including soaring unemployment, stagnant production, a crippled housing market, and ballooning government spending. Although each issue is important, it is the government's burgeoning spending, along with the recent two-year extension of the Bush era tax cuts, that has really captured everyone's attention. The hot economic topic discussed around the kitchen table, at dinner parties and business meetings, on nightly news programs, and in academic settings is the deficit and the national debt.

Most people agree that the government is a big spender and the mounting debt is troublesome. In fact, in a recent USA Today/Gallup poll, federal government debt and terrorism tied as the most serious issue of concern to Americans for the future well-being of the United States. Yet some people, including prominent economists, are not all that worried about the debt.

In the press, on the Internet, and in the media, the public is often misinformed regarding the specifics of the current deficit and debt issue. In fact, the terms deficit and debt are routinely and incorrectly used as interchangeable vocabulary. This book will set the record straight on the deficit and the debt, while presenting the facts in a clear, concise manner.

Here is a preview of what you will learn. The federal government's annual budget impacts the national debt. If the government were to post a balanced budget, it would mean the government's revenues equal expenses, or that taxation and fee collection are equal to spending. A balanced budget is an extremely rare occurrence. Routinely, budgets are either in a surplus or a deficit. When the government spends less than it collects in taxes, it runs a surplus. Each year for a four-year period from 1998 to 2001, the United States had a surplus budget. Since then, the government has incurred a widening and alarming deficit.

The deficit is the yearly amount by which government spending exceeds taxation. The yearly deficit for 2011 is projected to be $1.5 trillion. The deficit stirs concern and debate because the government must borrow funds to pay for its excess spending. Too large to place on a giant credit card, the funds are borrowed by the federal government by issuing Treasury securities and savings bonds. The total amount of borrowing, known as the *national debt* (sometimes referred to as the *federal debt* or *public debt*), has topped $14 trillion. To picture just how large the debt figure is, envision $14 followed by 12 zeros—$14,000,000,000,000. Another way you can think of it is going into debt for $14 billion, and doing this one thousand times.

Who owns this enormous amount of debt? About $4.6 trillion of the total is held by U.S. government agencies, like the Social Security Administration and government trust funds. The government borrows the other $9.5 trillion from the public, which includes individuals, businesses, banks, state and local governments, and foreign entities. Foreign creditors have recently played a part in the debt debate. Increased reliance on foreign countries—like China, our largest creditor nation with holdings of more than $1 trillion in U.S. Treasury securities—has caused anxiety to some.

The amount of debt held by the public mirrors the amount of the nation's wealth that has been assumed by the federal government to finance total federal spending from prior years. When a cash deficit exists, the government must borrow. When a cash surplus exists, the funds can be used to pay down the debt held by the public.

It's important to note that the federal government does not get free use of this money. The government must pay for the use of funds by offering a rate of interest that is attractive to its investors. Each year, there is a line item in the federal budget for interest, an expense for which we receive no current productive value. In 2010, the government paid $414 billion for the use of the funds. It is possible that the issuance of new debt might put upward pressure on interest rates, and consequently, interest payments.

Calculating the national debt takes a simple math formula. Add up all the deficits (negative numbers), and then add in the few surpluses, and you get the national debt—the total amount of Treasury and savings bonds outstanding. So each year that the government incurs a deficit, the debt will increase. As noted, this habit of deficit spending has resulted in more than $14 trillion in U.S. debt to this point.

The government debt has risen over the years, experiencing especially dramatic growth spurts during wartimes (due to high defense spending) and during recessions. When the country is experiencing tough economic times, work is not as plentiful, business profits falter, and the government receives less money from taxpayers. At the same time, the government is spending more money than usual on welfare programs, social initiatives, and aid to the unemployed. This widening gap between spending and revenue makes the deficit grow.

In December 2007, the United States entered a recession, or a general slowdown in the economy. The government, in an effort to help the economy, paid for many new stimulus programs designed to create jobs or bolster the safety net for its citizens. The goal of dampening the recession and improving economic growth has caused the recent deficits and debt to rise.

The public debt—and controversy about it—has been with us for some time. The Bureau of the Public Debt notes its first recorded debt in 1791, at just over $75 million to honor the Revolutionary War obligations. The debt shrank to zero by January 1835, but soon sprang into the millions again. Rising and falling over the years, it was in 1982 that the debt topped $1 trillion. Since hitting this marker, it has been a wild ride on the debt roller coaster.

Now let's fast-forward to look at the growth over the past decade. At the turn of the century, the national debt stood at just under $6 trillion and the country sported a slight surplus. The official fiscal 2010 national debt total clocked in at $13,561,623,030,891.79, and the yearly deficit at a whopping $1,294,090,000,000. According to the Treasury Department's *Annual Report on the Public Debt*, the debt is estimated to hit $19.6 trillion by 2015. The federal government has borrowed roughly 40 percent of its total budget for the past several years, a trend that could leave the United States in an economic crisis.

Increasing interest payments, the debt burden to your children and grandchildren, and an increased reliance on foreign creditors are just a few of the foreseen problems.

On the other hand, there are positive aspects of deficit spending, too. Government spending provides needed goods and services to our economy; deficit spending supports fiscal policies during times of need; and Treasury securities are useful instruments to support a strong monetary policy.

In reading this book, you will learn to think like an economist who must weigh the pros and cons of an issue. Specifically, you will learn to sharpen your economic skills and decide, after reading the facts, whether deficits and the debt will lead to economic ruin and anarchy; a stronger economy that will, over time, allow us to pay down the debt before disaster strikes; or something in between. Here is a sneak peek:

- *Chapter 1, Crash Course on the National Debt*: This chapter delves into the role of the government in the U.S. economy. The government must provide certain essential goods and services for its taxpayers. In turn, the government collects taxes to pay for these goods and services. But when the government spends more than it takes in, a deficit occurs, and the government must borrow to pay for its overspending. The federal budget process begins each year in February, when the president submits his budget request to Congress. Congress then debates, amends, and takes action on the budget. On October 1, the government's fiscal year begins. This chapter takes a look at the budget process and the different types of budgets: balanced, deficit, and surplus. You will learn the correct definitions of *deficit* and *national debt*, and see how each is calculated.

Figure 1. President Barack Obama and Vice President Joe Biden meet with Jack Lew, Office of Management and Budget Director, and Rob Nabors, Director of Legislative Affairs, on April 5, 2011, in the Oval Office. The President and Vice President later met with House Republican and Senate Democratic leaders to discuss ongoing budget negotiations. On Friday, April 8, 2011, President Obama announced a last-minute budget deal, which averted a partial government shutdown that was scheduled to occur at midnight. *Source: Office White House photo by Pete Souza.*

- *Chapter 2, A Huge Credit Card*: This chapter introduces the history of the debt and the issuing agency, the Bureau of the Public Debt. It examines details of the agency's financing instruments, Treasury securities, and savings bonds. These outstanding securities total the national debt, so learning the particulars is important. Other main topics include the ownership of the debt, United States versus foreign, and interest payments, which hamper the government's ability to balance the budget. Get a glimpse into the recent unparalleled growth of the deficits and the debt.
- *Chapter 3, Deficit and Debt Projections*: This chapter describes how the government's spending and tax policies influence output. The government has historically used fiscal policies to alter the macro economy, with some successes and some failures. We will look at an overview of recent fiscal policies, including the economic stimulus package designed to combat the December 2007 downturn, and impacts on the deficit and debt. This chapter introduces the rising debt compared with gross domestic product (GDP), considers the productive capacity debate, and provides projections on the debt trend.
- *Chapter 4, Do Deficits and the Debt Matter?*: This chapter sets the stage for the debt debate. The broad dispute over the deficit and the national debt has been stirring for years. A notable historic point dates back to the Depression era, when Franklin Roosevelt took over in 1932 as a four-term president (1933–1945). FDR instituted a number of different programs, such as Social Security, welfare reforms, new banking controls, and the New Deal programs, in an effort to restore the economy. Although FDR ran some modest deficits, he refused to run up huge deficits, which were essential to end the Great Depression.

  It was back in 2002, at a meeting of President Bush's economic advisors, that Vice President Dick Cheney said, "Deficits don't matter," a viewpoint many politicians and economists have held for years. The deficit at that time was just $158 billion. Now some in Congress and many interest groups say deficits matter a great deal, and we must eliminate deficits and pay down the debt. In early 2009, as many citizens became concerned with hefty government spending, self-organized groups began sprouting, using the Tea Party name as a basis for their political platform. The Tea

Partiers believe in limited government, fiscal restraint, and lower taxes, and they have held Tea Party rallies to protest excessive government spending.

- *Chapter 5, Deficits Do Not Matter*: This chapter focuses on the viewpoint that deficit spending is not a concern to the health of the U.S. economy. In fact, sometimes running a deficit contributes beneficial effects for the economy. Government spending supports the economy through building strong economic growth and more jobs. The federal government's deficit financing provides many essential services to society, such as national defense, education, public welfare, Social Security, Medicare, and Medicaid. In addition, the government sells Treasury securities and savings bonds to finance the debt. Not only are these important savings instruments for investors, but the Federal Reserve formulates monetary policy using government securities.

  A common view says that Treasuries can be issued continually to finance the government's needs, and it is not imperative to pay down the debt. Furthermore, a popular way to measure the deficit level, deficits to GDP, shows declining numbers on the horizon. Many other countries are in a similar deficit spending mode, planning to ride out the global downturn. The United States is not unique in its deficit situation.

- *Chapter 6, Deficits Do Matter*: This chapter explores the concerns with deficit financing. It provides a deeper explanation as to why some feel the debt matters more now than it has in the past. You will be introduced to both the long-time arguments against deficit financing—burden to future generations, hefty interest payments, crowding out of the lending, and economic instability—along with some new twists. The United States has an increased reliance on foreign creditors. China is now our number one creditor. In addition, many feel that the U.S. government is setting a bad example of fiscal irresponsibility for its citizens.

- *Chapter 7, Get a Handle on the National Debt*: This chapter teaches the reader about government spending and ways to curb deficit spending. Pork projects impact government money spent in a particular locale and bring advantages to their political representatives. Fundamental reform of Social Security, Medicare, and