The Almighty Deficit and Debt

The federal budget deficit has deteriorated drastically since 2001. During the Clinton administration, the federal deficit (in constant dollars) shrunk from $191 billion in 1993 to $187 billion in 1995; it then grew to $340 billion in 1998. For the first time in nearly 40 years, the federal budget turned into a sizable surplus of $272 billion in 1999 and $145 billion in 2000.

In the presidential debate of 2000, the candidates debated what to do with the actual and projected budget surpluses over the following four years and beyond. The candidates favored using the surpluses to overhaul the Social Security Fund or pay down the national debt. Before long, the surplus evaporated for several reasons: the ensuing recession, the Stock Market free-fall, terrorist attacks of September 2001, and the war on terror resulting in the establishment of the Department of Homeland security and invasion of Afghanistan and Iraq.

During the Bush administration, balance of the federal budget deteriorated to a deficit of $174 billion in 2001. While fluctuating, the deficit grew to $431 billion in 2007. With increased government spending and falling tax revenues in the subsequent recession, the federal deficit ballooned to $1.3 trillion in 2008, when aggressive fiscal policy
measures were implemented to help alleviate the adverse recessionary effects. The main pillars of the government’s fiscal policies were:

**The American Recovery and Reinvestment Act of 2009** - This $787 billion of the economic stimulus plan was the largest fiscal injection into an ailing economy in history. It consisted of $226 billion in discretionary spending, $288 billion in tax credits and incentives for individuals, and $273 billion in direct aid to states and unemployed and for increased health-care coverage.

**The Financial Stability Plan and Troubled Asset Relief Program of 2008-2009.** This $700 billion recovery plan was designed to address the credit crisis by providing capital injections to failing large banks, creating a mechanism to purchase "toxic securities" through a public-private fund, supporting business lending through the purchase of business loans in the secondary markets, and assisting homeowners impacted by the steep decreases in home prices.

In addition to financing two expensive wars, these new expenditure items plus all others smaller initiatives raised the federal deficit to $1.4 trillion in 2009 and is expected to reach $1.6 trillion in 2010. The New York Times has separated the federal deficit into four major categories along with their estimated shares:

- Recession: reduced tax revenues and increased spending (37%);
- Policies enacted by President Bush (33%);
- Policies enacted by President Bush and supported or extended by President Obama (20%); and
- New policies enacted by President Obama (10%)

Massive federal spending is supported by funds that the government does not have. Thus, the federal government has to borrow money by issuing new U.S. Treasury bonds and selling them to public agencies (e.g., Federal Reserve), public funds (e.g., Social Security), domestic investors (e.g., Bank of America), and foreign investors (e.g., Chinese companies). Upon maturity, investors redeem their bonds for principle plus interest. Regardless of presidential administration, national debt (in constant dollars) had an ever-increasing trend from $3.0 trillion in 1993 to $6.5 trillion in 1999; from $6.5 trillion in 2000 to $10.9 trillion in 2008; and from $12.6 trillion in 2009 to an estimated $13.7 trillion in 2010.

With increased national debt, the government must allocate more money from its budget to service the debt. As a result, it may run a larger deficit, which will require increased borrowing, and in turn, greater interest payment on debt. Thus, this process creates a vicious cycle of deficit and debt, which is difficult to break.
During the Clinton presidency, interest payment on national debt (in constant dollars) increased from $374 billion in 1993 to $407 billion in 1999. In the president Bush era, interest payment on national debt declined from $408 billion in 2000 to $332 billion in 2004 before rising gradually to $415 billion in 2008. During the first year of Obama’s presidency, interest payment on national debt fell to $350 billion, but it is expected to rise to $387 billion in 2010.

For comparative purposes, federal deficit and debt are measured as percentage of the GDP. During Clinton’s presidency, the GDP share of the federal deficit increased from 2.2 percent in 1993 to 3.3 in 1998. Over the next two years, the federal surplus increased to 2.5 and 1.3 percent, respectively. While fluctuating during the Bush administration, federal deficit as a percentage of the GDP increased from 2.5 percent in 2001 to 9.8 percent in 2008. This rising trend continued under President Obama as the
GDP share of federal deficit grew to 11.0 percent in 2009 and is likely to reach 11.5 percent in 2010.

Similarly, the GDP share of national debt had a rapidly rising trend. It climbed gradually from 35.2 percent in 1993 to 58.0 percent in 2000. In the following 8 years, when Bush was president, national debt as a percentage of the GDP continued to grow from 60.3 in 2001 to 82.6 in 2008. With continued “deficit-financing” approach of Obama administration, the GDP share of national debt climbed to 97.6 percent in 2009 and is expected to exceed 100 percent in 2010.

The Federal Reserve Chairman, Ben Bernanke, has warned us about the adverse consequences of mounting deficit and debt, including higher taxes and reduced entitlements such as Medicare and Social Security. He has called for the federal government to exercise fiscal responsibility for the sake of long-term economic growth and stability, “... unless we as a nation demonstrate a strong commitment to fiscal responsibility, in the longer run we will have neither financial stability nor healthy economic growth." The cost of staggering deficit and debt is also measured by foregone public investment is such areas as education, infrastructure, and culture. With mounting interest payment on public debt, fewer funds are available for investment on human, social, and physical capital, thus reducing the standard of living for future generations.

References: