Gerald Faverman, Ph.D. • *Chairman of the Board*
Robert J. Kleine • *Editor*

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A Nation in Decline: The Role of the Federal Budget Deficit

by Robert Kleine and Frances Spring

The federal budget deficit recently claimed another victim as Senator Warren Rudman (R-New Hampshire), one author of the Gramm-Rudman Act, announced that he will not run for reelection. Several days later, Kent Conrad (D-North Dakota), another highly respected senator, made the same announcement for similar reasons. Senator Rudman stated that a major factor in his decision was his frustration and disappointment with the continuing inability of the president and Congress to control the federal budget deficit. One of the most respected members of the Senate, Rudman has worked as hard as anyone to find a solution to the runaway deficit. He warned that if nothing is done the deficit could swell to $700–800 billion (per year) in five years, which would place our future in the hand of foreign lenders and reduce us to a third-rate economic power.

The senator is correct, but is anyone listening? We continue to suffer from government paralysis, with no leadership forthcoming from either the president or Congress. The only presidential candidate to address the problem and talk about the hard choices that must be made was Paul Tsongas, who dropped out of the race due to a lack of money and the seeming disinterest of the public in the most serious economic problem facing this nation.

Public indifference to the problem could stem from a perception that the budget deficit is some vague "national" problem that does not directly effect them. Nothing could be farther from the truth. In Michigan the negative effects of the federal deficit have hurt the state's economy more than any other single factor. As the old saying goes, "when the nation catches a cold, Michigan catches pneumonia."

The "solution" that seems to interest Michiganians most is trade barriers, which is merely an admission that we cannot compete with other manufacturing countries. Trade barriers would ensure, for example, more expensive and lower quality automobiles and would seriously damage the national economy over the long term. We need to stop bashing Japan and Mexico and focus on the real problem: If the federal budget were balanced, interest rates would be lower, productivity would be higher, and we would not be in a recession. We also would have money to spend on programs that promote long-term economic growth, such as education, health care, job training, and infrastructure.

As things now stand, we cannot deal with any of our pressing problems. Bill Clinton is an intelligent politician, but he cannot deliver on his promises to change this country until he first deals with the federal budget deficit; unfortunately, he barely addresses the issue. To quote the Congressional Budget Office (CBO), "there is no room in the current or prospective budget outlook to finance any of these arguably good things" (such as education, crime prevention, health insurance, poverty, and infrastructure). "Cuts to existing spending or an increase in taxes must occur if any new initiatives are to be undertaken, or the deficit will grow worse."[1] As Roger Rosenblatt said on the March 25 edition of *The MacNeil-Lehrer Report*, the irrelevance of government to the problems of this nation has reached a dangerous point. One need only look at what is happening to the youth of our inner cities to become frightened for our future. What we need is a

1 Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options* (Washington, D.C.: CBO, February 1992).

Public Sector Consultants, Inc.
Knapp's Centre • 300 S. Washington Sq. • Suite 401
Lansing, MI 48933-2134 • (517) 484-4954

Marshall Plan to save our cities, but it appears that we lack the vision, the will, and the resources to undertake such a program.

A start at resolving this problem begins with educating people about the issues. What follows is a primer on the federal budget, including how we raise and spend money, how this nation has gone so deeply into debt, and what we might do to halt the growing crisis.

THE PROBLEM

Federal Expenditures All governments in the United States (federal, state, and local) spent more than $2.2 trillion in fiscal year (FY) 1989–90, of which about $1.4 trillion, (62.8 percent) was spent by the federal government (see Exhibit 1). Although today it is a given that the federal budget exerts a major influence on total government spending, this was not the case until the 1930s. By FY 1950, federal expenditures still accounted for only 14.8 percent of gross domestic product (GDP), a figure that now exceeds 25 percent.

Sources of Federal Revenue The major source of federal revenue is the personal income tax, which provided more than 44 percent of FY 1991 revenues. Since 1979 the importance of the corporate income tax as a revenue source has declined sharply. Social Security taxes have contributed an increasing proportion. (See Exhibit 2.)

Growth in Federal Outlays and Revenues Federal outlays increased at an annual rate of 9.2 percent from FY 1976 to FY 1991, while revenues rose at a rate of only 9 percent. Since FY 1982, growth in spending and revenues has been at rates of 7.2 percent and 6.6 percent, respectively. As a result, the deficit (excluding Social Security) ballooned from $120 billion in FY 1982 to $321 billion in FY 1991 and will reach an estimated $449 billion in FY 1992. (See Exhibit 3.)

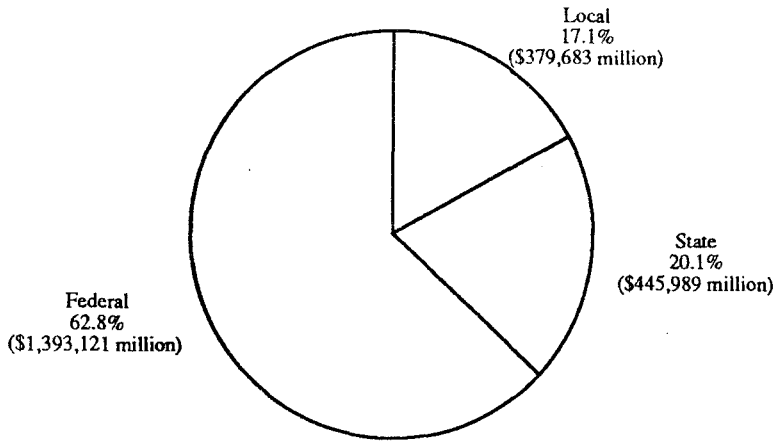
Federal Expenditures and the Economy Total spending as a share of GDP rose from 20.6 percent in FY 1979 to a post-World War II record of 23.5 percent in FY 1991; the figure is estimated at 24.9 percent in FY 1992. Federal outlays as a percentage of GDP are expected to decline steadily over the next four years, largely as the result of spending limits imposed under the FY 1991 federal budget agreement, reduced defense requirements, the expected improvement in economic growth, and the declining cost of the savings and loan bailout. Beginning in FY 1997, however, expenditures are expected again to rise faster than the growth in the economy due to projected increases in outlays for Social Security and Medicare (as the population ages) and an end to the "peace dividend."

The Composition of Federal Spending Defense spending in FY 1970 comprised 39.3 percent of the budget (due largely to the Vietnam War), but it fell to 20.7 percent in FY 1991. Nondefense discretionary spending (foreign aid, space and science, transportation, the environment, housing, and general government, for example) also has declined sharply as a share of the total, falling from 21.8 percent in FY 1970 to 15.3 percent in FY 1991, and this decline is expected to continue. Nondiscretionary entitlement programs—such as Medicaid, Medicare, Social Security, retirement, and disability—have risen significantly as a share of the budget, from 32.2 percent in FY 1970 to 44.5 percent in FY 1991. The CBO estimates that by FY 1997 these programs will comprise about 57 percent of the total; if interest on the debt is added, these two categories will account for 73 percent of the budget in FY 1997. There were no expenditures for deposit insurance claims in FY 1970, but in FY 1991 these accounted for 4.6 percent of federal outlays because of the savings and loan bailout (see Exhibit 4).

As a share of GDP, defense spending has declined—from 8.2 percent in FY 1970 to a CBO estimate of 3.7 percent in FY 1995. Entitlement and other mandatory spending programs increased their share from 6.7 percent in FY 1970 to 11.5 percent in FY 1990, and this category will rise to an estimated 12.1 percent by FY 1995. Net interest more than doubled as a share of GDP between FYs 1970 and 1990, but it is expected to stabilize over the next few years as lower interest rates offset the increase in the size of the debt. (See Exhibit 5.)

EXHIBIT 1

Expenditures by Level of Government, FY 1989–90
($2,218,793 million)

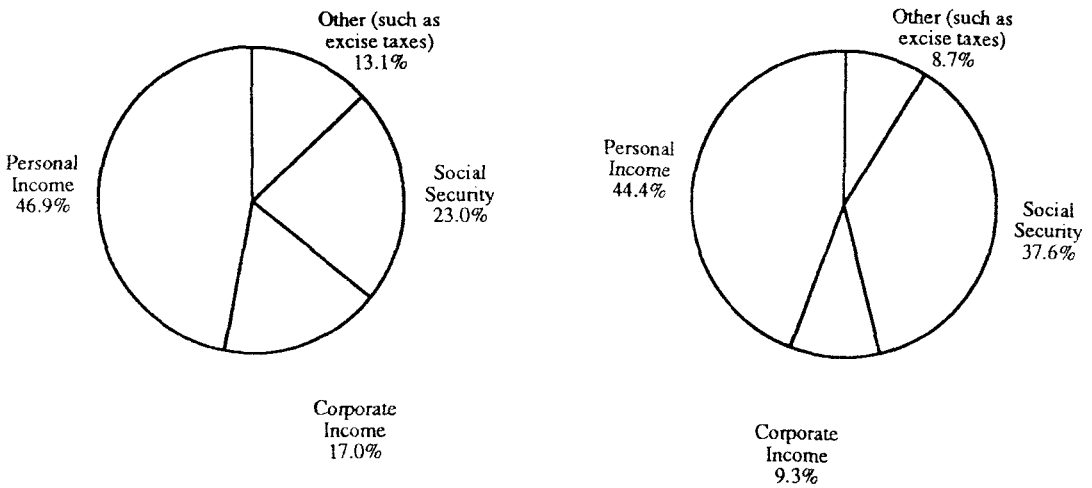


SOURCE: Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1993–97* (Washington, D.C.: CBO, January 1992; cited hereafter as CBO, *Outlook*.

EXHIBIT 2

Federal Revenues by Major Source, FYs 1970 and 1991

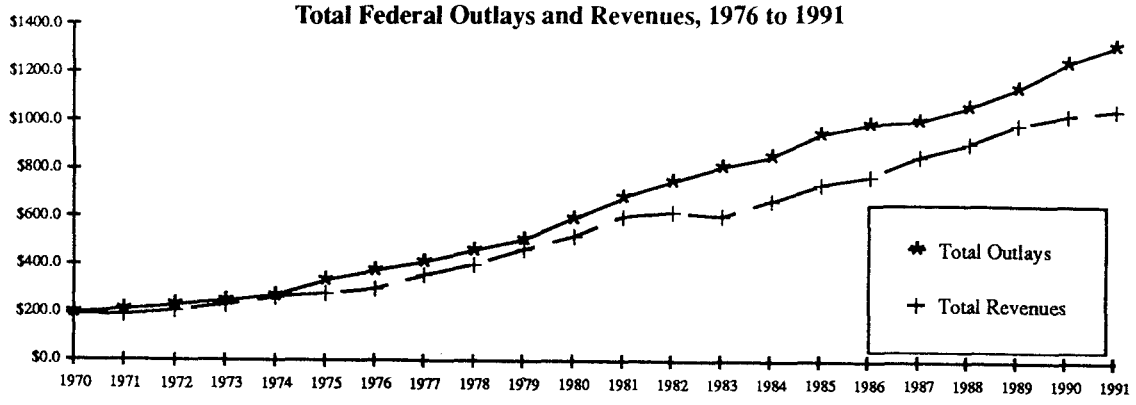
1970 **1991**



SOURCE: CBO, *Outlook*.

EXHIBIT 3

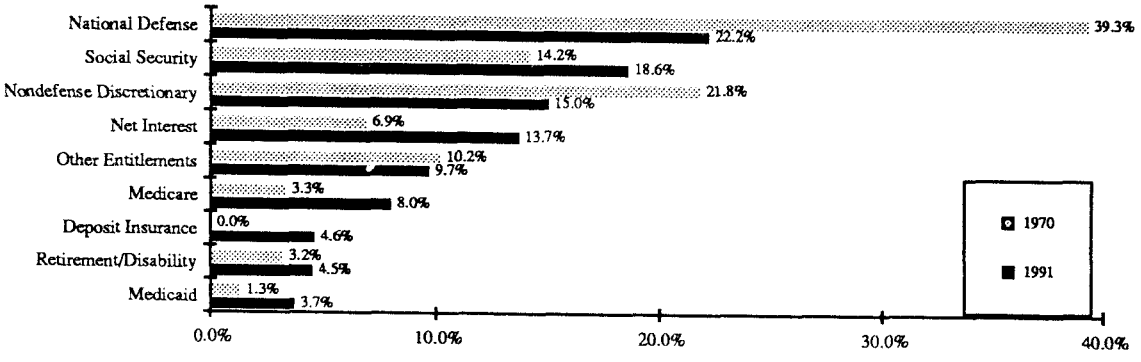
Total Federal Outlays and Revenues, 1976 to 1991



SOURCE: CBO, *Outlook.*

EXHIBIT 4

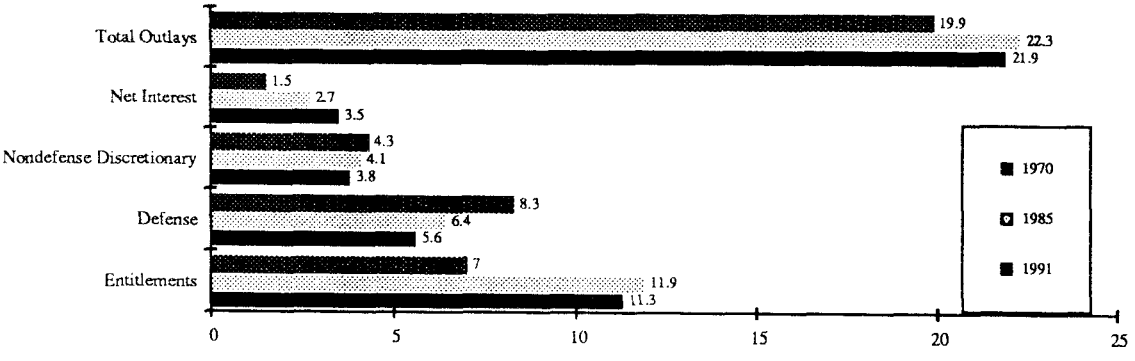
Composition of Federal Spending (Excluding Offsetting Receipts), 1970 and 1991



SOURCE: CBO, *Outlook.*

EXHIBIT 5

Selected Federal Outlays as a Share of GDP, Selected Years



SOURCE: CBO, *Outlook* and Council of Economic Advisors, Joint Economic Committee, *Economic Indicators, February 1992* (Washington, D.C.: U.S. Government Printing Office, March 1992).

The Size of the Deficit The Bush administration estimates that the "real" (on-budget) federal budget deficit will reach $449 billion in FY 1992.[2] The official deficit will be **only** $400 billion because of the large surplus in the Social Security Trust Fund. The gap, shown in Exhibit 6, between the real and the official deficit largely reflects this growing surplus, which, along with other trust funds is estimated to reach about $120 billion by FY 1997. The savings and loan bailout accounts for about $67 billion of the FY 1992 on-budget deficit.

As a percentage of GDP, the on-budget deficit exceeded 6 percent in FY 1983, the highest level since World War II, and it is expected to exceed that level in FY 1992 (see Exhibit 7). The CBO projects that the deficit will account for only about 3 percent of GDP by mid-decade, however. Although the CBO has a good track record, recent history indicates that this projection probably is too optimistic.

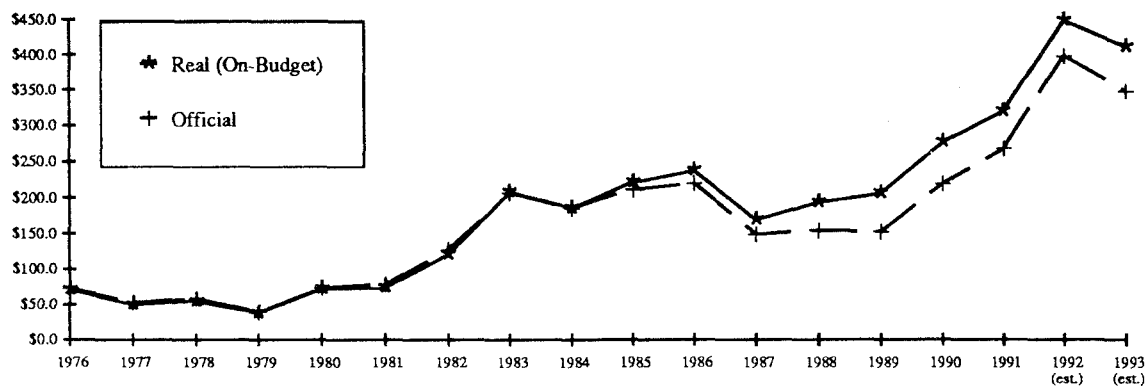
The National Debt The gross national debt, which was about $600 billion in FY 1976, will exceed $4 trillion in FY 1992. By FY 1995, gross debt is estimated to exceed $5 trillion. (See Exhibit 8.)

Interest on the Debt The interest on the federal debt is one of the fastest growing components of the budget, rising from about 7 percent of total federal outlays in FY 1976 to nearly 15 percent in FY 1991. (See Exhibit 9.) This growth has added to the difficulty of controlling federal spending, is partly responsible for the decline in aid to state and local governments, and has hampered the federal government's ability to deal with many of this nation's pressing problems.

The interest (net of investment earnings) on the federal debt in FY 1991 was almost $200 billion, which was the size of the entire federal budget in FY 1970.

EXHIBIT 6

Official and Real Federal Deficit, 1976 to 1993
(billions of dollars)



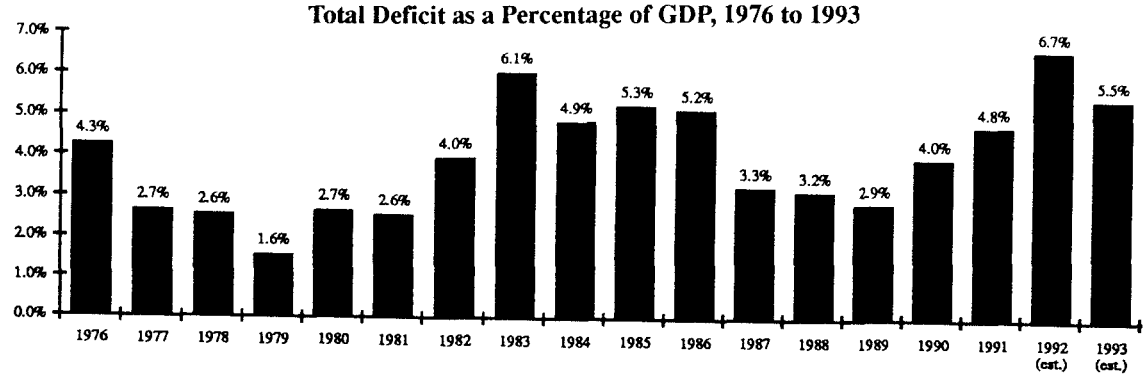
SOURCES: CBO, *Outlook*; and Council of Economic Advisors, Joint Economic Committee, *Economic Indicators, February 1992* (Washington, D.C.: U.S. Government Printing Office, March 1992).

NOTE: On-budget deficit excludes Social Security and the Postal Service. Official deficit includes income from the Social Security Trust Fund. Revised estimates for 1992 and 1993 by the U.S. Department of Treasury and the Office of Management and Budget

2 The on-budget deficit does not include spending for the U.S. Postal Service or monies in a variety of trust funds, including the Social Security Trust Fund.

EXHIBIT 7

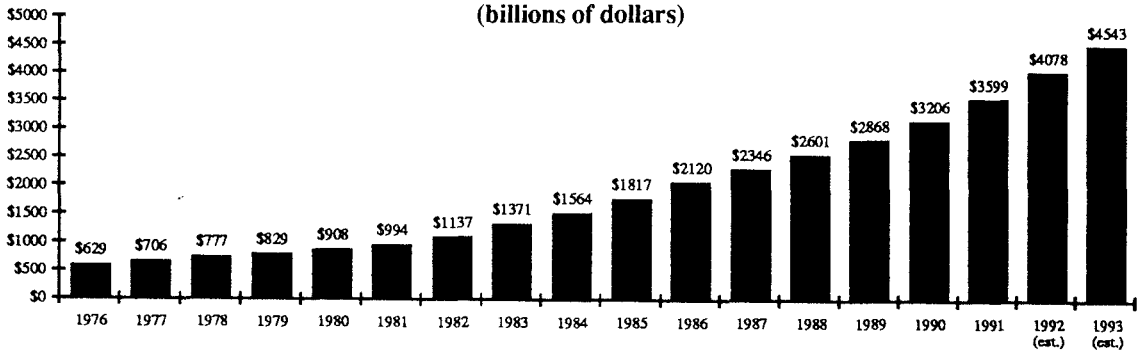
Total Deficit as a Percentage of GDP, 1976 to 1993



SOURCE: Council of Economic Advisors, *Economic Indicators, February 1992* (Washington, D.C.: U.S. Government Printing Office, March 1992).

EXHIBIT 8

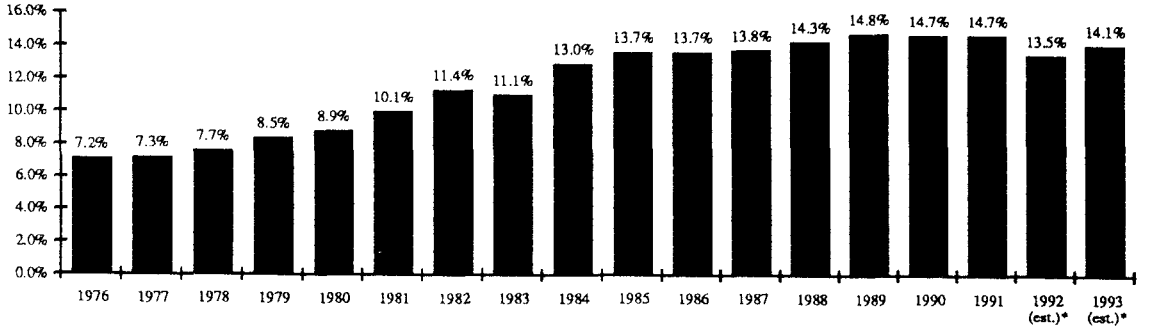
Gross Federal Debt, 1976 to 1993 (billions of dollars)



SOURCE: Council of Economic Advisors, *Economic Indicators, February 1992* (Washington, D.C.: U.S. Government Printing Office, March 1992).

EXHIBIT 9

Net Interest as a Percentage of Total Outlays, 1976 to 1993



SOURCE: Council of Economic Advisors, *Economic Indicators, February 1992* (Washington, D.C.: U.S. Government Printing Office, March 1992).

*Revised estimates by the U.S. Department of Treasury and the Office of Management and Budget

THE SOLUTION

There are no easy answers. As Paul Tsongas was fond of saying, "I am not Santa Claus." No one is going to bail us out. As our ancestors sacrificed to make this nation great, so must we sacrifice to keep America great.

The only choice is to slow the growth in federal spending and raise taxes. The peace dividend will help to some extent, but it will not solve the problem. For the period FYs 1988–93, total outlays are projected to increase at an annual rate of 7.3 percent. (It is worth noting that the rate of increase between FYs 1985 and 1991 was only 5.7 percent.) As shown in Exhibit 10, a major problem is accelerating Medicaid spending, estimated to increase at an annual rate of 21.3 percent between FYs 1988 and 1993. Spending on Medicaid has grown fourfold since FY 1984. Clearly, if we wish to limit the pace of spending, we must pay particular attention to entitlement programs, such as Medicaid, Medicare, and Social Security. One option is to cap the rate of increase for entitlements to no more than one percent above the rate of inflation.

We also must raise taxes. The most logical options are to increase the gasoline tax and institute a national value-added tax (VAT). Each 5-cent increase in the motor fuel tax would raise about $5 billion annually, while a 5 percent VAT (exempting food, housing, and medical care) would raise about $70 billion annually. There are other ways to raise revenue, such as a surtax of 5 percent on the personal and corporate income tax, which would raise about $30 billion per year. The CBO recently issued an excellent report (cited above) listing numerous options for reducing spending and increasing revenues. This document contains all the ideas anyone needs. The only remaining ingredient necessary for success is the political willpower to get the job done—before it is too late.

We are destroying our children's future. The young people in this country should be outraged, but they are either unaware or apathetic. The CBO is projecting weak economic growth in the 1990s because of slow growth in worker productivity, which it partially attributes to the federal deficit's negative effect on savings and investment. The CBO study states: "One problem the low rate of post-recession growth poses for our society is a challenge to the American Dream that each generation will be better off than its parents .... Hastening growth in productivity is the only way to avoid the spread of this stasis or erosion of living standards to growing segments of the population."

Aside from the terrible legacy we are leaving our children, the government's ability to function effectively is being undermined, as is our respect for government. The consequences of continued delay have been clearly enunciated by Senator Rudman. We can wait no longer.

EXHIBIT 10

Federal Budget Detail, Spending Levels and Growth Rates, FYs 1980–93
(billions of dollars)

Year	Discretionary Spending	Defense	Foreign Aid	Domestic	Entitlements/ Other	Medicaid	Social Security	Medicare	Deposit Insurance	Other	Net Interest	Offsetting Receipts	Total Outlays	Deficit (incl. Soc. Sec.)	On-Budget Deficit
1980	$276.5	$134.6	$12.8	$129.1	$291.5	$14.0	$117.1	$34.0	($0.4)	$126.4	$52.5	($29.2)	$590.9	($73.8)	($72.7)
1981	308.1	158.0	13.6	136.5	340.6	16.8	137.9	41.3	(1.4)	144.6	68.8	(37.9)	678.2	(79.0)	(74.0)
1982	326.2	185.9	12.9	127.4	372.7	17.4	153.9	49.2	(2.2)	152.2	85.0	(36.0)	745.8	(128.0)	(120.1)
1983	353.5	209.9	13.6	130.0	411.6	19.0	168.5	55.5	(1.2)	168.6	89.8	(45.3)	808.4	(207.8)	(208.0)
1984	379.6	228.0	16.3	135.3	406.3	20.1	176.1	61.0	(0.9)	149.1	111.1	(44.2)	851.8	(185.4)	(185.7)
1985	416.2	253.1	17.4	145.7	450.0	22.7	186.4	69.7	(2.2)	171.2	129.5	(47.1)	946.4	(212.3)	(221.7)
1986	439.0	273.8	17.7	147.5	459.7	25.0	196.5	74.2	1.5	164.0	136.0	(45.9)	990.3	(221.2)	(238.0)
1987	444.9	282.5	15.2	147.2	470.2	27.4	205.1	79.9	3.1	157.8	138.7	(53.0)	1,003.9	(149.8)	(169.3)
1988	465.0	290.9	15.7	158.4	494.2	30.5	216.8	85.7	10.0	161.2	151.8	(57.0)	1,064.1	(155.2)	(194.0)
1989	489.6	304.0	16.6	169.0	527.2	34.6	230.4	94.3	22.0	167.9	169.2	(63.9)	1,144.2	(153.5)	(206.2)
1990	501.7	300.1	19.1	182.5	566.5	41.1	246.5	107.4	58.1	171.5	183.8	(58.4)	1,251.8	(220.5)	(277.1)
1991	532.2	317.0	19.5	195.7	635.9	52.5	266.7	114.2	66.3	202.5	196.3	(107.8)	1,323.0	(268.7)	(320.9)
1992	547.0	313.0	20.0	214.0	708.0	68.0	285.0	128.0	67.0	227.0	201.0	(69.0)	1,475.0	(399.7)	(449.1)
1993	538.0	294.0	21.0	224.0	752.0	80.0	301.0	142.0	68.0	229.0	213.0	(67.0)	1,515.0	(349.9)	(391.0)
Annual Growth Rates															
1980-1991	6.1%	8.1%	3.9%	3.9%	7.3%	12.8%	7.8%	11.6%	NM	4.4%	12.7%	12.6%	7.6%	12.5%	14.5%
1985-1991	4.2	3.8	1.9	5.0	5.9	15.0	6.2	8.6	NM	2.8	7.2	14.8	5.7	4.0	6.4
1988-1991	4.6	2.9	7.5	7.3	8.8	19.8	7.1	10.0	87.9	7.9	8.9	23.7	7.5	20.1	18.3
1988-1993	3.0	0.2	6.0	7.2	8.8	21.3	6.8	10.6	46.7	7.3	7.0	3.3	7.3	17.7	15.0

NM: not meaningful.
Note: Detail does not add to total for FYs 1992 and 1993.