

**Presentation to the American Association
for Budget and Program Analysis**

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**“In the Wink of an Eye:
From Deficits to
Surpluses
and Back to Deficits”**

1980s . . .

- Deficits Skyrocketed from \$74 billion in 1980 to . . .
- \$128 billion by 1982
- \$208 billion in 1983

Deficits as a Percentage of the Economy. . .

- 2.7% in 1980
- 4.0% by 1982
- 6.0% 1983

Reasons for the 1980s deficits:

- Recession in the Early 1980s
- A Massive Tax Cut in 1981
- Major Increases in Defense Spending
- Significant Growth in Medicare and Medicaid

Mid-1980s

With a strong economic recovery,
deficits began to moderate:

- \$221 billion in 1986

declined to

- \$152 billion in 1989

1990: Rising Deficits, Again. . .

- Another Recession
- Record Outlays to Resolve the Savings & Loan Crisis
- Record Interest Payments to Finance Accumulated Debt from the 1980s

- In 1990, the annual deficit rose to \$221 billion, nearly 4% of GDP
- This set the stage for the first of 3 historic deficit reduction laws

1990 Budget Summit Agreement

- Senior Officials of the (George H.W.) Bush Administration met for 2 weeks at Andrews Air Force base with Democratic congressional leaders →
- Omnibus Budget Reconciliation Act of 1990

OBRA 1990

- Provided for \$500 billion in spending cuts and tax increases over 1991-1995
- Included Budget Enforcement Act of 1990
 - Discretionary Spending Caps
 - PAYGO requirement to offset any new tax cuts or entitlement increases

(Both enforced by automatic spending cuts)

OBRA 1993

- \$500 billion of deficit reduction over 5 years, roughly equal amounts of tax increases and spending cuts
- Unlike 1990, was not bipartisan; passed without any Republican votes

1995: Divided Government

- Divided government led to a dramatic political standoff → the most serious government shutdown in history
- Core dispute: Medicare, Medicaid, Education, and the Environment
- But, negative political fallout + increasing pressure to balance the budget, led to the Balanced Budget Act of 1997

1997 Budget Agreement

- **Balanced Budget Act of 1997 (extension of spending caps and entitlement cuts through 2002)**
- **Taxpayer Relief Act of 1997 (tax cuts)**
- ***Net Deficit Reduction***

The (short) era of Budget Surpluses

- Unified Budget (including Social Security surpluses) showed a surplus of \$69 billion in '98, growing to \$236 billion in FY 2000
- The Budget (excluding Social Security) showed a small surplus in 1999, and an \$86 billion surplus in FY 2000.

Surpluses in the Trillions

- By January 2001, CBO projected a 10 year budget surplus (2002-2011) of \$5.6 trillion

By January 2002, the fiscal outlook had changed dramatically.

The \$128 billion surplus of 2001 was followed by deficits of--

- \$158 billion in 2002,
- \$378 billion in 2003,
- \$413 billion in 2004,
- \$319 billion in 2005,
- \$248 billion in 2006, and
- \$163 billion in 2007

Excluding Social Security Surpluses,

the deficits were—

- \$317 billion in 2002;
- \$538 billion in 2003;
- \$568 billion in 2004;
- \$494 billion in 2005;
- \$435 billion in 2006; and
- \$344 billion in 2007.

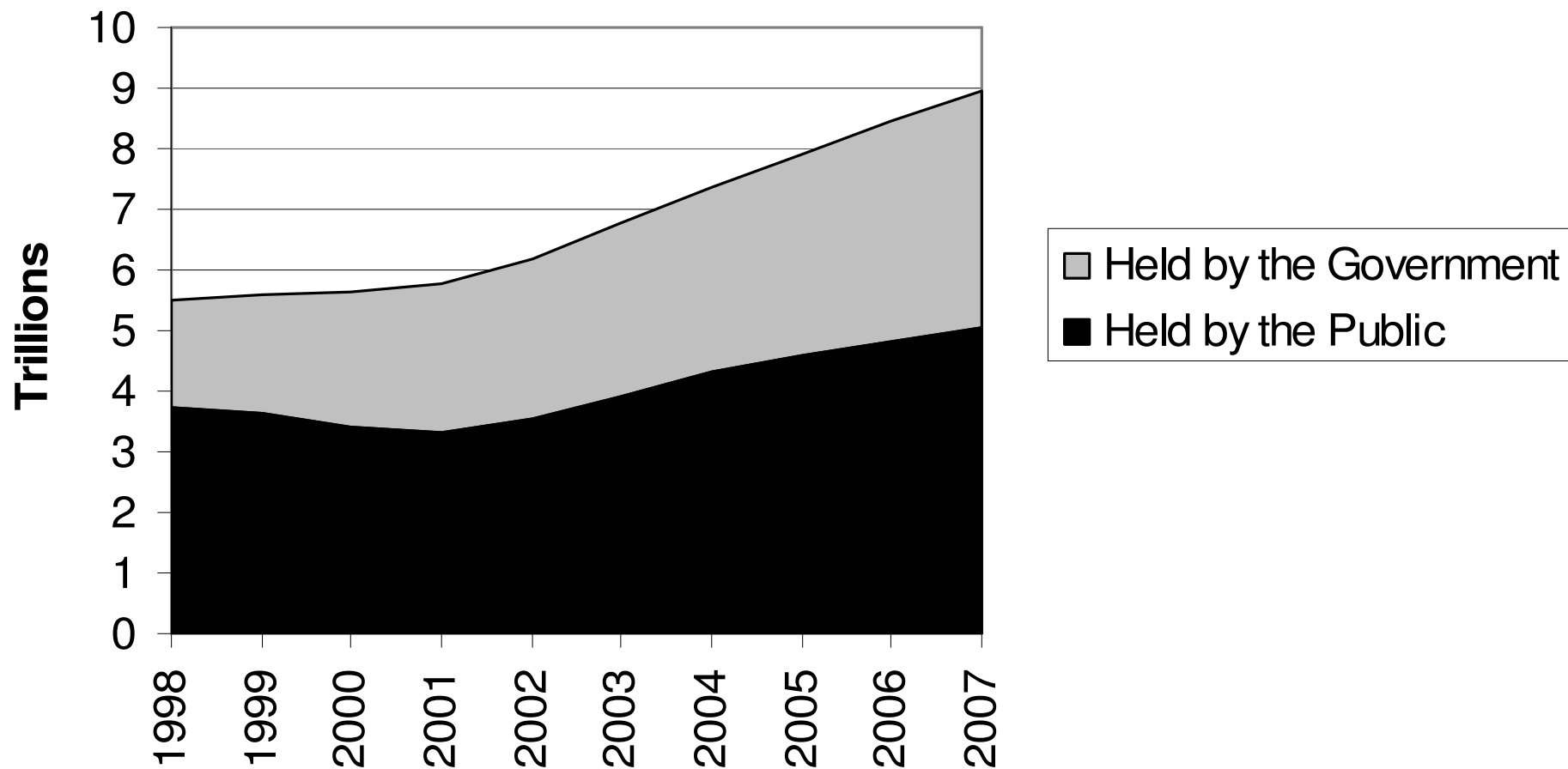
Federal Deficit or Surplus 1998-2007 (in billions)

(Excluding Social Security surpluses)



Gross Federal Debt 1998-2007 (in trillions)

(Gross Federal Debt is the sum of Debt Held by the Public and Debt Held by Social Security and other Government Trust Funds)



Between 2001 and 2007:

- Gross Federal Debt increased from \$5.8 trillion to \$9 trillion; and
- Debt Held by the Public increased from \$3.3 trillion to more than \$5 trillion.

Using *either measure of debt* – gross debt, or debt held by the public – our nation's accumulated debt has grown by more than 50% in 6 years.

What Happened?

- How did we go from CBO projections, in January 2001, of a 10-year \$5.6 trillion surplus, to a 50% increase in our nation's accumulated debt.

*Four Causes of this
Dramatic Reversal:*

1. Tax Cuts
2. The Recession
3. Increases in Defense Spending
4. Major Expansion of Medicare

1st Factor: Tax Cuts

- In 2002, CBO estimated that the largest single factor in the fiscal decline was the 2001 tax cuts, which cost \$1.35 trillion over 10 years.
 - Reduced marginal tax rates
 - Increased child tax credit
 - Phased out of the estate tax
 - Temporary reduction in the AMT

Additional Tax Cuts after 2001:

- **2002: \$30 billion** (accelerated depreciation)
- **2003: \$320 billion** (accelerated phase in of the '01 cuts and reduced tax rates on dividends and capital gains)
- **2004: \$147 billion** (extended earlier cuts and added energy tax subsidies)
- **2005: \$12 billion** (fossil fuel tax incentives)
- **2006: \$69 billion** (extended earlier cuts)

Extending the Tax Cuts Beyond 2010 would dramatically increase the Federal Debt

- CBO estimates that extending the 2001 and 2003 tax cuts and indexing the AMT would cost more than \$3 Trillion over 10 years.

2nd Factor: Recession

- CBO attributed about 1/4 of the fiscal decline to the recession of 2001-02.
- The impact of the recession is threefold:
 - Reduced revenues
 - Increased debt service costs
 - Increased entitlement outlays (e.g., unemployment benefits and other low-income programs)

3rd Factor: Defense Spending

- Defense spending nearly doubled between fiscal years 2001 and 2007
- Significant Factor:
 - Spending on the wars in Iraq and Afghanistan
 - Rapidly accelerating military health care costs
 - Increasing the size of the Army and Marines
 - Major cost overruns in weapons systems

4th Factor: Medicare Part D

- The enactment of the Medicare Part D prescription drug benefit, without any attempt to pay for the enormous increase in Medicare outlays.

Looking Ahead

- **Even if:**
 - The tax cuts are not extended beyond 2010;
 - We avoid deep recessions through careful monetary policy; and
 - Defense spending is moderated. . .
- There is broad agreement that we still face the greatest fiscal crisis since the Great Depression

CBO's 2007 Budget and Economic Outlook

- “The *aging of the population* and *continuing increases in health care costs* are expected to put considerable pressure on the budget in coming decades. Economic growth alone is unlikely to be sufficient to alleviate that pressure as Medicare, Medicaid, and (to a lesser extent) Social Security require even greater resources under current law.”

David Walker, Comptroller General of the United States (January 11, 2007)

- “Our current financial condition is worse than advertised. Our long-term fiscal outlook is both imprudent and unsustainable. . . . Long-term fiscal simulations by GAO, CBO and others all show that we face large and growing structural deficits driven primarily by rising health care costs and known demographic trends.”

FED Chairman Ben Bernanke on January 18, 2007

- “A vicious cycle may develop in which large deficits lead to rapid growth in debt and interest payments, which in turn adds to subsequent deficits. . . . [T]he effects on the U.S. economy would be severe.”

Congressional Research Service

- Reported to Congress in July '07: “The retirement of the baby boomers, rising life expectancy, and the rising cost of medical care are projected to place current federal policy on an unsustainable fiscal basis over the next several decades.”
- By 2030, Medicare, Medicaid, and Social Security could consume ALL Federal tax revenues.

CONCLUSION

The recent downward trend in annual deficits does not signal a positive fiscal outlook.

- The deficit numbers used by both the Administration and the Congress (projecting disappearing deficits by 2012) are misleading because they include Social Security surpluses that will soon disappear; and
- They fail to address the skyrocketing costs of Medicare and Medicaid beyond 2012.

Washington Budget Report - FY 2008 Appropriations

November 6, 2007 – Budget Authority in Billions – Sb = Subcommittee, FC = Full Committee, FL = Floor

Subcommittee/Bill #	Veto Threat?	House 302(b)	House Bill	House v. Pres.	Pres. Request	FY'07 Level	Senate 302(b)	Senate Bill	Senate v. Pres.	Conf.	Conf. v. Pres.
Agriculture HR 3161 / S1859	VETO THREAT	18.825	FL:18.817	+0.982	17.835	17.774	18.709	FC:18.709	+0.874		
Comm-Justice-Science HR 3093 / S1745	VETO THREAT	53.551	FL:53.551	+2.31	51.241	50.344	54.418	FL:55.4 [†]	+4.2		
Defense HR 3222 /		459.332	FL:459.594	-3.285	462.879	419.612	459.332	FL:463.1 ^{††}	+0.2	459.3	-3.5
Energy-Water HR 2641 / S 1751	VETO THREAT	31.603	FL:31.603	+1.13	30.473	30.298	32.273	FC:32.273	+0.8		
Financial Services HR 2829	VETO THREAT	21.434	FL:21.434	-0.244	21.678	19.518	21.394	FC:21.8**	+0.122		
Homeland Security HR 2638 / S 1644	VETO THREAT	36.254	FL:36.254	+2.063	34.191	33.7	36.439	FL:39.4***	+5.25		
Interior-Environment HR 2643 / S 1696	VETO THREAT	27.598	FL:27.598	+1.946	25.652	26.405	27.150	FC:27.15	+1.498		
Labor-HHS-Education HR 3043 / S 1696	VETO THREAT	151.112	FL:151.748	+10.828	140.920	144.522	149.236	FL:149.9	+9.0	150.7	+9.8
Leg. Branch HR 2771 / S 1686		4.024	FL:3.104*	n/a	4.331	3.773	4.051	FC:2.8*	n/a		
Mil Con-VA HR 2642 / S 1645	Insists on Offsets	64.745	FL:64.745	+4.0	60.745	49.752	64.745	FL:64.8	+4.0	64.7	+4.0
State-Foreign Ops HR 2764	VETO THREAT	34.243	FL:34.243	-0.7	34.943	31.277	34.243	FL:34.243	-0.72		
Transportation-HUD HR 3074 / S 1789	VETO THREAT	50.738	FL:50.738	+2.775	47.963	47.538	51.063	FL:51.063	+3.1		
TOTAL		\$953.459	\$953.429	+20.578	\$932.851	\$874.513	\$953.053				

Follow the unfolding Appropriations and Tax Developments

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