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America Speaks' Misguided Federal Budget 101

America Speaks' introductory guide, *Federal Budget 101: An Introduction to the Federal Budget and Our Fiscal Challenges [http://usabudgetdiscussion.org/wp-content/uploads/2010/03/Federal-Budget-101-Final-061110.pdf]*, claims to present a broad range of viewpoints in order to frame an intelligent discussion of the country's long-term budget problems, but it fails to do so.

Defining "Our Current Course"

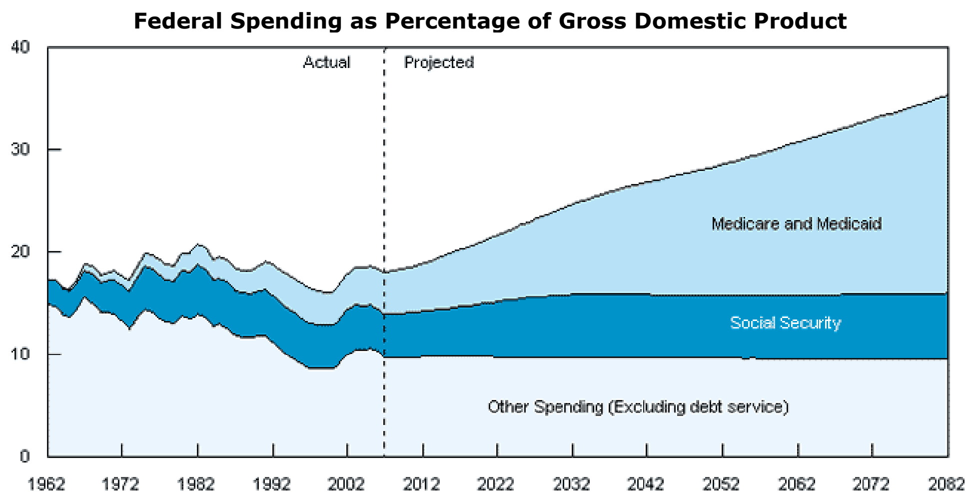
Throughout the guide, federal budget projections for 2025 are based on the assumption that "we continue on our current course." However, it deviates from current law and increases the 2025 deficit by extending all of the 2001 and 2003 tax cuts for high earners (p. 1), despite the fact they are scheduled to expire at the end of this year. The expiration of these tax cuts is explicitly supported by the President and Congressional leadership, and the cumulative effect over 15 years (including interest) would reduce the 2025 debt by more than $1 trillion [http://www.whitehouse.gov/omb/budget/fy2011/assets/tables.pdf]. This implies an interest burden that it is $40-50 billion less than what is assumed in the guide.

The guide also effectively assumes that nothing has been done to rein in the budget between now and 2025. In reality, it is virtually certain that other changes will be made between now and 2025 that will prevent the deficit from growing as large as projected in the guide.

Lumping Together Medicare, Medicaid and Social Security

In framing the challenge (p. 7) and discussing the aging of the population (p. 11), the guide fails to differentiate between Medicare, Medicaid and Social Security, despite the fact that Social Security is not a major contributor to future budget deficits. Through Medicare and Medicaid, the government pays for approximately half of the country's health care, almost all of which is actually provided by the private sector. Thus, the bulk of our projected rising budget deficits are due to skyrocketing health care costs.

Federal Spending as Percentage of Gross Domestic Product



Source: Congressional Budget Office [http://www.cbo.gov/ftpdocs/88xx/doc8877/Frontmatter.1.3.shtml]

Aging Population

In its discussion of an aging population (p. 11), the guide points out that "the 'baby boom' generation is just beginning to retire, making them eligible for Social Security and Medicare" but fails to mention that payroll taxes were increased in 1983 with the explicit purpose of partially pre-funding the retirement of the baby boomers. Nor are participants informed that the most recent projections from the Congressional Budget Office show that [Social Security will be able to pay full benefits through the year 2044 with no changes whatsoever](http://www.cbo.gov/doc.cfm?index=10457) [http://www.cbo.gov/doc.cfm?index=10457].

The Value of the Dollar

The guide gets some very basic economics wrong in its creation of frightening scenarios by telling readers that high deficits can lead to a "collapsing" dollar (pp. 3, 12-13).

In fact, standard economic models predict just the opposite relationship: While budget deficits can lead to higher interest rates, that would result in a stronger – not weaker – dollar. Higher interest rates would attract investors around the world to invest more in U.S. treasuries and other U.S. financial assets, increasing the strength of the dollar. It is remarkable that America Speaks managed to turn this economic basic relationship on its head.

Interest Rates and Inflation

The guide warns about the risks of both higher interest rates and higher inflation (pp. 3, 13). While it can be harmful to the economy if interest rates rise more than inflation, therefore leading to higher real interest rates, it would actually be beneficial to the economy if both were to increase modestly.

As the IMF recently argued, if inflation were to rise from the current range of 1-2 percent to a range of 3-4 percent, it would lead to a situation where the debt burden weighing on households would gradually be eroded. If wages moved in step with prices, then mortgages and other forms of debt would pose less of a drain on monthly paychecks. In addition, if house prices rose in step with inflation, then many currently underwater homeowners would again see positive equity in their home. In short, there is little reason for people to fear the scenario the guide warns against.

Economic Growth and Future Generations

The guide states that "When government borrows large amounts of money… our children and grandchildren may have to endure a weaker economy and lower living standards than they would otherwise enjoy" (pp. 3, 12-13) and that "not even a return to the strong, sustained growth of the 1990s would eliminate the deficit" (p. 15). Of course the well-being of future generations will depend importantly on the physical infrastructure and technical knowledge that we pass on to them. If cutbacks in spending are associated with cutbacks in government investments in these areas, then we will be making our children poorer, not richer.

The guide also fails to note that average incomes are rising through time and [the average hourly wage is projected to buy 20 percent more in 2025 than it does today](http://www.cbo.gov/ftpdocs/102xx/doc10297/AppendixA.9.2.shtml#1091396) [http://www.cbo.gov/ftpdocs/102xx/doc10297/AppendixA.9.2.shtml#1091396]. These basic

facts are especially important in the context of a discussion that focuses on intergenerational equity.

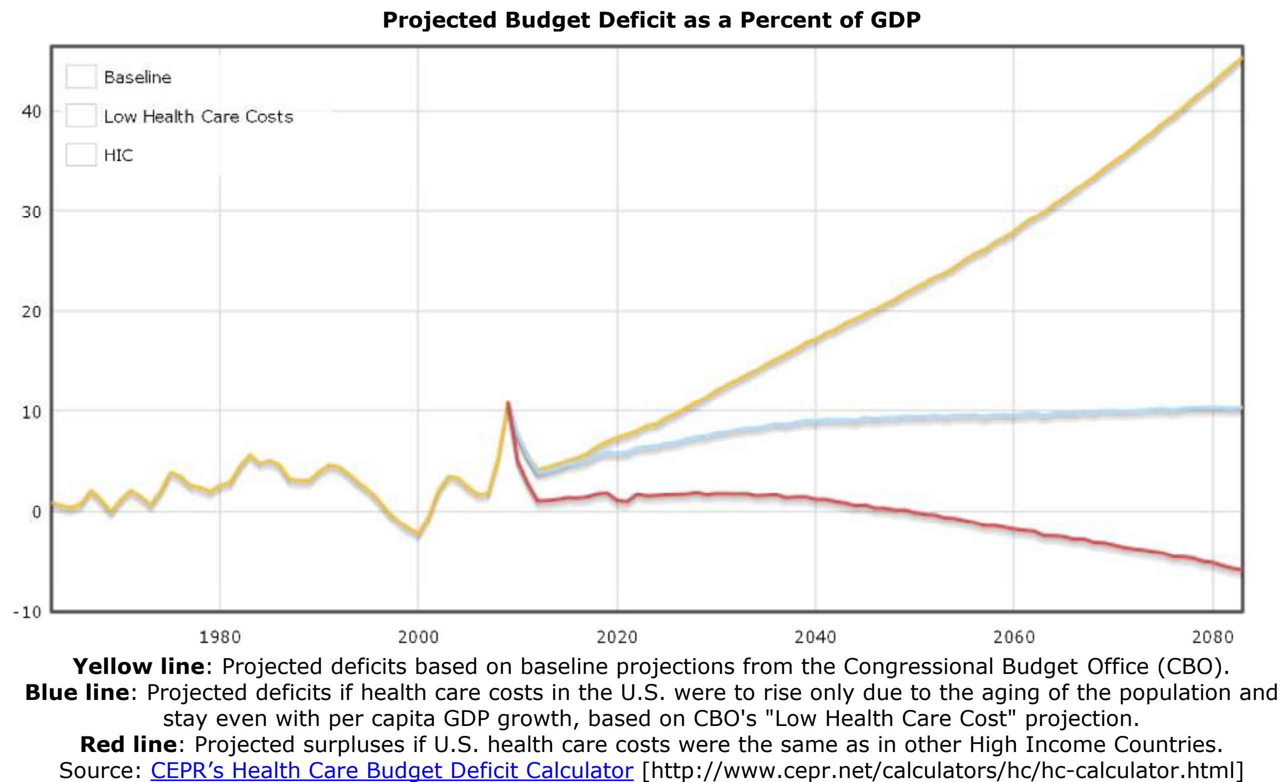
Drivers of Future Deficits and Debt

The guide drives readers to the conclusion that rising deficits and debt are mainly due to rising health care costs, an aging population, and large tax cuts (pp. 7-8, 15). It does not discuss the cause of the recent explosion of the deficit, the collapse of the housing bubble. The downturn resulting from this collapse will add more than $4 trillion to the national debt between 2007 and 2017.

It is important for readers to know that this debt (and the resulting interest burden) is not due to profligate spending or reckless tax cuts. Rather it was the result of economic mismanagement that allowed an $8 trillion housing bubble to grow unchecked.

Also, while the does note that most of the growth in future budget deficits is due health care costs and an aging population, it does not explain the full extent to which the deficits are the result of the inefficiency of our health care system. If our per person health care costs were the same as any for any other wealthy country, then the U.S. would face huge surpluses in the long-run rather than deficits [http://www.cepr.net/calculators/hc/hc-calculator.html]. If readers were made aware of this fact, it is likely that they would place far more emphasis on fixing the U.S. health care system.

Projected Budget Deficit as a Percent of GDP



Yellow line: Projected deficits based on baseline projections from the Congressional Budget Office (CBO).
Blue line: Projected deficits if health care costs in the U.S. were to rise only due to the aging of the population and stay even with per capita GDP growth, based on CBO's "Low Health Care Cost" projection.
Red line: Projected surpluses if U.S. health care costs were the same as in other High Income Countries.
Source: CEPR's Health Care Budget Deficit Calculator [http://www.cepr.net/calculators/hc/hc-calculator.html]