

WebMemo



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Fiscal Challenges for Government at All Levels: How Economic Stimulus Drives Up Deficit and Debt

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The 111th Congress begins its work with a war against an enemy that is as intractable as it is illusive and with an economic crisis that borders on historic in its severity and complexity. It is clear that the 111th must rise to levels of policymaking that few Congresses have had to achieve. While it does so, the new Congress must also be more aware of its limitations than those predecessors who were less challenged.

This is particularly true in the area of economic policy. The new Congress convened in a rapidly declining economy with an economic trough not yet in sight. Many Members may be tempted to “pay any price, bear any burden” to set the economy right. Indeed, one of the great threats to economic recovery is just this temptation: In its eagerness to do bold things, Congress may deepen the recession by damaging the country’s ability to borrow needed funds at affordable rates and by impeding the much-needed process of resetting spending and revenue priorities by state and local governments all across the country.

Debt and Deficit. The House and Senate may soon be asked to vote on economic stimulus legislation with a price tag near or exceeding \$1 trillion over two years. It may even sooner vote on a resolution to release the second half of TARP funding, or \$350 billion. Revenues will be down this year and next by percentages that few active Members of Congress have ever seen, and this Congress will find itself creating more debt more rapidly than any Congress in U.S. history just to meet current expenses.

However, the U.S. government is not alone in borrowing to stimulate its economy and to pay for current services. Every major economy, including the Asian giants, is in recession. Every government is borrowing or creating money and credit at historic levels. Furthermore, over the next three decades the need to find lenders to pay for promised income and health programs for retirees will only increase, particularly among those countries that experienced unusually rapid population growth following World War II.

Indeed, last spring one of the world’s leading credit rating agencies suggested that continued failure to reform entitlement programs would lead to such excessive spending and debt that U.S. bonds could well be downgraded to junk status.

While many Members are working to avoid this financial calamity, few have addressed the economic harm that massive borrowing will produce.

The Numbers of Debt and Deficit. Where is our nation in terms of the annual surplus or deficit and the total amount of U.S. debt?

First, the annual surplus or deficit:

- In FY 2000, the federal government had a surplus of \$189 billion (as measured in the National Income and Product Accounts).

This paper, in its entirety, can be found at:
www.heritage.org/Research/Economy/wm2227.cfm

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- In FY 2008, that deficit stood at \$541 billion.
- Given the slow economy, the deficit will likely grow to \$941 billion (including the second installment of TARP funds).
- If Congress passes an \$800 billion, two-year stimulus bill, that deficit in FY 2009 could stand at \$1.31 trillion and for FY 2010 could be \$1.27 trillion.
- As a percent of GDP, the FY 2009 deficit could be 9.2 percent of GDP, and the FY 2010 could be 8.7 percent of GDP.

Second, the total amount of federal government debt:

- In 2000, total federal government debt stood at \$5.7 trillion, or 58 percent of GDP.
- By 2008, that debt had grown to \$10 trillion, or 70 percent of GDP.
- If Congress borrows the funds for its economic stimulus plan, total debt could grow to \$13 trillion in FY 2009, or 92 percent of GDP.
- By 2010, total debt could grow to \$14 trillion, or 95 percent of GDP.

The Challenge for the States. The recession has hit state governments nearly as hard as it has depleted federal revenues. However, it is during bad economic times that state and local governments often have the best opportunity for reforming costly programs and righting their financial problems. And, indeed there are problems:

- The net operating surplus for state and local governments fell into negative territory in 2008 to $-\$81.7$ billion.
- That is down from an operating surplus of \$10 billion in 2007.
- States will likely produce negative operating balances through the end of fiscal year 2012: $-\$75$ billion in FY 2009, $-\$35$ billion in FY 2010, $-\$34$ billion in FY 2011, and $-\$25$ billion in FY 2012.

Given that states must balance their budgets each year, these operating deficits mean that state and local governments must manage their programs

more efficiently and carefully examine their spending priorities.

For example, education outlays constitute a major portion of every state and local government's budget. However, these governments often cannot innovate and reform their education programs due to federal education guidelines. One thing the federal government could do is to grant emergency powers to states to allow them to get more value out of their education spending. Education spending has risen rapidly over the last decade with little improvement to student scores. However, in states like Florida, where continuous educational innovation has been a high priority, improvements have been dramatic.

Medicaid outlays are the largest federally mandated spending program at the state level. Similar freedom to innovate is desperately needed here, particularly in creating a customer status for patients and permitting more competition in the provision of low-cost insurance for Medicaid eligible individuals.

Unexpected Opportunities. As a result of the current financial crisis, public officials at every level of government are facing unprecedented challenges—and opportunities. For the new Congress, these challenges include not only the temptation to overreach its inherent limitations, but the need to reform entitlement programs such as social security. Congressman Frank Wolf (R-VA) and others in the House have joined together to lead the entire Congress toward a better understanding of needed entitlement reform. At the state and local level, governments must recognize this economic downturn as an opportunity to implement crucial reforms while re-examining spending priorities.

The numbers do not lie: Our nation's projected debt is astonishing. Yet by enacting tough but necessary policy making decisions, the new Congress has an opportunity to realize good and lasting economic reform.

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