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Chapter 15 Fiscal Policy

This article from the March 2002 *Wall Street Journal Classroom Edition* examines reasons for the shrinking federal budget surplus. In “Four Trillion Gone,” *Wall Street Journal* Staff Reporter Jacob M. Schlesinger explored the long-term impact of the budget deficit on spending priorities. Some of his predictions came to pass, while others did not. Instead of a smaller surplus, the federal government now predicts large deficits.

Before reading the article below, you may want to look up the following terms: *deficit, discretionary spending, dissipated, federal debt, gargantuan, hammer, prudent, surpluses, and vise.*

A year ago, politicians and economists were proclaiming that a decade of budget surpluses would make it possible to simultaneously cut taxes, offer more health benefits to the elderly and eliminate the federal debt.

But a month ago, the Congressional Budget Office announced that the government will be running a deficit this year and next, the first red ink since 1997. That means no money for shoring up Social Security or sweetening Medicare or other pet projects. It could even mean a weaker economic recovery if the budgetary ills push long-term interest rates higher.

Even though surpluses will return mid-decade, the agency expects the black ink over the next decade to total \$1.6 trillion, well below the \$5.6 trillion it projected in January 2001. The government now projects deficits.

“Whew!” said Maryland Sen. Paul Sarbanes at a recent Budget Committee hearing, holding up a pie chart illustrating how the funds had evaporated. “Four trillion gone.”

“Unfortunately, that’s correct,” said CBO Director Dan Crippen at the hearing. He attributed 60% of the shrinkage to tax cuts and spending increases that Congress approved last year and the remaining 40% to the recession, the plunging stock market and technical factors.

As the new budget math sinks in, the implications are profound. Among them:

- Reforms of Social Security and Medicare, central to both parties’ promises in the 2000 presidential campaign, are all but dead. Putting the popular but troubled retirement programs on a sound financial footing was only politically feasible with trillions of dollars. Now, these issues will have to be revisited much closer to the time when the Baby Boomers retire, making the inevitably painful cuts more politically difficult.

- The government won’t do much to help the elderly or the uninsured with mounting health-care costs. Some form of government aid was going to come from surpluses, but that now seems less likely.

- Vast parts of the federal government outside of defense and homeland security—from infrastructure to environmental programs to science—will get squeezed.

As politicians worked to contain the swelling deficits of the 1980s, they scaled back substantially the size of the federal government. “Discretionary spending”—spending outside benefit programs like Social Security and interest on the federal debt—shrank to 6% of the economy in 2000 from about 10% through much of the 1970s and 1980s. Now, after years of declines, the military is poised to get a huge increase, thanks to the war on terrorism.

Deft politicians could declare that the hand-wringing about deficits in the past has been overdone, that deficits don’t really hurt and that other

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priorities rank higher than avoiding new government borrowing. That, in essence, is the White House strategy. It is proposing a budget for fiscal 2003, which begins Oct. 1, that shows a deficit of at least \$80 billion.

“The purpose of federal governments is not to run surpluses that are gargantuan, taking more money away from the American people,” White House spokesman Ari Fleischer says.

And there’s some evidence that voters may agree. In a Wall Street Journal/NBC News poll conducted recently, half those surveyed said they considered the re-emergence of deficits “just somewhat of a problem” or “not really a problem,” while the other half said they considered the development “fairly serious” or “very serious.” Even if voters do consider the deficit a problem, they tend to blame it on events beyond politicians’ control—recession and the war on terrorism.

Still, Democrats are likely to hammer away at the erosion of fiscal discipline through this election year. Florida Democratic Sen. Bill Nelson recalled during the recent budget hearing that, “in my campaign in the year 2000, and almost every other candidate running for office in the year 2000, a promise was made to the American people” not only to keep the government in surplus, but to wall off the special surpluses accumulating in the Social Security and Medicare trust funds. The new numbers mean Congress is “breaking the faith,” Mr. Nelson said.

But the biggest problem isn’t broken promises, says the CBO’s Mr. Crippen. Facing legislators who expressed concern about the next 10 years, the 49-year-old CBO director said the following decades are even more frightening. The 10 years covered by the new forecast “will only begin to touch on the era of what is likely to be the largest actual, real, not merely projected, fiscal swing in our history,” namely, “the retirement of my generation.”

Without a big surplus, the alternatives are ugly. “We’ll have to increase borrowing by very large, likely unsustainable amounts, raise taxes to 30% of gross domestic product ... or eliminate most of the government as we know it,” Mr. Crippen says.

The experience of Mr. Bush’s first year in Washington helps illustrate why holding the line on spending is highly unlikely. Thanks to the usual political pressures before Sept. 11—and the new demands after the terrorist attacks—Mr. Bush ended up signing bills that increased spending by 13%, the biggest increase in two decades, according to the CBO’s math. After that, Mr. Bush proposed a further increase to fund his big defense build-up.

“I don’t think anyone will ever mistake President Bush for someone who’s not fiscally prudent,” says White House Budget Director Mitchell Daniels. But, he adds, “neither will they mistake his first priorities” including the war on terrorism, domestic security and job growth.

QUESTIONS FOR DISCUSSION

- 1. Recognizing Cause and Effect** What are some causes for the change in the budgetary outlook?

- 2. Analyzing Information** How does the modified budget outlook affect the government’s spending priorities?

- 3. Identifying Alternatives** According to CBO Director Dan Crippen, without a big surplus, what alternatives to funding the retirement of the baby-boomer generation must be considered?

- 4. Drawing Conclusions** Do you think operating the federal government under a budget deficit is a problem? Why?
