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The Fiscal Facts of Life

By Michael Tanner - January 9, 2013

Having completed yet another deficit-reduction agreement that somehow managed to increase the deficit, Congress and the Obama administration are now laying the groundwork for upcoming fights over the debt ceiling, the sequester, and the continuing resolution that will fund the government given continued refusal by Senate Democrats to pass a budget.

But before sitting down to negotiate another deal that will kick the problem down the road, perhaps our legislators could use a refresher course on the fiscal facts of life.

Let's start with the basics. This year, the federal government will spend at least $3.62 trillion, an increase of almost $92 billion from last year. Of that amount, we will borrow $941 billion, or 26 percent. Indeed, our deficit this year is almost equal to the entire federal budget in 1985. And, in reality, spending will likely be even higher, since almost every year sees additional "emergency" expenditures as well. Thus, when all is said and done, expect our deficit to actually end up exceeding $1 trillion for the fifth consecutive year.

Our national debt, which can be thought of as the cumulative total of our annual levels of fiscal irresponsibility, reached $16.4 trillion this month. This already technically exceeds the debt ceiling that was agreed to less than a year and a half ago. It is worth noting that our debt at that time was just $14.3 trillion, meaning we have added $2.1 trillion to the debt since the last time we promised to cut spending as a trade-off for agreeing to more debt.

Our debt currently exceeds 102 percent of GDP, if one considers both debt held by the public and intragovernmental debt (such as the Medicare and Social Security Trust Funds), so we now owe more than the value of all goods and services produced in this country over the course of a year. It's much as if your credit-card bills exceeded your entire pre-tax salary.

Worse, that likely understates the true size of our indebtedness. If one includes the full future unfunded liabilities of Social Security and Medicare, this country's real indebtedness could run as high as $129 trillion (in current dollars). Even under the most optimistic scenarios, our real debt approaches $80 trillion. Measured as a percentage of GDP, our total debt exceeds the debt of Greece or Spain.

The debt burden means that economic growth will be lower in the future. For example, the International Monetary Fund looked at the relationship between federal debt levels and economic growth, concluding that from 1890 to 2000, countries with high debt levels consistently saw their economies grow at slower rates than those with low debt levels. Similarly, Carmen Reinhardt of the University of Maryland and Harvard's Kenneth Rogoff conclude that countries with a debt ratio above 90 percent of GDP have median growth rates 1 percent lower than countries with a lower debt, and average growth rates nearly 4 percent lower.

If economic growth stays as slow as it has been lately, but spending stays high, our debt-to-GDP ratio will get bigger, slowing economic growth further and creating a devilish sequence of cause and effect.

At the same time, there is no possible way to tax our way out of this debt. As much as President Obama wants to keep talking about taxing the rich, there isn't enough money there to solve our fiscal problems. In 2010, millionaires and billionaires in America earned $840 billion. At these levels, even confiscating all of their income would not cover the post-fiscal-cliff-deal 2013 budget deficit, leaving a shortfall of almost $100 billion. If you wanted to go after the debt, you would have to confiscate their entire wealth, estimated at roughly $11 trillion according to the Census Bureau, and you would still fall short of paying off the feds' credit card. Of course you could only do this once, and you would very likely wreck the economy in the process.

In 2008, the Congressional Budget Office estimated that in order to simply pay for then-projected spending, we would have to raise both the corporate tax rate and the top individual tax rate to 88 percent, raise the rate for middle-income workers to 63 percent, and raise the rate for low-income Americans to 25 percent. Given the explosion of spending in the last four years, those rates would have to be even higher today.

Does anyone this side of Paul Krugman believe we can sustain taxes at that level?

That means the only real solution must be on the spending side of the equation. Yet, we must recognize that there is no easy or painless way to cut spending to the degree it needs to be cut. For example, foreign aid amounts to just one percent of federal spending. Federal subsidies to Planned Parenthood and the Corporation for Public Broadcasting amount to a combined two one-hundredths of a percent. Indeed, all domestic discretionary spending this year, after adjusting for the fiscal cliff deal, will total just $628 billion. You could abolish all of it and you would still have a deficit this year of more than $312 billion.

Domestic discretionary spending amounts to 18 percent of all federal spending. Interest on the debt amounts to another 6 percent, but that is essentially untouchable. This leaves defense (19 percent) and entitlement programs, notably Social Security, Medicare, and Medicaid, which consume 46 percent of federal spending. (Another 11 percent goes to other entitlements, homeland security, and a few additional categories.)

That is why it is so disappointing that Republicans are working to undo the sequester for defense spending, while President Obama is keeping entitlement reform off the table. Frankly, there is no way to balance the budget or reduce the debt if 71 percent of the budget (defense plus entitlements plus interest payments) is uncuttable.

Unfortunately, we have been here before. In 2011, we had a fight over the Continuing Resolution funding the government. After a near government shutdown, Congress and the president promised to do something about the deficit and overspending. A few months later, we had a crisis over the debt ceiling. Congress and the president promised to do something about the deficit and overspending. Two weeks ago, we almost fell off the fiscal cliff. Congress and the president promised to do something about the deficit and overspending.

Does anyone see a pattern here?

We are not going to tax our way out of debt. We are not going to grow our way out of debt. And we are not going to get out of debt by trimming "fraud, waste, and abuse." It's time to face the fiscal facts.