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The Ho-Hum Return Of the Red Menace

This Time, the Deficit Isn't Generating Much Interest

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Long ago, an abomination roamed the political landscape, a thing so horrible that the mere mention of its name -- *the deficit* -- could make a grown economist whimper like a baby.

It unnerved Republicans and Democrats alike. Op-ed columnists flogged it mercilessly (while secretly being grateful that it gave them a topic on a slow news day). Numbers-crunching budget analysts said it was not just loathsome and mortifying, it was something even worse: fiscally imprudent.

Something had to be done. Congress implemented deficit-reduction targets. A Republican president named Bush broke a pledge and agreed to raise taxes. A Democratic president named Clinton pushed another tax increase through Congress. Deficit hawks soared majestically over the nation's capital. The deficit shrank. The economy boomed. Tax receipts surged. The deficit melted away entirely. Never again would it terrorize the American people.

That's just a fairy tale, it turns out.

The White House this week revealed that it expects the government to run a record \$455 billion deficit for fiscal year 2003. That's \$455,000,000,000. That's $4.55 \times 10^{+1}{+1}$ dollars.

The White House also said that, contrary to assertions earlier this year that budget surpluses will return, the large deficits will actually continue through the foreseeable future. The news is a veritable blast from the past, like hearing that perestroika is the buzz of the think tanks or that Guns N' Roses is topping the charts.

"Big deficits make budget geeks cool again. That's great news for me," Congressional Budget Office Director Douglas Holtz-Eakin said yesterday. "Think of what it will do now for the collected works of David Stockman."





For those for whom deficit humor goes whooshing over the head, that's a reference to the controversial director of the Office of Management and Budget under President Reagan. The new deficit bears a certain resemblance to those 1980s models. Like the old ones, this deficit is driven to a considerable degree by a combination (a "perfect storm," as one analyst put it) of a weak economy, higher defense spending and tax cuts.

"Here we go again," former senator Warren Rudman said yesterday.

Rudman, a Republican from New Hampshire, co-authored the fabled, if not overwhelmingly successful, Gramm-Rudman (aka Gramm-Rudman-Hollings) deficit-reduction law of the mid-1980s. He knew that deficits might come back -- but not like this.

"There's a limit to how much you can borrow before you start to crater," he said.

Deficit hawks admit that a deficit can actually be helpful when the economy is weak. But they think the real shortfall will be worse than \$455 billion, and that long-term deficits -- what analysts call a structural deficit --

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will suck up investment capital that might otherwise go to private-sector initiatives. Interest on the federal debt will eat up more tax dollars. The baby boomers will retire and put a drain on national resources. Rudman sees a potential tidal wave of red ink -- and yet he hears no one putting up much of a fuss.

"The Republicans suddenly don't seem to care. The Democrats say they care. I'm not sure they do," Rudman said.

There is no significant movement in Congress or in the White House to do anything about the deficit. The Republicans are committed to tax cuts and are expected to try to extend the cuts that are set to expire in coming years. The Democrats are committed to the expansion of Medicare to include a prescription drug benefit, and the Republicans have signed on to the plan as well. Meanwhile there are wars to be prosecuted, a homeland to be secured.

"Everybody's out there spending money," Holtz-Eakin said.

The reason no one is panicking is that the United States government no longer abides by that famous maxim that, if you start adding up a billion dollars here and a billion dollars there, pretty soon you're talking about real money. Nowadays it takes hundreds of billions of dollars to really get people's attention. The national economy is quite large, something like an \$11 trillion operation. Thus when the White House made its announcement this week, it said that the \$455 billion wasn't such a big number.

It's "manageable," in the words of Joshua B. Bolten, who took over the Office of Management and Budget just a few weeks ago and thus can truthfully claim that he's not the one who blew a \$455 billion hole in the national ledger.

The White House points out a key fact, one that even critics concede: The \$455 billion represents only about 4.2 percent of the Gross Domestic Product. That 4.2 percent figure is hardly a record. In the past, the deficit has been as much as 6 percent.

It is possible to make big numbers smaller when you look at them the right way. You can also make them look bigger. Consider that in 1962, \$107 billion is what the federal government spent on every program, including the military and Social Security.

What really matters, according to several analysts, is not the \$455 billion figure, or even the 4.2 percent of GDP figure, but the trendline, the direction of things over the course of a number of years.

"I would say 4.2 percent is entirely manageable," Holtz-Eakin said. "But 4.2 every year forever is a different proposition. That's going to put a real crimp in our ability to conduct federal policy. Just paying the interest is going to be a larger and larger part of the budget."

The problem with borrowing money is that it has to be paid back with interest, and the government is already several trillion dollars in the hole. The government will have to pay interest on that new debt, and to do that, it will have to borrow even more money in coming years, as the various Treasury bills get redeemed -- and will thus have to pay interest on *that* extra borrowing.

It's very much like what happens when you buy a house, and you think you're paying one price, and the lawyer at the closing hands you a document that discloses the real price once you add in all the interest, and it turns out to be that dreaded number that Ian Frazier once wrote about -- *a killion*.

A number so big, it kills you.

Among deficit hawks, the worst-case scenario (unlikely, but fun to talk about) is something called "debt explosion." This is when the debt rises faster than the Gross Domestic Product for a number of years in succession, and interest on the debt begins to eat up more and more of the country's resources until finally the

economy goes into a death spiral.

"It's a runaway greenhouse effect, or it's those biology experiments with microbes in a petri dish," said Richard Kogan, budget analyst for the liberal Center on Budget and Policy Priorities. "It's another manifestation of the laws of compound interest. It's an exponential growth curve."

As a percentage of GDP, Kogan said, the \$455 billion deficit is about equal to the deficits that Franklin Delano Roosevelt had during the Great Depression.

"If you go back to 1789, there are only three times in history when we had debt rise faster than GDP -- that is, when we were on a trajectory for a debt explosion: When we were in war, when we were in a recession and when Ronald Reagan was president," Kogan said. He said the Bush administration has provided estimates on deficits only until 2008 because it doesn't want to show that there will be big deficits into the far distant future.

A sharply different perspective comes from Jonathan Collegio, spokesman for Americans for Tax Reform, a conservative group. In his view, Big Government spending programs are the culprit. He cited bloated budgets for the Departments of Education, Transportation and Health and Human Services, increases in spending for such programs as Head Start, and a farm bill that he called a "disgrace."

Collegio said the government could save, over the course of a decade, \$13 billion by eliminating food stamp "payment errors," \$33 billion by eliminating similar errors in payments from the Department of Housing and Urban Development and \$121 billion by stopping Medicare fraud. ("Medicare fraud is huge," he said.)

It should be clear by this point that fiscal policy is not a realm of absolutes. Different people point to different numbers. The harshest critics of the Bush administration can point out that the government was running a surplus in 2000 that represented 2.4 percent of the GDP. In the euphoria of the moment there was talk of multitrillion-dollar surpluses over time and serious debate about what should be done with all the extra money. That now seems a momentary madness, like the brief celebrity of Darva Conger.

The projections of huge surpluses were made during a bubble economy and were never truly grounded in reality. No one ever knows how much the economy will or won't grow. The Bush administration is assuming the return of a strong economy, humming along at something like a 3.9 percent growth rate over the next year. Deficit hawk Rudman says that's possible but represents a risky assumption.

"If you're interested in betting the farm, bet the farm. And if it doesn't happen, where are you?" Rudman said.

Even a seemingly hard number such as \$455 billion is nothing more than a projection by the White House. The number includes the Social Security surplus, the current excess of Social Security taxes over Social Security outlays. Without the Social Security surplus, the deficit for 2003 would be \$614 billion.

Robert Bixby, executive director of the Concord Coalition, has greeted the resurrection of the deficit with precisely the kind of alarm you'd expect from a group that came into existence in 1992 expressly to fight this scourge of fiscal sanity. "There's a vicious cycle, very much like credit card hell," he said. "This deficit this year is going to have to be financed, and that will show up in future years as a cost."

It has to be a slightly bittersweet time for Bixby and his colleagues. The monster is back but brings with it a renewed sense of purpose for those who fight it. Bixby said Sen. Paul Tsongas, a founder of the coalition, "always said that our goal should be to go out of business."

There's no danger of that. The deficit hawks soar again.

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