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Reaping the Whirlwind

Unless we curb the deficit, our children will inherit an economy incapable of supporting them.

Popular history tells us that when Franklin Delano Roosevelt became president in 1932, he saved the American republic from collapse by abandoning the policy of governmental nonintervention in economic affairs and engaging in deliberate deficit spending. This action suggested to some observers that not only could government mitigate downturns in the economy, it should assist the marketplace to reach socially acceptable goals. But while active economic management may produce valuable temporary results, it can also have negative consequences. The budget deficit and the national debt are two instances where bad federal policies are leaving the next generation to reap the whirlwind.

Consider the size of the deficit and how it has grown:

- The federal deficit exceeded $60 billion only twice before 1980. Since then it has averaged $171.2 billion a year.
- In 1986, the federal government will spend about $215 billion more than it will receive.
- In 1980, cumulative federal borrowing was $715 billion. It now exceeds $1.5 trillion.
- Annual outlays for interest on the national debt grew by 146 percent between 1980 and 1985, an increase that far outstrips the growth in any other major spending category.

There is no doubt that budget deficits can bring short-term benefits. Additional spending, regardless of the source, can boost a sluggish economy. But these extraordinarily large deficits bring with them multiple problems that outweigh the short-term gains.

The first problem is simply financing the deficit. When the government borrows money, the loanable funds available to the private sector are reduced. And when the supply of anything is reduced, prices rise. Sooner or later this kind of borrowing will drive up interest rates.

Some people argue that the current level of deficit spending is not a problem because when the government spends, it helps ensure that the economy is operating at full capacity. But this is not a persuasive argument. U.S. consumers have an enormous demand for automobiles, houses, and other goods. If the government were not absorbing so much of the available capital, loans would be cheaper, and consumers could purchase more.

Government borrowing also affects private sector investments. Current interest rates are lower than they have been for several years. Nonetheless, an investment that would have been profitable at a 6.5 percent interest rate could very well be unprofitable if it has to be financed at a 10 percent rate. If the private sector does not make new investments in plants and equipment, the nation's capital stock is diminished. This, in turn, will cause a decline, over time, both in our productivity and standard of living. Ultimately, we bequeath this problem to our children, who will inherit whatever capital stock we leave them.

The second problem concerns the source of funds to finance the deficit. There is a little equation in economics that says "public borrowing minus excess private savings equals inflow of foreign capital." For much of its history, America's private saving has exceeded government borrowing. This has meant that foreign capital has not been needed to finance the federal budget. But now the sheer weight of the deficit is swamping our domestic savings, and foreign capital is flowing into the United States. At a recent U.S. Treasury Bill auction, for example, the Japanese alone bought around 30 percent of the total offering.

Foreign capital currently flows into the economy at the rate of $150 billion dollars a year. This would be wonderful if it never stopped, but foreign investors are willing to invest in the U.S. because of the high returns relative to the rest of the world. At some

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point (for example, if interest rates fall and investments no longer offer a high return), the flow of foreign capital may reverse. If this happens, less money will be available for loans and interest rates will rise.

But imagine if this happens in a recession (as it well might). When government tries to borrow even more money to offset lower revenues and larger welfare payments, the upward pressure on interest rates will increase. This could make the recession longer and more severe.

The third problem is what is left or, more accurately, what is *not* left, for the next generation. Whatever money the federal government borrows today will be repaid by future taxpayers. The bills are already considerable. In fiscal year 1986, interest payments made up roughly 25 percent of the federal government's on-budget revenues. That amounted to $138 billion. To put this in perspective, consider that it is more than the federal expenditure for any social program except social security. It is roughly equal to the total amount that the nation spent for elementary and secondary education in 1984. More ominous, the amount is growing.

Budget deficits and an increasing national debt are not only troublesome for this generation and an unacceptable legacy for our children, they are a problem for the entire world. Major international organizations such as the World Bank list the federal budget deficit as the number one international economic imbalance. It is so important that alternative growth scenarios for the world are based on how successfully America deals with cutting the budget deficit.

To calmly accept the current level of federal deficits seems equivalent to calmly accepting a barrel ride over Niagara Falls. Yes, it is a risky enterprise that might turn out all right, but which of us in our right mind would take that risk? Perhaps the biggest danger is that such huge deficits virtually eliminate any margin for error. Tom Wolfe coined the phrase "the edge of the envelope" to describe the delicate line between success and disaster that test pilots face every day. As a society, thanks to budget deficits, we also live at the edge of the envelope.

That a change must be made, for our own sake, for our children, and for the world community, is obvious. Government receipts and expenditures must be brought into rough balance. This need not happen overnight, but it must happen. This will not be easy or pleasant, but it must be done.

If this cannot be accomplished by political resolve to cut spending or raise taxes, and some automatic mechanism such as that offered by the now invalid Gramm-Rudman-Hollings law is required, so be it. Reducing the deficit during periods of prosperity and increasing it in time of economic hardship is a sensible idea. Trimming government spending now would reduce some economic stimulus, but the idea of a nonescalating national debt and a strong economy capable of supporting new industries and increased employment far outweighs any short-term negative consequences.

When President Reagan was inaugurated, he said, "You and I, as individuals, can, by borrowing, live beyond our means, but only for a limited period of time. Why, then, should we think that collectively, as a nation, we're not bound by that same limitation?" This was true in 1981 and it is true today. Unfortunately, the "tax and spend" philosophy that characterized the 1960s and 1970s was replaced by a "borrow and spend" mentality in the 1980s. Unless we stop this excessive borrowing, we will ensure that the next generation will reap the whirlwind.☐

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