

# Budget Deficit Politics

By Logan Scisco

During the “off season” after NFL Nationals, the issue of the budget deficit has come to be a major one in American politics. It has the potential to shape the outcome of the midterm elections in 2010 and is playing a role in President Barack Obama’s declining popularity ratings. As extempers get ready for the 2009-2010 season, which starts in less than six weeks with the Wake Forest National Early Bird, they will face questions about an array of economic issues such as unemployment, the effectiveness of the stimulus package, and the level of international trade as well as the controversial issue of healthcare reform. All of these issues have something to do with the budget of the United States government and by proxy the deficit the U.S. government currently finds itself facing.

Americans in the late 1990s got used to seeing fiscal discipline on Capitol Hill between the executive and legislative branches. President Bill Clinton worked with Republican leaders on Capitol Hill, a relationship that was often tense through impeachment proceedings and a government shutdown, to craft a budget that was balanced and that ran a surplus totaling \$128 billion. In fact, the major issue of the 2000 election between Vice-President Al Gore and then-Texas Governor George W. Bush was over what to do with this budget surplus, with Gore arguing that it needed to be used to shore up entitlement programs such as Social Security in a “lockbox” and Bush arguing that it needed to be given back to the American people in the form of a tax cut. After the first presidential debate between the two men in the fall of 2000, *Saturday Night Live* had a hilarious mock debate over this issue.

After Bush won the election, he was able to get Congress to approve his tax cut package and celebrated the occasion as a victory for small government. However, thanks to September 11<sup>th</sup> and a U.S. recession that began after Bush was elected, the federal government started to see deficits early in the Bush administration. By the time Bush left office, he and Congress, which was controlled for six years of his administration by Republicans, left the country with nearly a \$500 billion deficit. To put this into perspective, that number represents nearly three percent of America’s gross domestic product (GDP), the total value of goods and services produced within the U.S. in a given year.

Therefore, this topic brief will describe the state of the budget deficit under the Obama administration, how Congress and the Obama administration are trying to cope with it, and the political fallout on the budget deficit issue.

## Obama and the Deficit

By the latest estimates, the federal government’s deficit has ballooned under the Obama administration to \$1.8 trillion. Deficits of this size were unthinkable before, but as last week’s edition of *The Economist* pointed out, the current size of the deficit is related to three factors. First, tax revenue for the federal government has fallen as the economy has contracted over the last year. With the economy shrinking, businesses have shut down and wealthy taxpayers do not have as much income to tax and middle class Americans, some of whom have been laid off from work or have had to accept pay cuts, have shrinking incomes to tax as well. A second factor is the interest of the national debt that the federal government must pay to creditors. Those who were not a fan of the stimulus package argued that much of it was financed by the Chinese government, which holds over \$500 billion of U.S. national debt. A final factor is the way that Obama and his predecessor have handled the economic crisis. The infamous Troubled Asset Recovery Program (TARP), meant to help financial institutions, cost the federal government \$700 billion. Obama’s stimulus package, the so-called Recovery and Reinvestment Act cost the government another \$787 billion. And keep in mind that the size of the current healthcare legislation is said to be \$1 trillion.

There is one message from economists concerning the U.S. and its massive deficits: get used to them. Based on the three factors outlined above, the current pace of U.S. government spending will only decrease the deficit from \$1.8 trillion to \$1.2 trillion by 2019, which is considered a big year because that is when entitlement programs such as Medicare and Social Security will begin to dig a bigger hole in the deficit and make it grow even larger.

If you are looking at how much GDP is being swallowed by the deficit, the current amounts are over five percent. The current Federal Reserve Chairman Ben Bernanke prefers to have the deficit at three percent of GDP, arguing that anything higher is simply unsustainable for the government to have and that higher debt burdens will eventually reduce investor confidence in the American economy.

Obama has tried to take the stance that he is committed to bringing these deficits down when an economic recovery takes place, which his economic team argues will start next year. However, to many Americans Obama is not moving quick enough to solve this deficit problem and his willingness to spend federal money on legislation that they perceive have had little effect on the economy is not helping him politically, especially in states that are hard hit by the economic recession.

### **Combating the Deficit**

Sensing that there is political danger in playing with the deficit, especially since they promised to bring more fiscal accountability to Washington when they won the 2006 midterm elections, Democrats in the House of Representatives passed legislation last month that would reinstate “pay as you go” rules to federal spending. The “pay as you go” principle, also called “pay go” for short, is that if the federal government tries to spend federal revenue that is non-existent in the form of new programs or tax cuts that there are automatic spending cuts in other parts of the budget or taxes are raised to pay for them. However, before anyone out there gets any wild ideas about the cuts that take place, consider that programs such as Medicaid, food stamps, Social Security payments, and many parts of the Medicare program are exempt from automatic cuts since those programs are seen as helping the most vulnerable of Americans, notably the poor and the elderly.

While this idea makes sense because it could potentially lead to more fiscal responsibility from legislators, there are problems with “pay as you go” rules in their current form. First, the “pay as you go” rules can be waived aside by Congressional leaders if they really want to push for tax cuts or a new federal program which weakens their effectiveness. Second, the current rules make it possible for Republicans and other political forces to reinstitute the Bush tax cuts without having to adhere to the “pay as you go” rules. Finally and maybe most important, under the July legislation, appropriation bills, which often have lots of “pork” and unnecessary spending, are not subject to the “pay as you go” rules.

It is hardly any wonder that after this legislation was passed, Congressional Republicans argued that it was an attempt by the Democratic leadership to make it appear to the American people that their party was getting tough on the budget deficit when it had no intention to do so. For “Blue Dog” Democrats, those Democrats elected from conservative districts and who have committed themselves to fiscally conservative principles, the legislation was a symbolic attempt to shore up their fiscal credibility in the eyes of their constituents, which for some is painfully needed in light of healthcare reform and the cap and trade legislation.

Another way of deficit reduction is coming in the form of taxation. On August 2<sup>nd</sup>, on an edition of *This Week* on ABC, Treasury Secretary Timothy Geithner refused to say that tax increases were not coming in the future. While this might not be news if it only dealt with tax increases on the wealthiest Americans, that does not appear to be the case on closer inspection. Extempers should keep in mind that the latest

healthcare legislation does impose a tax on wealthy Americans to make up part of the program, so giving rich Americans a “double whammy” in the form of taxes may not be a great idea, because there is only so much that you can soak the rich, especially to make up for a budget shortfall. Therefore, any tax increases may have to come on those Americans that are part of the middle class, which Obama defined during the 2008 campaign as those making less than \$250,000 a year. Geithner clarified that these tax increases may only happen when the economy starts to witness a recovery, but any tax increases like these do put Obama in a tricky political position, as he promised no tax increases at all on this group and is probably astute enough to know that Bush 41 lost his re-election campaign to Bill Clinton because he violated his “no new tax pledge” from 1988. Ironically, Bush’s decision to back off of that pledge was because of America’s budget deficits.

## **Political Fallout**

While Americans are not always given credit for their economic prowess, a significant part of the American electorate is beginning to take notice of the deficit issue. According to a recent *Wall Street Journal/NBC* poll, nearly a quarter of Americans believe that the budget deficit is the most important issue facing the country. On top of that, nearly forty percent of Americans do not believe that Obama is taking the problem of the deficit seriously, pointing to his programs that he is appearing to want to rush through on healthcare and climate change.

To put this in an even bigger perspective, Obama’s popularity ratings have come down to “normal” levels, as voters are not seeing any relief of their economic problems. Part of this is because of the Obama team’s decision to sell the stimulus package so as to prevent unemployment from nearing ten percent. However, economists now expect unemployment to hit that mark by the end of the year and it does not help that unemployment is what economists consider to be a lagging indicator, one that does not necessarily reflect the conditions for the economy.

Although it is unlikely that the Republicans will be able to win nearly forty House seats to wrest control of the body, as a party has only won those numbers on two occasions, 1946 and 1994, the deficit does allow them to repair some of their fiscal credentials that were shattered under Bush. As the party completely out of power, the Republicans cannot be blamed for much of the current economic mess, whether the Democratic Party likes that or not. Since they control all of Capitol Hill, all policies bear the Democrats insignia and for some “Blue Dog” members, they are facing immense criticism in their districts over government spending and Obama’s social policies. RNC Chairman Michael Steele has made the deficit a major part of the Republican platform and young Republican Congressman such as Paul Ryan of Wisconsin are trying to center the party on fiscally conservative principles.

The deficit is also helping Republicans in their fight against healthcare reform. Although the Obama administration has tried to sell the reforms as deficit neutral, the Congressional Budget Office (CBO) has estimated that the healthcare legislation will add \$239 billion to the federal deficit over by 2019 and increase significantly in costs after that point. Faced with these prospects and voter discontent over mortgaging America’s future with deficit spending, the conservative Congressman the Democrats have to rely on to pass healthcare reform may not go along and a failure to pass healthcare reform when the party has a majority on Capitol Hill would be embarrassing. It may not be Obama’s “Waterloo” if he fails to pass healthcare reform, but it would not endear him to the Democratic base. The healthcare debate can also recast the Republicans as the party of smaller government and limited intervention, although they still have to reconcile this with their willingness to use big government as an instrument to appease their social conservative allies on topics such as abortion, gun rights, and gay marriage.

Economic problems in general could wreak havoc for the Democratic party in 2009 and 2010. The 2009 gubernatorial elections in Virginia and New Jersey will likely be viewed as early referendums on the

Obama administration, and although the Virginia governor's race is neck and neck, it appears that New Jersey's Democratic Governor John Corzine is in trouble and could lose. Couple this with rising unemployment in Michigan (nearing 20%) and Ohio and you have recipe for disaster as far as Democrats are concerned in some battleground states. Despite this, the Democrats can probably weather some losses in 2010 as far as the House goes because they are primed to win four to five Senate seats based on the latest projections. Nevertheless, if the economic situation continues to deteriorate and American's continue to feel anxiety about the state of the economy, their jobs, and the budget deficit it may help the chances of former Massachusetts Governor Mitt Romney to win the Republican primary and successfully challenge and defeat Obama in 2012 for the presidency.

