THE CONSEQUENCES OF AMERICA'S DEBT ON OUR ECONOMIC FUTURE

ANALYSIS FROM
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TENNESSEE'S 8TH DISTRICT | WAYS AND MEANS COMMITTEE

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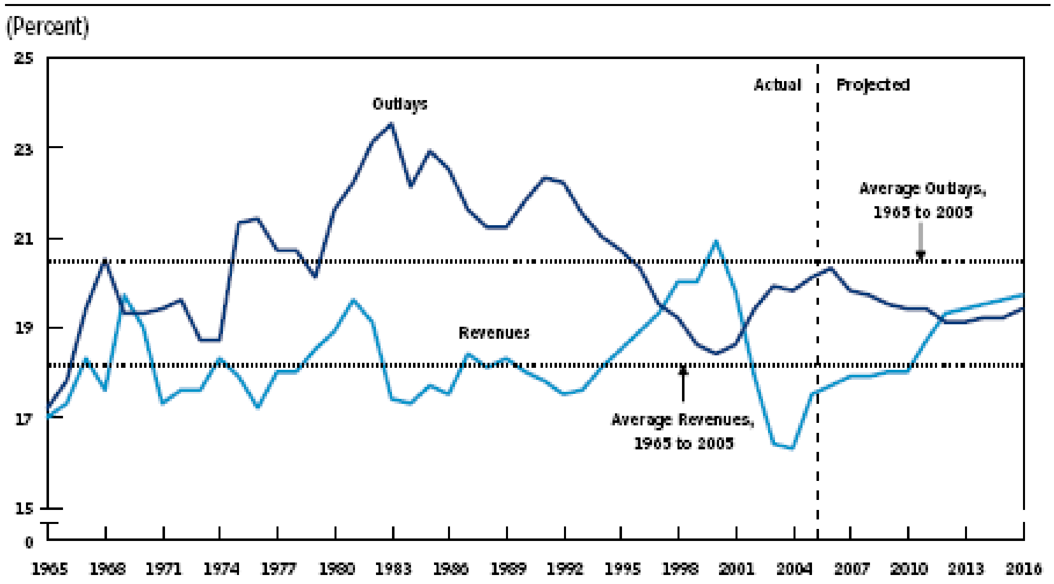
OVERVIEW

For several years, I have been speaking publicly and privately about the large and growing long-term fiscal crisis that we face as a nation. This fiscal gap is principally driven by demographic trends associated with an aging population and rising health care costs, compounded by an Administration and Congress unwilling to address chronic deficit spending. Unfortunately, even though we enjoyed a brief period between 1998 and 2001 with budget surpluses, it has become clear that, without a change of direction, record deficits are here to stay.

There is no single explanation why the long-term budget outlook has deteriorated so rapidly. Fundamentally, Congress and the President seem unwilling to recognize deficit spending as a problem. For example, even though the Federal Government ran a record one year deficit of $419 billion in 2004, Congress enacted a new Medicare prescription drug bill, adding $8.1 trillion to the outstanding commitments and obligations of the U.S. government. Federal deficits have also reflected higher defense, homeland security and other spending, which has exceeded growth in the economy. Even as spending is on the rise, federal revenue has been reduced to below its historical average (see chart below).[1]

While the size of the nation's long-term fiscal imbalance has grown significantly, the retirement of the "baby boom" generation is becoming closer to a reality. Given these and other factors, it is clear that the nation's current fiscal path is unsustainable and that tough choices will be necessary to address the growing imbalance.

Total Revenues and Outlays as a Percentage of Gross Domestic Product, 1965 to 2016



Source: Congressional Budget Office.

[1] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016*. January 2006.

Before getting into greater detail about the budget outlook, it is important to cover some basics in federal budgeting. Many times people ask about the difference between the deficit and the national debt. The national debt is the total amount of funds that the federal government has borrowed over the years and not yet repaid. Currently, the national debt stands at $8.4 trillion, information that is publicly available at www.publicdebt.treas.gov. The deficit is the amount that the government spends each year in excess of what its tax, tariffs and fees bring in. The government must borrow to make up the difference. When deficits accumulate year after year it constitutes the total national debt.

There are two types of debt: debt held by the public and intragovernmental holdings. The debt held by the public is all federal debt held by individuals, corporations, state or local governments, foreign governments, and other entities outside of the United States government. Currently, the debt held by the public stands at $4.9 trillion. Intragovernmental holdings are government securities held by government trust funds, such as the Social Security trust fund and the Medicare trust fund. Currently, intragovernmental holdings stand at $3.5 trillion.

Many ask why we have deficits at all. They are created when the government makes commitments to spending programs without finding a way to pay for them and has to borrow the money instead.

This January, the Congressional Budget Office's (CBO) budget outlook covering the years 2007 through 2016 projected that the federal government will accumulate approximately $832 billion in deficits over that time period (see chart below).[2] This figure, however, is misleadingly low because CBO only considers legislation that has already been signed into law, without the assumption that Congress and the President will extend expiring programs or revenue reductions, even though Congress has routinely done so in the past.

Projected Deficits and Surpluses in CBO's Baseline

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
On-Budget Deficit	-494	-518	-466	-476	-474	-473	-380	-238	-243	-230	-218	-226	-2,269	-3,424
Off-Budget Surplus[a]	175	181	196	217	233	250	266	276	283	288	291	293	1,162	2,592
Total Deficit (-) or Surplus	**-318**	**-337**	**-270**	**-259**	**-241**	**-222**	**-114**	**38**	**40**	**57**	**73**	**67**	**-1,107**	**-832**
Memorandum:														
Social Security Surplus	173	180	195	214	231	246	262	271	278	282	286	287	1,148	2,552
Postal Service Outlays	-2	-2	-1	-3	-2	-4	-4	-5	-5	-5	-6	-6	-14	-40
Total Deficit (-) or Surplus as a Percentage of GDP	-2.6	-2.6	-2.0	-1.8	-1.6	-1.4	-0.7	0.2	0.2	0.3	0.4	0.3	-1.4	-0.5
Debt Held by the Public as a Percentage of GDP	37.4	37.6	37.8	37.7	37.5	37.2	36.3	34.6	32.9	31.3	29.6	28.1	n.a.	n.a.

Source: Congressional Budget Office.

Note: GDP = gross domestic product; n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

[2] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016*. January 2006.

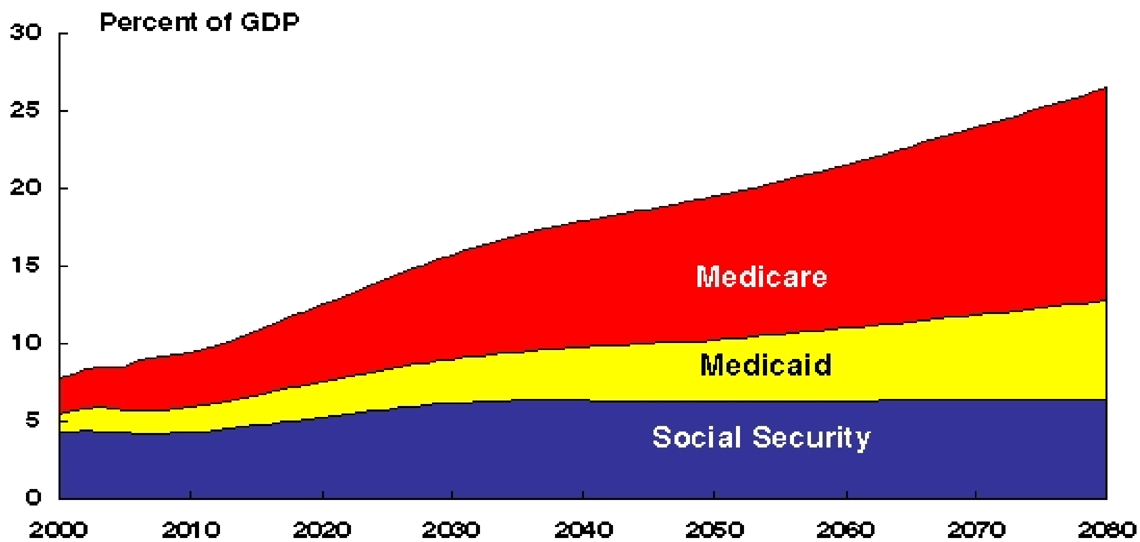
All reputable budget simulations demonstrate that the deficit problem is too big to be solved by quick fixes or by making modest changes but will require a thorough re-examination of all major spending programs and tax policies. Without a bipartisan, honest public debate on both spending and taxes, our government runs the risk of failing to meet the future needs of the American people.

IMPACT OF CHANGING DEMOGRAPHICS

The baby boom generation's retirement will prove to be one of the greatest budgeting challenges we face as a nation. According to the Government Accountability Office (GAO), total federal spending for Social Security, Medicare and Medicaid is projected to grow from 8.4 percent of GDP in 2004 to nearly 18 percent in 2040.[3] It is clear that, taken together, Social Security, Medicare and Medicaid in their present form represent an unsustainable burden on future generations (see chart below).

There has been considerable discussion about reforming the Social Security program. During the debate, attention was given to current estimates that project the Social Security trust fund will be solvent until 2042. Unfortunately, long before the trust fund runs out of money, spending for this program along with Medicare and Medicaid will demand a rapidly growing share of the budget and our economy.

Social Security, Medicare, and Medicaid Spending as a Percent of GDP



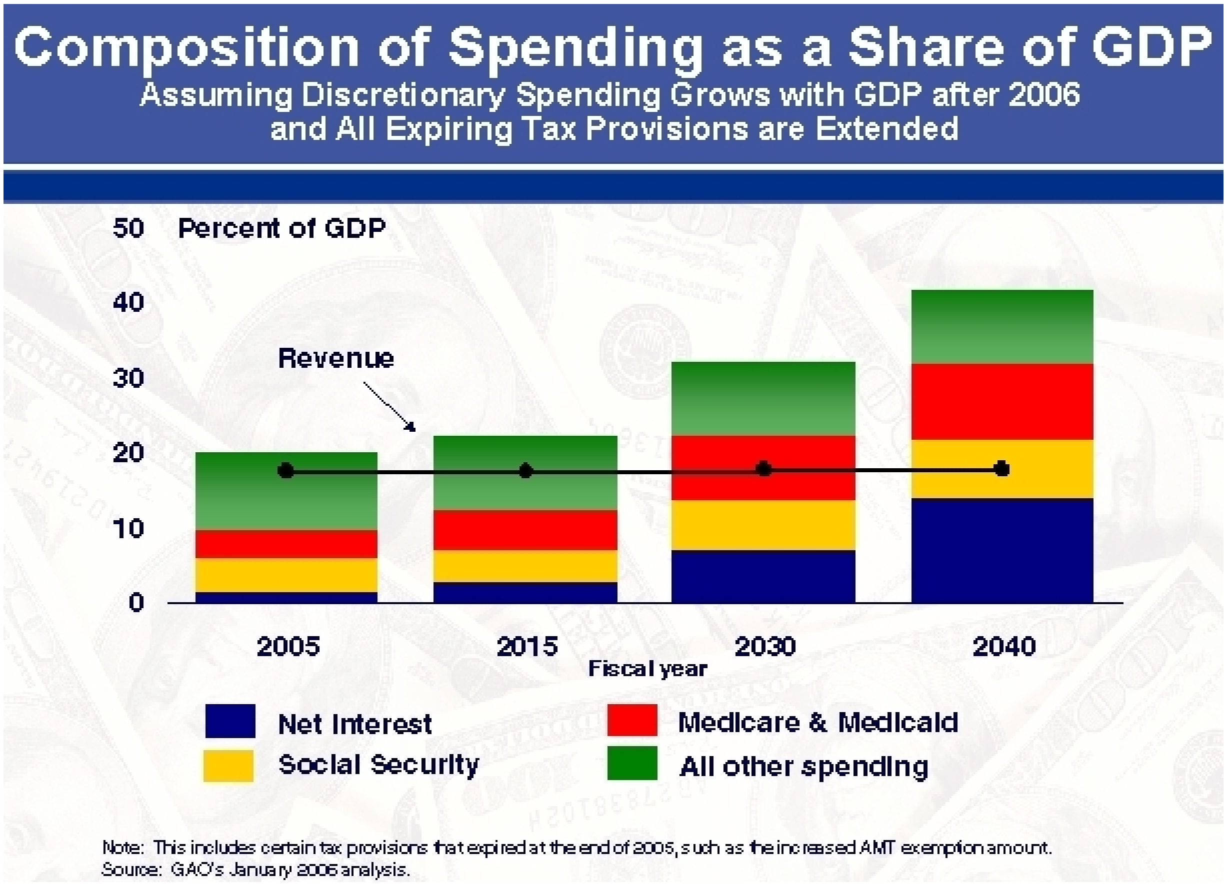
Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration; Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

Note: Social Security and Medicare projections are based on the intermediate assumptions of the 2005 Trustees' Reports. Medicaid projections are based on CBO's January 2006 short-term Medicaid estimates and CBO's December 2005 long-term Medicaid projections under mid-range assumptions.

The future sustainability of these programs will begin to dominate the federal budget and squeeze out spending for nearly all other federal programs. To illustrate this point, GAO created a long-term simulation to demonstrate the magnitude of the fiscal challenges associated with an aging society. GAO assumed in this project that discretionary spending will grow with the economy after 2005 and that the tax cuts enacted in 2001 and 2003 will be extended. It is clear that absent policy changes on the spending or revenue side of the budget, the growth in spending on federal retirement and health entitlement programs will consume an unworkable amount of government resources. By 2040,

[3] GAO, *Our Nation's Fiscal Outlook: The Federal Government's Long-Term Fiscal Imbalance.*

federal revenues may be adequate to pay little more than interest on the federal debt (see chart below).[4]



Unfortunately, most of the debate in Congress about the federal budget has been confined to tax reductions and small spending decreases. However, substantive reform of Social Security, Medicare and Medicaid remains critical to recapturing our future fiscal strength. Comprehensive budget reform will be impossible without restructuring these important and increasingly costly federal entitlement programs.

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[4] GAO, *21st Century: Addressing Long-Term Fiscal Challenges Must Include Re-Examination of Mandatory Spending*. Statement by David Walker, Comptroller General of the United States. GAO-06-456T. February 15, 2006.

BUDGET OUTLOOK

The Congressional Budget Office projects that the federal budget will report a deficit of $337 billion in 2006 (see chart below).[5] This amount would be the 3rd most in history and is more than the $318 billion deficit in 2005. Because of the rules that govern budget projections, CBO's current estimates omit a significant amount of spending that is likely to occur later this year. In particular, additional funding will probably be necessary in 2006 to pay for military activities in Iraq and Afghanistan and for flood insurance claims from Hurricane Katrina. If that funding is provided, CBO expects that federal spending will grow by another $20 to $25 billion this year, resulting in a 2006 deficit in the vicinity of $360 billion – the second highest in history.

CBO's Baseline Budget Outlook

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
							In Billions of Dollars							
Total Revenues	2,154	2,312	2,461	2,598	2,743	2,883	3,138	3,378	3,546	3,724	3,912	4,113	13,823	32,496
Total Outlays	2,472	2,649	2,732	2,857	2,984	3,105	3,252	3,340	3,506	3,666	3,839	4,046	14,930	33,328
Total Deficit (-) or Surplus	**-318**	**-337**	**-270**	**-259**	**-241**	**-222**	**-114**	**38**	**40**	**57**	**73**	**67**	**-1,107**	**-832**
On-budget	-494	-518	-466	-476	-474	-473	-380	-238	-243	-230	-218	-226	-2,269	-3,424
Off-budget[a]	175	181	196	217	233	250	266	276	283	288	291	293	1,162	2,592
Debt Held by the Public at the End of the Year	4,592	4,925	5,204	5,477	5,732	5,967	6,092	6,064	6,032	5,981	5,912	5,848	n.a.	n.a.
							As a Percentage of GDP							
Total Revenues	17.5	17.7	17.9	17.9	18.0	18.0	18.7	19.3	19.4	19.5	19.6	19.7	18.1	18.9
Total Outlays	20.1	20.3	19.8	19.7	19.5	19.4	19.4	19.1	19.1	19.2	19.2	19.4	19.6	19.4
Total Deficit (-) or Surplus	**-2.6**	**-2.6**	**-2.0**	**-1.8**	**-1.6**	**-1.4**	**-0.7**	**0.2**	**0.2**	**0.3**	**0.4**	**0.3**	**-1.4**	**-0.5**
Debt Held by the Public at the End of the Year	37.4	37.6	37.8	37.7	37.5	37.2	36.3	34.6	32.9	31.3	29.6	28.1	n.a.	n.a.
Memorandum:														
Gross Domestic Product (Billions of dollars)	12,293	13,082	13,781	14,508	15,264	16,021	16,768	17,524	18,311	19,121	19,963	20,839	76,343	172,101

Source: Congressional Budget Office.

Note: n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

A practical examination of CBO's budget analysis would include the cost of extending the tax cuts enacted in 2001 and 2003, adding the cost of reforming the Alternative Minimum Tax (AMT), and adding the ongoing war costs in Iraq and Afghanistan. These and other adjustments would add $3.1 trillion to CBO's ten-year baseline estimate, generating a total deficit of almost $4 trillion over ten years.[6]

[5] Congressional Budget Office: *The Budget and Economic Outlook: Fiscal Years 2007 to 2016*. January 2006.

[6] Congressional Budget Office: *The Budget and Economic Outlook: Fiscal Years 2007 to 2016*. January 2006

The official budget deficit for 2005 was $319 billion, but the federal government uses an accounting method that is different from what American businesses employ. The government uses a method called "cash accounting" while businesses are required to use "accrual accounting." The Department of the Treasury publishes a little-known document using accrual accounting, which provides a more accurate reflection of the government's obligations. The report, titled "Financial Report of the United States Government 2005," showed that the U.S. deficit under practical business accounting methods ran a deficit in 2005 of $760 billion – more than double the more widely reported $319 billion.

CBO also projects that the federal debt will continue to grow. Every year that the budget is in deficit, the shortfall must be financed by additional federal debt. Under the assumptions used by the CBO, gross debt is projected to climb to $11 trillion by 2011 and $13 trillion by 2016. The debt is increasing at more than $600 billion every year over the next ten years.

It has been the position of some that the current U.S. budget deficit is manageable and not large as a percentage of U.S. Gross Domestic Product (GDP). In the budget submitted to Congress in February, the Administration anticipates a deficit as a percentage of GDP of -3.2 percent in 2006. Since the end of World War II, the U.S. has only accumulated deficits larger than -3.2 percent of GDP thirteen times.[7]

It should also be noted that the current deficit projection does not include money borrowed from the Social Security trust fund. If Social Security funds were not used to pay for general spending the deficit as a percentage of GDP in 2006 is projected to total -4.6 percent.

A federal deficit level so large that it has only happened thirteen times since World War II is not something to be taken lightly. Furthermore, the deficits we now confront are occurring at a time when our demographic changes will be the most challenging. During the 1970s and 1980s it was assumed that the large federal deficits were temporary. Today, it is hard to imagine how our large structural deficits, in addition to our future commitments for entitlement programs, will be manageable, even as a percentage of GDP.

Some people both inside and outside the government claim that economic growth will be sufficient to allow us to maintain government programs and eliminate the budget deficit. Clearly, economic growth is very important, but we will not be able to simply grow our way into a balanced budget because the projected fiscal gap is just too large. Closing the current budget shortfall would require sustained economic growth far beyond what has been experienced in U.S. economic history. Based on reasonable assumptions, the GAO calculated it would require double-digit real growth for decades to grow our way out of this problem.[8] Stated plainly, our federal obligations are growing much more rapidly than our economy.

[7] Budget of the United States Government for Fiscal Year 2007: Historical Tables. February 6, 2006.
[8] GAO Comptroller General David Walker. Interview with the *Christian Science Monitor*. January 2004.

Some have also argued that federal revenue will grow if taxes continue to be cut. This is known as the "Laffer Curve" effect, which argues that a reduction in tax rates will generate new economic activity which, in turn, drives up tax revenue. Theoretically it could occur if marginal tax rates became so high and stifling that a decrease in tax rates would produce so much new economic activity that the tax base increased more than enough to make up for the rate decreases.

However, in testimony before the House Budget Committee last fall, former Federal Reserve Chairman Alan Greenspan explained that "it is very rare and very few economists believe that you can cut taxes and you will get the same amount of revenues."[9]

Federal revenues collected last year were among the lowest as a share of GDP in nearly fifty years. Total federal revenues have fallen from 20.9 percent of GDP in 2000 to 17.5 percent in 2005.[10] There was a one-year increase in tax revenue that occurred between 2004 and 2005. According to the CBO, the most likely causes of the revenue spike are temporary factors: the expiration of a business tax cut called bonus depreciation; and the one-year tax cut on corporate repatriated profits enacted at the end of 2004.

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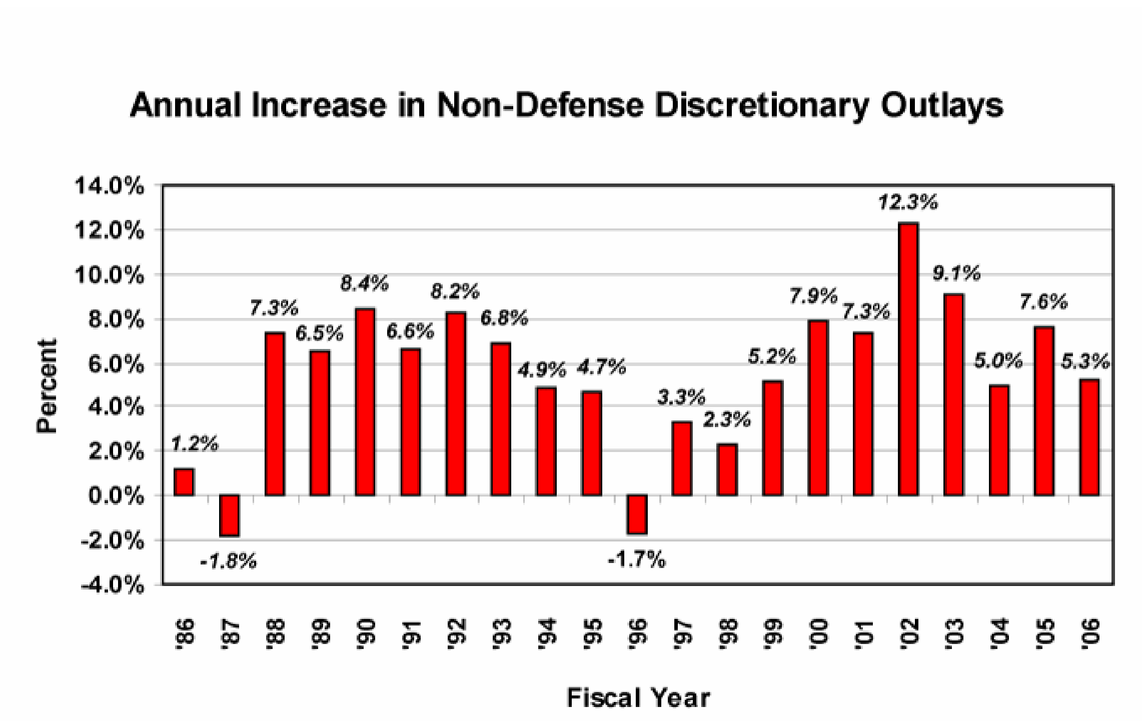
[9] Committee on the Budget: Hearing: *The Economic Outlook and Current Fiscal Issues*. September 8, 2004

[10] Budget of the United States Government for Fiscal Year 2007: Historical Tables. February 6, 2006

FEDERAL SPENDING

Federal spending comes in two parts: discretionary spending, items voted on by Congress each year, which accounts for approximately 40 percent of federal spending; and mandatory spending, programs such as Medicare and Social Security that do not require annual appropriations, account for the remainder.

From 1994 to 2004, in real terms, federal spending has increased by about 30 percent and total federal spending has reached $20,000 per household for the first time since World War II. According to the conservative Heritage Foundation, overall discretionary spending rose 2.3 percent annually under President Clinton, compared to 9.7 percent annually under President Bush. Non-defense discretionary spending rose 4 percent annually under President Clinton versus 8 percent annually under President Bush (see chart below).[11]



The libertarian CATO Institute reported President Bush has presided over the largest overall increase in inflation-adjusted federal spending since Lyndon B. Johnson. Even after excluding spending on defense and homeland security, President Bush is still the biggest-spending president in thirty years.[12] The report can be viewed at www.cato.org.

With regard to spending, a major difference between the Clinton Administration and the Bush Administration is the impact of divided government. For six years, President Clinton needed to work with a Republican Congress. The competing interests between

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[11] The Heritage Foundation, *Discretionary Spending Trends: Past Present and Future*. Testimony by Brian Riedl, Grover M. Hermann Fellow in Federal Budgetary Affairs. February 16, 2006.

[12] CATO Institute. *Grand Old Spending Party: How Republicans Became Big Spenders*, by Stephen Slivinski. May 3, 2005.

the Administration and Congress forced compromise on spending priorities. During most of the past five years, there has been one-party control of both Congress and the Administration. This dynamic has made it difficult for one branch of government to limit the spending needs of the other, which is illustrated by the fact that President Bush may become the first full-term president since John Quincy Adams not to veto a single bill. The result of one-party control of federal policy is a government that has been completely unwilling to control spending.

Reducing federal spending is never easy. Once a federal program is created, it often becomes difficult to limit budget increases, and, more importantly, ensure the money appropriated by Congress is being utilized properly. Nonetheless, it will be critical for Congress and the Administration to control the growth of spending, or we will simply continue to borrow money that our children and grandchildren will be forced to pay back.

ACCOUNTABILITY

One of the primary problems with the federal budget process is the lack of accountability and transparency in government. Last year, the federal government spent approximately $2.5 trillion and the government's watchdog agency, GAO, determined that material deficiencies in financial reporting and other limitations prevented them from expressing an opinion on the federal government's consolidated financial statements for the ninth consecutive year.[13] In short, the GAO, which is charged with auditing the government's books, cannot account for all of the federal government's assets and liabilities.

Our government has a duty to ensure that tax dollars are spent properly and in the most cost-effective manner possible. Unfortunately, it has become extremely difficult to determine which agencies are efficiently using taxpayer dollars. In a review of the Treasury Department's Financial Report of the United States Government, the GAO determined that the "majority of federal agencies are still unable to routinely produce reliable, useful, and timely financial information; and the federal government's capacity to manage with timely and objective data is limited, thereby hampering its ability to effectively administer and oversee its major programs."[14] When it is impossible to adequately audit the books of our federal agencies, it is also impossible to truly determine whether those agencies are responsibly spending taxpayer dollars.

Currently, 19 of 23 federal agencies are not in compliance with proper accounting standards. The GAO also stated that the ability to produce the data needed to efficiently and effectively manage the day-to-day operations of the federal government and provide accountability to taxpayers continues to be a challenge for most federal agencies.[15]

Inspector General (IG) reports from individual agencies find potential savings of billions of dollars in waste every year. Inspectors General provide a wonderful service to the taxpayer by finding and investigating waste, fraud and abuse. However, a simple review of federal agency audit reports finds that many recommendations made by IGs are never acted upon because the responsibility to correct the problem rests with the federal agency engaged in the waste. Congress needs to restore its constitutional responsibility of oversight and ensure that waste, fraud and abuse are eliminated or the American taxpayer will lose faith in the government's ability to provide services to its citizens.

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[13] GAO, *Sustained Improvement in Federal Financial Management Is Crucial to Addressing Our Nation's Financial Condition and Long-term Fiscal Imbalance*, GAO-06-406T. March 1, 2006

[14] *Financial Report of the United States Government 2005, Government Accountability Office Report*. December 2005.

[15] GAO, *Financial Management: Achieving FFMIA Compliance Continues to Challenge Agencies*, GAO-05-881. September 2005.

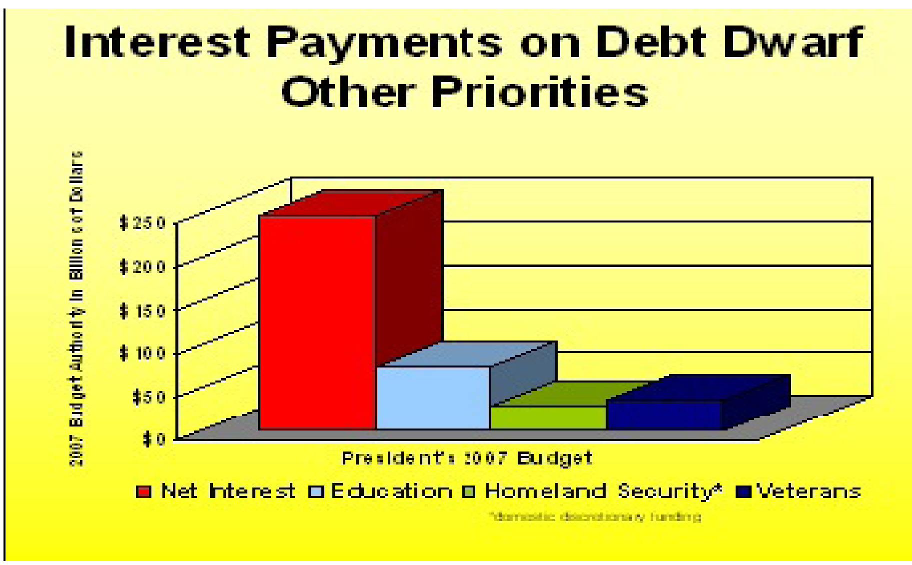
NET INTEREST

Interest on the federal debt reflects the cost of financing the outstanding amount the federal government has borrowed from the public. Net interest represents interest payments to non-federal owners of Treasury securities and does not include interest paid by one part of the government to another.

Interest has become the fastest-growing spending item in the federal budget and will, over the next five years, grow significantly faster than other spending in the federal budget. CBO projects that interest payments will grow from $184 billion in 2005 to $289 billion in 2010.[16]

The federal government will spend $247 billion in net interest in 2007 and it will rank as the fourth largest spending item in the government's budget after Social Security ($581 billion), the Department of Defense ($503 billion), and Medicare ($387 billion).[17]

Net interest on the federal debt displaces other investments. Money spent to pay interest on the national debt is truly wasteful spending. It doesn't educate a child, build a road or keep the nation secure (see chart below).[18]



This rapid increase in net interest is attributable to both a large accumulation of new debt and rising interest rates. For instance, interest payments made in 2006 will likely be approximately $33 billion more than what was paid in 2005. About half of the increase stems from more debt, and half comes from higher short-term interest rates.[19]

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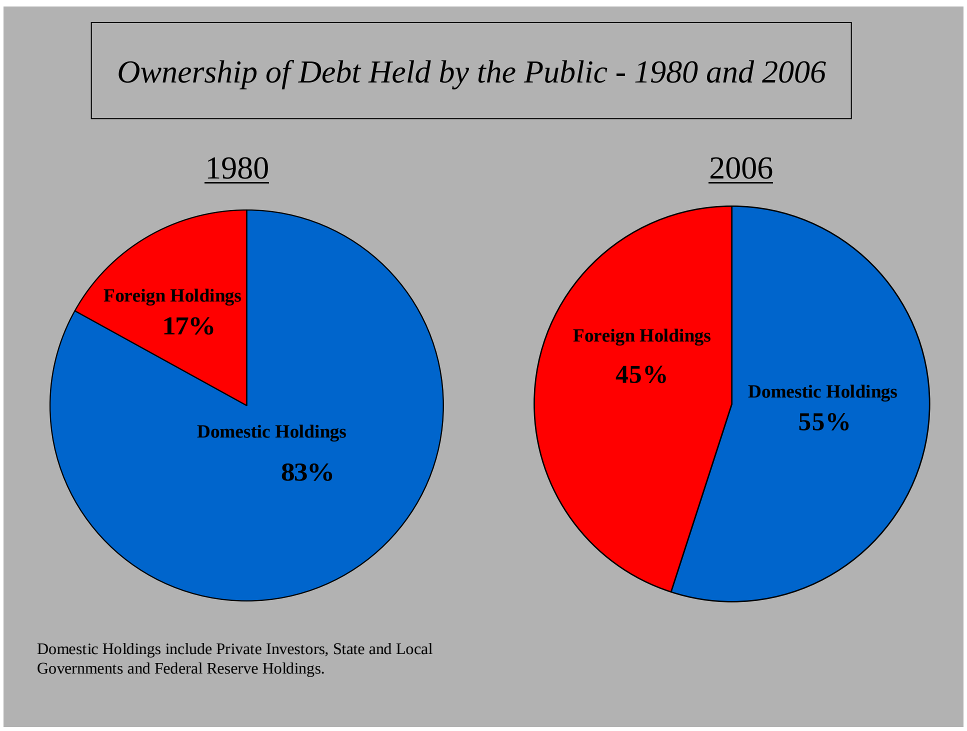
[16] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016.* January 2006.
[17] Budget of the United States Government for Fiscal Year 2007. February 6, 2006.
[18] House Budget Committee, Democratic Staff
[19] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016*. January 2006.

FOREIGN HOLDINGS OF U.S. DEBT

According to the Treasury Department, major foreign holdings of U.S. Treasury securities total $2.18 trillion. Currently, China is the world's second-largest buyer, exceeded only by Japan. Furthermore, China's purchases of U.S. government securities have exploded by more than 211 percent since the beginning of 2001 and now total $311 billion.

This situation is dangerous because it is how we are in part funding the federal government - by selling our debt to the Chinese. In 1980, 17 percent of the federal debt held by the public was in foreign hands. By 2006, 45 percent of the debt held by the public was owned overseas (see chart below).[20] Unfortunately, this trend seems to be increasing rapidly. During the past year, approximately 90 percent of the debt we have accumulated has been purchased by foreign banks, individuals and governments.



The high level of foreign holdings of U.S. securities could have a debilitating impact on our economy and foreign policy. If China threatened to sell large volumes of U.S. Treasury securities, it could easily fuel higher inflation and put pressure on the Federal Reserve to increase interest rates, putting our economy at risk for a large-scale recession.

There have already been indications of such a threat. "China should stop buying U.S. Treasuries and take steps to reduce its holdings in those bonds," a Hong Kong newspaper quoted a high-ranking Chinese official as saying. "Currency traders said the report caused some players to sell the U.S. dollar."[21]

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[20] Created by the Office of Congressman John Tanner

[21] The Associated Press. "Chinese Official says China should stop buying U.S. bonds." April 4, 2006

Even though short-term interest rates are rising, longer-term debt yields in the United States are exceptionally low by historical standards. Any move by China to sell some of its massive debt holdings could drive up long-term rates, which ultimately could make it more costly for Americans to take out home mortgages, car loans and credit card bills.

Furthermore, the United States does not always see eye-to-eye with Beijing on foreign affairs. The mere threat made by the Chinese to sell U.S. debt could reduce our negotiating position on long-standing issues of disagreement such as national security and trade. The United States should not be put on the defensive when issues of conflict arise with China simply because the U.S. dollar can be held hostage by the Chinese government.

The Chinese are purchasing U.S. Treasuries in an attempt to keep the value of their currency, the yuan, artificially low. The yuan has been pegged to the U.S. dollar for more than ten years, despite experiencing record growth in the Chinese economy. The type of growth that the Chinese economy has enjoyed should have increased the value of the yuan during the past decade if it were a free-floating currency. Economists have estimated that the Chinese are undervaluing their currency by as much as 40 percent. By purchasing U.S. debt, China is able to continue manufacturing products that cost 40 percent less to produce than in the United States. This currency manipulation has contributed to the loss of millions of manufacturing jobs in the United States.

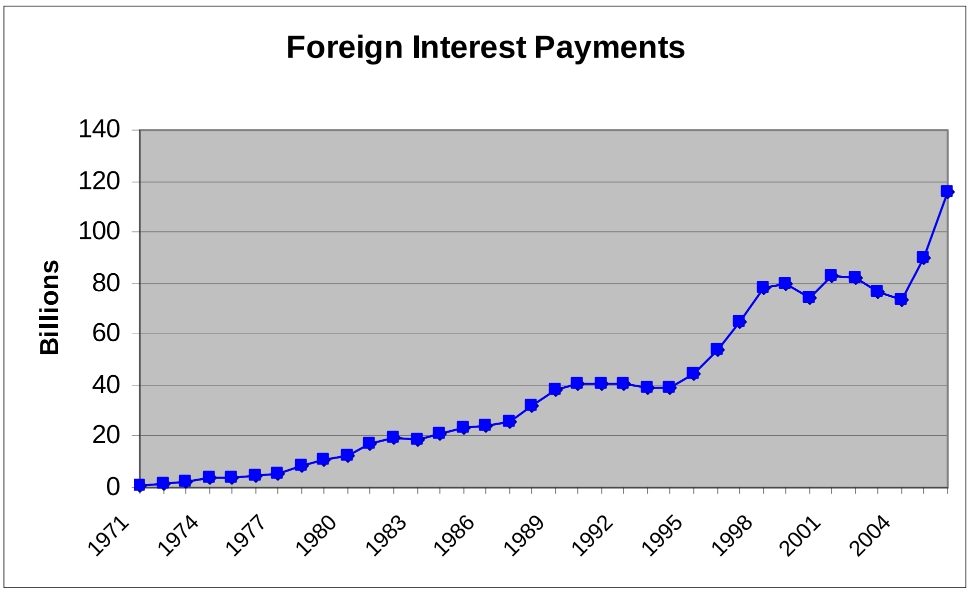
The vulnerability that we are creating is gaining considerable attention around the world. "The U.S. dollar is now at the mercy of Asian governments," said Joan Zheng, a former official at the People's Bank of China, the country's central bank, and now an economist at J.P. Morgan Chase & Co. in Hong Kong. "If China wants to influence the market, it can. Its financial power is just so strong."[22]

[22] Peter S. Goodman, "U.S. Debt to Asia Swelling; Japan, China Lead Buyers of Treasurys." *The Washington Post*. September 13, 2003.

FOREIGN INTEREST PAYMENTS

As the percentage of the debt held by the public in foreign hands grows, so do the interest payments the United States must pay to foreign lenders. In 2001, United States taxpayers paid foreign lenders $82 billion in interest payments. Last year, we paid $116 billion to overseas entities, a 42 percent increase in only five years.[23]

To put this into the proper perspective, $116 billion is approximately five times more than what the United States paid in foreign assistance last year. In one sense, foreign interest payments have become the United States' largest foreign aid program.



For several years, the U.S. government has been able to finance considerable foreign borrowing at low interest rates. Unfortunately, the amount of foreign holdings of U.S. debt has more than doubled since 2001 and interest rates are on the rise. Therefore, foreign interest payments are on the verge of exploding the same way credit card interest charges would skyrocket if a credit card balance doubled and the interest rate was increased.

Because many of the nations purchasing U.S. debt also face aging populations and declining national savings, continued reliance on foreign funds is neither a strong economic strategy nor a viable long-term solution.

[23] United States Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts Table, Federal Government Current Receipts and Expenditures. Revised March 30, 2006. Chart created by the Office of Congressman John Tanner

DEBT LIMIT INCREASES

As long as federal budget policy results in deficits, Congress must enact increases to the statutory debt limit. Legislation to raise (or lower) the debt limit is considered in the context of the congressional budget process.

The annual congressional budget resolution specifies the appropriate level of the public debt for each fiscal year. While the budget resolution does not become law itself, the specified debt limits serve as a guide for any necessary debt-limit legislation.

Last month Congress raised the debt limit of our country by $781 billion, after having raised the federal debt limit in 2002, 2003 and 2004. The last increase in the debt limit brings a total of $3 trillion of additional borrowing authority since 2001 (see chart below).[24]

The last debt limit increase of $781 billion is as large as the entire federal debt in 1978. It took the country more than 200 years to generate as much debt as we borrowed during the past two years alone.

It is also troubling that increasing the federal debt limit has lost the stigma it once had in Congress. The reason we have a statutory debt limit is to ensure the federal debt does not grow automatically and to make lawmakers accountable to the public for deficit spending. Today, Congress raises the debt limit without a separate vote in the House, amidst limited media attention and virtually no public outrage. This enables policymakers to simply deficit-spend and raise the debt limit instead of making the hard decisions needed to balance the budget.

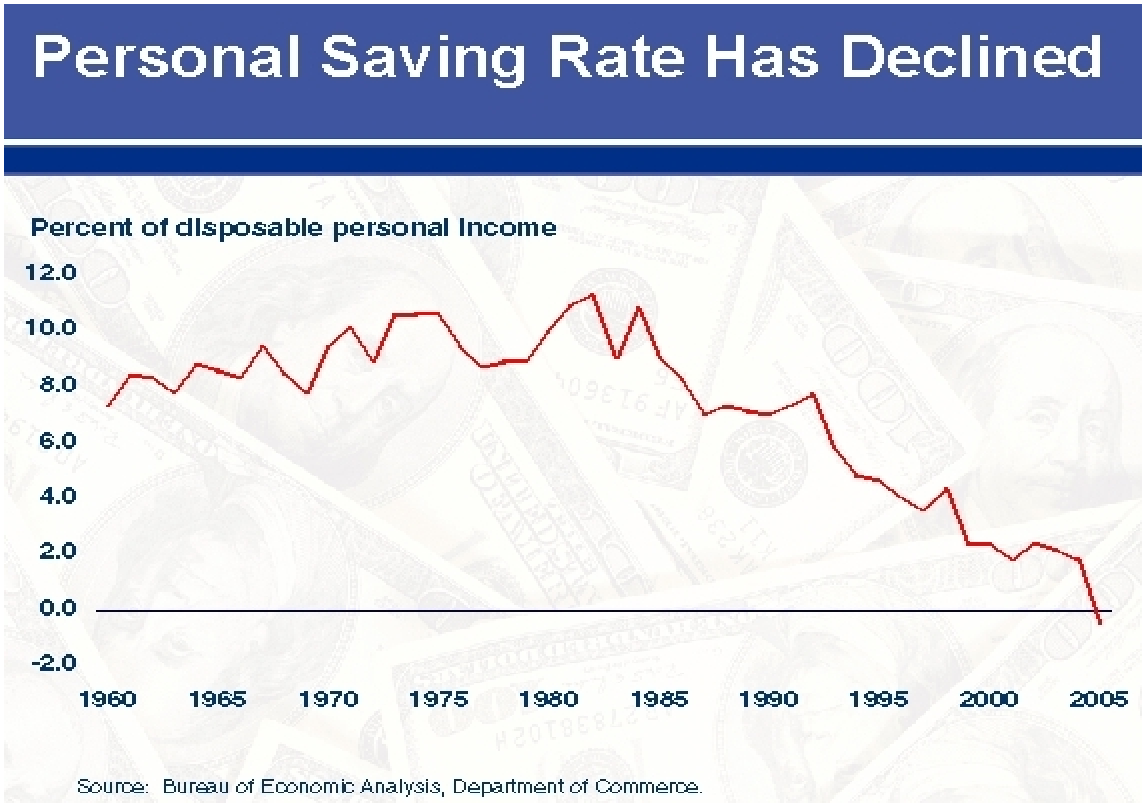
The Federal Debt Limit Has Been Increased $3 Trillion Since 2001
Trillions of Dollars

2001	5.950
2002	6.400
2003	7.384
2004	8.184
2006	8.965
Total Increase	$3 Trillion

[24] Created by the Office of Congressman John Tanner

INDIVIDUAL SAVINGS

As federal budget deficits have climbed, personal household savings have reached record lows. Too many Americans today are spending well beyond their means. Last year, for the first time since 1933, our annual personal savings rate was negative, meaning Americans are spending more on average than we earn. Such dismal personal savings has not been seen in the United States since the Great Depression (see chart below).[25]



Clearly, many Americans, like their government, are deeply in debt. This trend is particularly alarming in an aging society like we have in the United States. Those Americans who save more will certainly live better in retirement. Those Americans who save less are taking a serious risk given the problems facing Social Security and Medicare. Furthermore, in the private sector, we are seeing cutbacks in retirement benefits and pension freezes at major U.S. corporations. Unlike a generation ago, U.S. corporations are no longer offering defined benefit pension plans that ensure a steady stream of retirement income. They have been replaced by retirement plans such as 401(k) plans that shift responsibility to the individual to save for his or her own retirement.

With the future solvency of federal retirement programs such as Social Security and Medicare facing significant financial strain, the federal government must enact policies that encourage Americans to save for retirement and reverse the declining savings rate.

[25] GAO, National Savings: Current Saving Decisions Have Profound Implications for our Nation's Future Well-being, GAO-06-628T. April 6, 2006.

RECOMMENDATIONS

As stated earlier, according to the Government Accountability Office, 19 of 23 major federal agencies are not complying with federal law with regard to proper accounting and financial management. Government agencies should be doing a better job of tracking taxpayer dollars. Congress has abandoned its responsibility to hold government agencies accountable to the taxpayer. Office of Inspectors General and the Government Accountability Office regularly issue reports detailing billions in federal waste, fraud, abuse and mismanagement; however, these reports go unnoticed and unacted upon. Therefore, legislation must be enacted in Congress that would require Congressional Committees to hold hearings and review the findings of these reports to ensure taxpayer funds are being used appropriately.

The President and the Congress together must figure out how to balance the many demands on the federal budget. Unfortunately, all the budget rules in effect in the 1990s, including the pay-as-you-go rule (PAYGO) and spending caps, have expired. The PAYGO rule required tax cuts and spending increases to be offset with other tax increases or spending reductions, so new policies would have no net effect on the deficit. Restoring PAYGO should be a simple and effective way to begin working our way back toward fiscal responsibility.

Statutory caps on appropriations placed a strong limit on the funding amount Congress could provide in a given year. These budget rules were instrumental in providing the discipline that in the past helped turn large structural deficits into surpluses. Too often, Congress sets spending limits at the beginning of the year, circumvents them through year-end supplemental spending bills or simply outright ignores the limits. Spending caps need to be enforced by law.

Congress should more honestly estimate the budget cost of bills it considers. Both taxpayers and Members of Congress should be aware of the price tag for any legislation passed by Congress, and there are no current requirements that bills be accompanied by an honest and objective estimate of their fiscal impact. Every conference report and bill that comes to the floor of the House should be accompanied by a cost estimate prepared by the nonpartisan Congressional Budget Office.

Failing to address the future insolvency of Social Security, Medicare and Medicaid will have profound implications for the future of our country. These programs will become financially unsustainable over time, and reform must be done in a bi-partisan, bi-cameral way. The first step needs to be a reform commission--not made up of elected officials -to gather information and to educate Members of Congress and the public on the changes facing Social Security, Medicare and Medicaid and discuss ways to preserve these important retirement and health programs. The overall goal is to protect their long-term viability. This is not an endorsement of any particular reform or program cut but simply an attempt to remove some of the politics associated with reform and begin an honest debate.

Americans can no longer take for granted that the Social Security, Medicare and Medicaid programs will continue in their present form. The trends we have discussed make entitlement reform a near inevitability. One of the greatest threats to our nation's prosperity is our reluctance to make the hard choices that will make fiscal responsibility a reality. An entitlement reform commission is a good first step toward that goal.

The success of our voluntary tax system rests on the public's view of its fairness and comprehension. Taxpayer compliance is largely driven not only by IRS enforcement but also by Americans' willingness to fund the government. According to some polls about one in five respondents say it is acceptable to cheat on their taxes. This attitude is fueled by the complex and ever-changing tax code. Furthermore, the complex nature of the tax code makes it possible for creative individuals to create tax shelters which in turn require the IRS and Congress to enact new laws to eliminate the loopholes. Congress and the President should re-examine the tax code so that taxpayers have the confidence they need in the system and the government maintains the revenue it needs to function properly.

As we have seen time after time, there is no political will in Washington to reduce spending. Compounding the problem, Congress and the President have enacted legislation nearly every year since 2001 that has reduced revenue. Everyone understands that if spending is increased and revenue reduced the balance must be borrowed. The only way to ensure an end to deficit spending seems to be a Constitutional amendment to require a balanced budget every year except in times of war or national emergency. Otherwise, policymakers will continue to find ways around a balanced budget.

Chronic deficits and a staggering debt undermine our economic goals and depress our global competitiveness. Tough policy choices will need to be made and made soon.

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