

A GUIDE TO THE
ECONOMICS AND
FISCAL PERFORMANCE
OF THE FEDERAL
GOVERNMENT



(1976-2007)

ROBERT P. SINGH

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FISCAL PERFORMANCE OF THE
FEDERAL GOVERNMENT
(1976-2007)**

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For my children, Jade and Ajay

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Chapter 1

INTRODUCTION

As Americans, we enjoy the benefits of living in a free and democratic country. But maintaining our freedoms and our democracy requires some effort on the part of the citizenry. We have a basic obligation to be informed about the issues and the actions of our government in order to hold our elected officials accountable for their decisions. Only then can American democracy flourish and continue to pursue the ideals upon which the nation was founded. Unfortunately, the overwhelming majority of us simply do not pay attention to what happens in Washington, and, in many cases, we do not understand how the government operates. This is particularly true when it comes to economic issues and the fiscal performance of the federal government. Most Americans simply do not know such basic financial facts as how much money the U.S. government spends per year, what the national debt is, or how the government covers cash shortfalls that result from deficit spending.

Understanding the economic conditions of the country and the fiscal decisions of the government is critical for two reasons. First, all public policies in the country are subject to economic realities and limitations – the government’s resources are considerable, but they are limited by the amount of revenue it generates from taxes and the total amount it can borrow. Just as a household should never spend or borrow money without first knowing what its fiscal position is (i.e., household income, savings, existing debts, etc.), the federal government should operate within its financial means and recognize its fiscal position before spending or borrowing funds to pay for its public policy decisions. Second, the President, Congress, and all agencies of the federal government should be good stewards of American taxpayer money. While there are checks-and-balances within the government, the ultimate check-and-balance mechanism

in the U.S. is the election. It is the responsibility of the voters to decide whether our elected leaders have been effective, including whether they have been good financial stewards. We have the power to change our leaders if we determine that they have not met our expectations and their obligations. However, an active, concerned, and well-educated populace is required for representative democracy to work efficiently. There are more people interested in following the latest missing person story that is being covered by the 24-hour cable news channels, or learning the latest gossip about movie stars, or perhaps following a favorite sports team, than knowing what the current account deficit is, where the national debt stands, or how much the government spent on foreign aid programs. Without knowing the economic condition of the country and the implications of the decisions that are made on its behalf, the citizenry cannot properly assess the performance of its elected leaders and thus, cannot hold them accountable.

Perhaps the problem is that the fiscal figures for the government are too large. Some may view the numbers as boring to or too difficult to fully comprehend. Politics contribute to the lack of understanding. We live in a politically-polarized country that is facing challenging economic times. Constant spin from Democratic and Republican leaders infects much of what we hear and read about politics which makes it difficult to know what to believe. Even for those who want to understand the economic implications of the federal government's decisions, the constant spin makes it very difficult to do so. As a result, many people – from members of Congress to average Americans – are confused about fiscal matters. However, fiscal responsibility is not a conservative or liberal ideal – it is a responsibility for all Americans. The reality is that the federal government under both Republican and Democratic presidential administrations and Congresses has engaged in spending habits that have resulted in structural fiscal deficits that have required heavy borrowing in order for the government to function. This has put the nation's economic health at risk. But even more troubling is that the federal government has taken on an enormous amount of debt that is increasingly being held by foreigners. This threatens America's very sovereignty.

The national debt now stands at over \$10.5 trillion – a staggering figure that is difficult for most people to truly comprehend. American taxpayers are paying more than \$400 billion per year in total interest on that debt, and this figure will only rise in coming years. Even worse, over \$2.7 trillion of the national debt is now owed to foreigners, including over \$500 billion to China. At the same time, we now import \$250 billion more in goods and services from China than we export to China. Taken together, this means that the federal government has implicitly approved an economic policy with respect to China that has us borrowing Chinese money in order to buy Chinese products.

Americans have also increasingly felt the pain at the gas pump, but few realize the true impact of purchasing tens of billions of dollars of oil each month from foreign sources. The rising oil prices and a falling dollar have been primary contributors to the fact that we now owe the Organization of the Petroleum Exporting Countries (OPEC) about \$180 billion. The OPEC oil cartel's production decisions have significant impact on world oil prices and the price we pay at the pump. This might not really matter, except that the second largest producer of oil within OPEC is Iran – a nation that is considered an enemy of the U.S. It does not require a Ph.D. in public policy or economics to recognize that the geo-political economic realities of being economically beholden to Iran and China have significant consequences on our government's economic and foreign policy decisions regarding these nations. The fiscal imbalances we have with these countries limit strategic options, because we are financially beholden to them. As a result, they can (and often do) exert great influence on our economy.

Every American should read the U.S. Treasury Department's annual summary of the overall financial conditions surrounding the federal government's spending and revenues. The latest available report, entitled *The Federal Government's Financial Health: A Citizen's Guide to the 2007 Financial Report of the United States Government*¹ provides a very readable, but alarming picture of the fiscal health of the nation. The report clearly establishes that our government's spending priorities and debt accumulation are unsustainable. They will result in a fiscal disaster over the next several decades if action is not taken. Yet, most people either do not know about this report, or do not care enough to read it, let alone consider the implications.

With the enormous national debt and the growing challenges of financing the debt, the increased potential for political influence by foreigners who hold large amounts of American debt, the long-term structural budget deficits that are now in place, and the growing financial strains of popular entitlement programs such as Social Security and Medicare, it is now more important than ever for government officials and policy makers – as well as the voters who must hold them accountable – to understand the fiscal environment in which we now find ourselves as a country. The consequences of not dealing with the growing fiscal problems today, while they are manageable, will only serve to worsen the negative effect on future generations of Americans.

¹ The report is available online at the U.S. Treasury Department's website at "<http://www.fms.treas.gov/frsummary/frsummary2007.pdf>" and at the U.S. General Accountability Office's website at "<http://www.gao.gov/financial/citizensguide2008.pdf>". The full Treasury Department report (2007 Financial Report of the United States Government) is available online at "<http://fms.treas.gov/fr/index.html>".

The fact that you are reading this book makes clear your interest in government affairs. The purpose of this book is to serve as a reference guide or primer for those who want to better understand the economics of the federal government. Again, the U.S. government has financial limits and it is important for elected politicians who set public policies, students of government, and concerned citizens to understand the realities of these limitations. The chapters that follow provide readers with a straightforward discussion of key economic terms and the fiscal performance of the federal government. No reports or data provided by politically conservative or liberal sources are used. Only objective government statistics kept by federal agencies such as the U.S. Treasury Department, the Congressional Budget Office (CBO), the Bureau of Labor Statistics (BLS), the General Accountability Office (GAO), and the Bureau of Economic Analysis (BEA) are cited throughout the book. Data extracted from these sources are illustrated in easy to understand graphs, charts, and tables so that readers can track the changes over time, as well as compare and contrast economic performance during the presidential administrations from President Jimmy Carter to President George W. Bush.

The book breaks down fiscal performance figures by President as a way to subdivide and compare the U.S. economy during each President's term in office. It should be recognized that Presidents do not fully control the economy. Congress plays an important role in that it approves all spending. However, Presidents have far more influence in setting the nation's economic agenda. They submit the annual budget framework to the Congress before it is approved. They also have the power of the bully pulpit to influence Congress and the American people. Additionally, federal agencies such as the U.S. Treasury Department and the Securities and Exchange Commission – which have enormous power over fiscal policies and regulation over the nation's financial sector – are parts of the Executive Branch of the federal government. Congress provides oversight, but this is often after the fact, when policies and actions have already been taken.

It should also be mentioned that economic policies are implemented differently when one party (Democratic or Republican) controls the White House and both Houses of Congress versus when there is split government. Even the size of the majorities in the House of Representatives and the Senate makes a difference on the dynamics of economic policy making and federal spending. This book does not drill down to that level of analyses. Instead, the focus is on trying to educate the reader on the broader trends in the economy over time.

Chapters 2 through 12 discuss key financial figures (gross domestic product, government spending, deficits, the national debt, etc.). To help readers, and make it easier to understand the numbers, the chapters deliberately follow a similar

structure and are consistent in the way the numbers are presented, illustrated, and discussed. Chapter 13 discusses what is known as the “third rail of American politics” – Social Security – and its growing financial instability. Millions of Americans rely on the program for their very survival, but it is unsustainable over the longer term without government intervention and changes to existing laws governing the program. Chapter 14 makes an effort to integrate the numbers and figures from the prior chapters in order to explain what they mean when taken together. It summarizes where the nation is today, from a fiscal standpoint, and outlines several broad needs that must be addressed by policy makers. Chapter 15 provides concluding thoughts.

This book does not try to answer all questions that a reader may have about government finances, nor does it offer specific solutions to the growing fiscal challenges the nation faces. Rather, it provides the reader with information to build a solid foundation and good working knowledge of the federal government’s fiscal performance over the last three decades. There is no effort to attempt to influence readers toward any particular solutions. This allows readers to focus on the objective numbers and draw their own conclusions. It is important to cut through the spin and look at the actual figures and raw data related to GDP growth, the national debt, the budget deficits, spending, inflation, unemployment, etc. By looking at the objective economic data and the changes over time, one can gain a better understanding of where we now stand and how we ended up here. Only then, can we hold our leaders responsible for their performance, make educated decisions about what has worked and not worked in the past, and consider options to address our fiscal challenges in the future.

Chapter 2

GROSS DOMESTIC PRODUCT

One of the most widely used measures of how the economy is performing is Gross Domestic Product (GDP). GDP is the total market value – in dollars – of all goods and services produced within the U.S. in a year. GDP does not distinguish between U.S. and foreign-owned companies that produce products or services in the U.S., nor does it include products that are produced by U.S. companies in foreign countries. Thus, it is a great indicator of how well the country’s domestic economy is performing because the goods and services it counts are only being produced within the borders of the U.S.¹

When GDP is rising, the economy is expanding, as the country produces more goods and services within its national borders. When it is rising rapidly – faster than about three percent – then all is usually well economically. More specifically, job growth tends to be strong, unemployment is low, and government revenues increase because as more is produced, there is more that can be taxed. When GDP growth falls below two to three percent, economic concerns grow and Americans start to feel pinched economically. Revenue growth for the government (i.e., tax collections) slows and less money is available to fund existing government programs or to spend on new programs. When GDP contracts for two successive quarters, we have an official recession, and the country feels even more significant economic pain. Obviously, a recession has significant negative impacts on government revenues, and forces elected officials to change government programs, tax policies, and debt accumulation in order to stimulate the economy.

¹ For more information about GDP see the U.S. Bureau of Economic Analysis website (“www.bea.gov”). The GDP figures discussed in this book and illustrated in the figures can be found at “<http://bea.gov/national/xls/gdplev.xls>”.

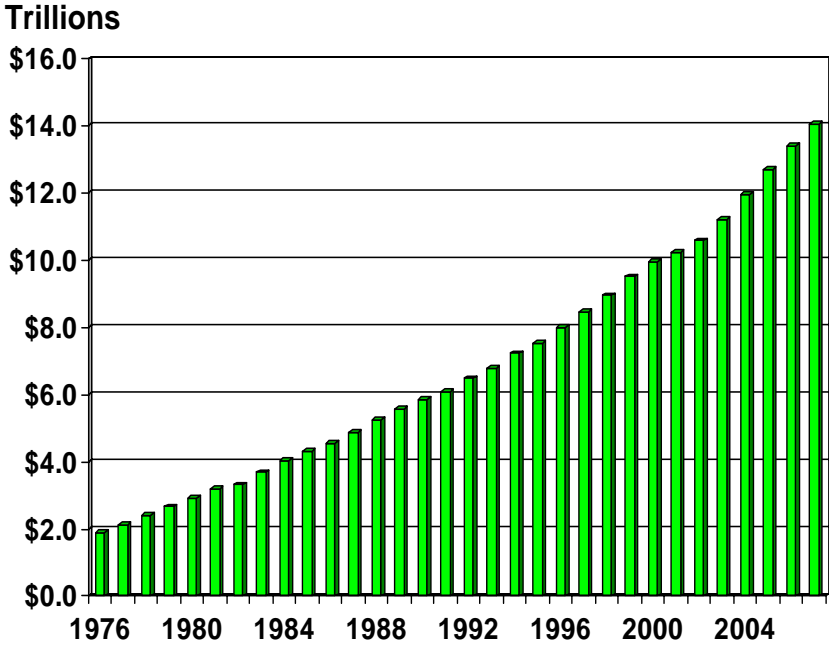


Figure 2-1. U.S. GDP Growth (1976-2007)

The U.S. economy has been resilient and has expanded every year over the last 30 plus years. Figure 2-1 shows the steady growth in U.S. GDP from 1976 to 2007.

In Figure 2-2, we can see that on a dollar basis, the economy has expanded by over \$4 trillion over the first seven years of President George W. Bush’s term in office. However, even under the four years of the Carter presidency – which has often been maligned as weak economically – U.S. GDP increased by about \$1 trillion.

It is important to recognize that a dollar 10 years ago, or 20 years ago, or 30 years ago, is not the same as a dollar in 2008, and the economy is far larger today than it was in the 1970s. For this reason, it is not necessarily surprising that U.S. GDP has grown by the greatest dollar amount in history under the current President relative to prior Presidents.

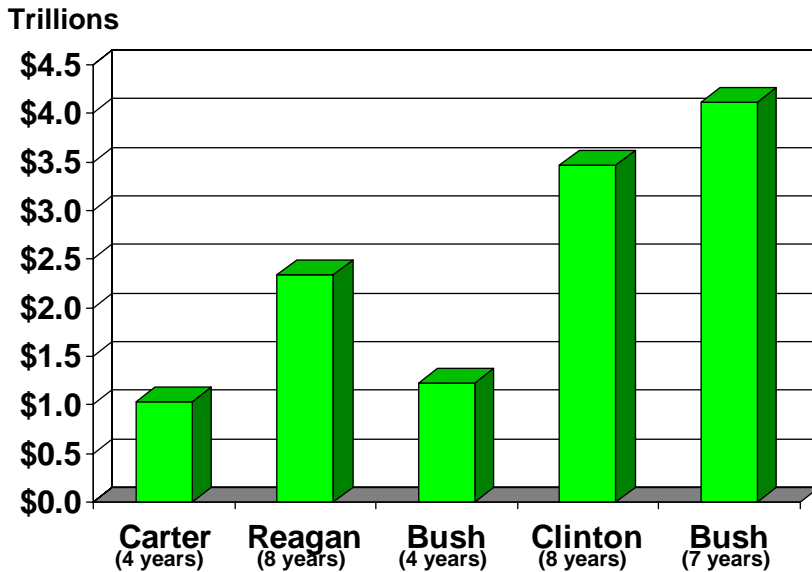


Figure 2-2. Dollar Growth in GDP by President²

Consider a household that earns an income of \$30,000 (Household A) and a household that earns \$200,000 (Household B). It would not be surprising to see Household B grow its household income by more dollars than Household A in a given year. In fact, all other things being equal, we should expect that to happen. However, if the lower income Household A were able to increase income by \$20,000 over a four-year period (66 percent increase), and Household B increased income by \$30,000 over a four-year period (15 percent increase), the increase by Household A would be far more significant and impressive. Even though in terms of actual dollars Household B increased by more than Household A, it is far more difficult to grow income by 66 percent than it is to increase income by 15 percent.

Thus, a better measure of relative performance is how fast and how much the economy grew on a percentage basis over the course of each presidency. For that, we can see in Figure 2-3 that the economy grew by the greatest percentage under President Reagan and grew by the smallest margin under President George H.W. Bush. The eight years of the Reagan presidency saw the economy grow by 80 percent. However, in reality, the economy actually grew faster during the Carter

² The figures represent the difference between the GDP figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through the fourth quarter of 2007.

presidency. If we divide the total GDP growth by the term length of each President, we can see that during the Carter presidency, GDP grew by an average 13.75 percent per year (55 percent divided by four years), whereas, GDP rose by an average 10 percent per year under Reagan (80 percent divided by eight years).

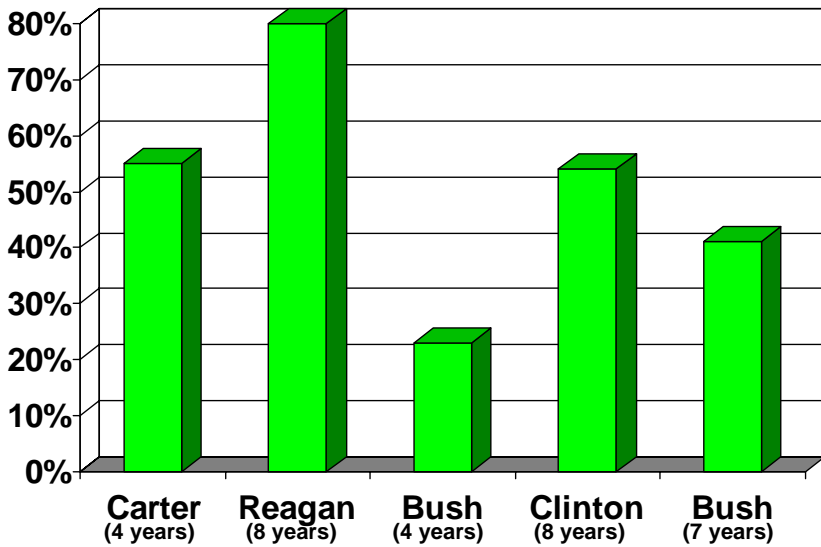


Figure 2-3. Percentage Growth in GDP by President³

The actual government GDP figures show that the U.S. economy grew at a healthy pace during each of the last five presidential administrations when you consider the performance over the entire presidencies. This is especially true of the Carter Administration, which again is contrary to the impression many people hold about the economic performance of that presidency.

Obviously, GDP is just one fiscal performance measure. We have to look at other numbers to get a more complete understanding of the financial decisions made by our government and the economic performance of the nation over time and under each President. However, GDP helps us better understand other fiscal performance measures of the government because it provides an important economic context.

³ The figures represent the percentage growth in GDP over the course of each President's term. For President George W. Bush, the term is through the fourth quarter of 2007. Calculated by taking the difference in GDP over the course of each President's term and dividing by the GDP figure at the end of the previous presidency.

To explain how and why, let us consider an example in which GDP is represented as total income in a single household. Let us assume that the total household income is \$140,000 per year. The income would be used by the family to address needs and financial priorities. Some money would be spent on daily expenses, some may be put away for retirement, some invested in stocks and mutual funds, some would be used to finance household debt (e.g., car loans, home mortgage, school loans), etc. As income rises, the household must make choices about how to use the additional income. Should it be used to pay down debt? Should the money be saved? Should it be spent? The decision about what to do with the money will be dictated by the goals of the household and the situation it finds itself in. Such is the case with the U.S. government, except instead of making financial decisions based on having \$140,000 in household income, the government makes choices based on a figure that includes eight more zeroes – the \$14 trillion U.S. GDP.

The above analogy is somewhat imperfect because the government does not have \$14 trillion to spend. However, actual government revenues are based on tax collections that are directly tied to U.S. GDP. When GDP is rising rapidly, tax collections tend to rise. Likewise, when GDP is falling, tax revenues tend to fall. With respect to the nation, at different times, different priorities are set. In times of war, more must be spent on defense. When the economy slows, money may be invested in education programs to retrain workers, or it may be used as part of an economic stimulus. However, just as a household must make decisions and choices relative to its own income, the government must consider spending priorities and make economic decisions relative to the GDP. In general, government revenues (i.e., tax collection) should increase at about the same pace as GDP growth, and, in most cases, it is not preferable to increase spending or debt at a faster pace than GDP growth. The reasons for these general “rules of thumb” are explained through examples and discussion in the next several chapters which examine various economic factors and actual financial figures, and compare them back to GDP.

Chapter 3

FEDERAL GOVERNMENT REVENUES

The federal government has to have a source of revenue to generate cash which can be used to pay for government operations and services. While GDP represents the size of the entire U.S. economy, it is not equivalent to government revenues that can be spent on government programs and priorities. It is important for all Americans to understand where the government gets its money (revenue) because the government's money is our money. The primary source of revenue for the government is taxes.

“Tax” is a bad word for many people, but the reality is, through tax revenues the government pays for such things as the military, federal highways, and popular government programs such as Social Security. People may differ on what an appropriate tax burden should be for individuals and corporations (or even whether there should be any taxes whatsoever), but they are a necessary part of American society because they fund our government and the services it provides.

In 2007, the U.S. government collected a record \$2.57 trillion in revenues. The sources of the money were as follows:¹

- 45% - Individual Income Taxes
- 14% - Corporate Income Taxes
- 34% - Social Insurance Taxes
- 3% - Excise Taxes
- 1% - Estate and Gift Taxes
- 1% - Customs Duties
- 2% - Miscellaneous Receipts

¹ Historical revenue collection figures can be found at the Congressional Budget Office website (“www.cbo.gov”). The revenue figures discussed in this book and illustrated in the figures can be found at “<http://www.cbo.gov/showdoc.cfm?index=1821&sequence=0>”.

Clearly, the above figures show that the overwhelming majority of revenues come from individual and corporate income taxes, as well as social insurance taxes. Most Americans are probably familiar with individual income taxes and corporate income taxes, but may not be as clear about what constitutes social insurance taxes. Social insurance taxes are the Federal Insurance Contributions Act (FICA) payroll taxes that are deducted from Americans' paychecks. Currently, they amount to 12.4 percent of gross salary up to \$102,000 (no additional FICA taxes are collected for Social Security on salary above \$102,000), and 2.9 percent of total gross salary (no limit) for Medicare. These taxes are split evenly between employers and employees. So, while an individual employee making up to \$102,000 sees a FICA deduction of 7.65 percent on his/her salary pay stub (6.2 percent for Social Security and 1.45 percent for Medicare), the government also collects 7.65 percent from the employer of that employee. (Additional details about the financial accounting and conditions surrounding Social Security can be found in Chapter 13).

The U.S. government has collected money from the same sources and in largely the same percentages for decades. As a comparison, in 1976, the government collected 44 percent of its revenues from individual income taxes, 14 percent from corporate income taxes, and 30 percent from social insurance taxes. These are fairly consistent with the 2007 figures.

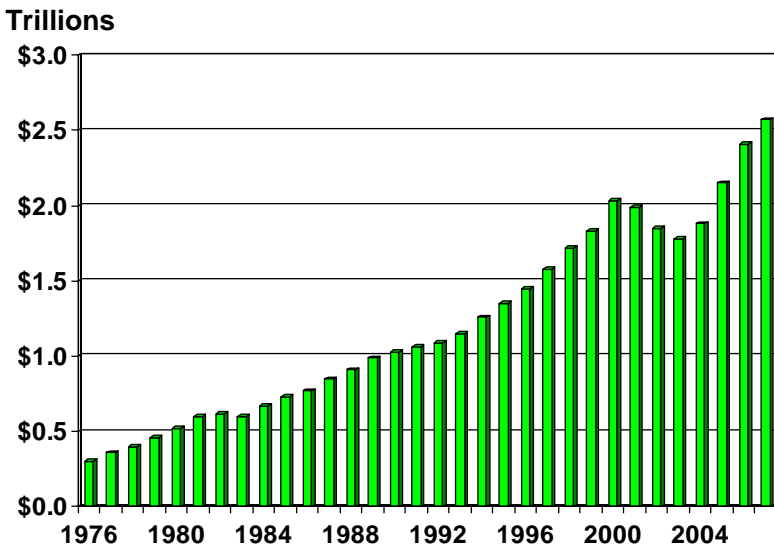


Figure 3-1. Federal Government Revenues (1976-2007)

Figure 3-1 illustrates the annual revenues collected by the U.S. government from 1976 to 2007. Revenues have steadily risen for most of the period. The only major drop in revenues occurred in the early 2000s. These dropping revenues can be attributed to a slowing economy, significant tax cuts, and the September 11 attacks, which had a significant negative economic impact on the country.

Figure 3-2 breaks down the total growth in annual government revenues over the terms of each of the last five Presidents. More specifically, the figures show the difference between how much revenue the government generated at the end of each President's term (e.g., revenues in the final year under President Reagan minus the revenues in the final year of President Carter). By far, annual government revenues increased by the greatest dollar amount during the Clinton presidency. In 1992, the U.S. government generated \$1.09 trillion in revenues, but in 2000, the last year of President Clinton's term, government revenues had nearly doubled to \$2.03 trillion.

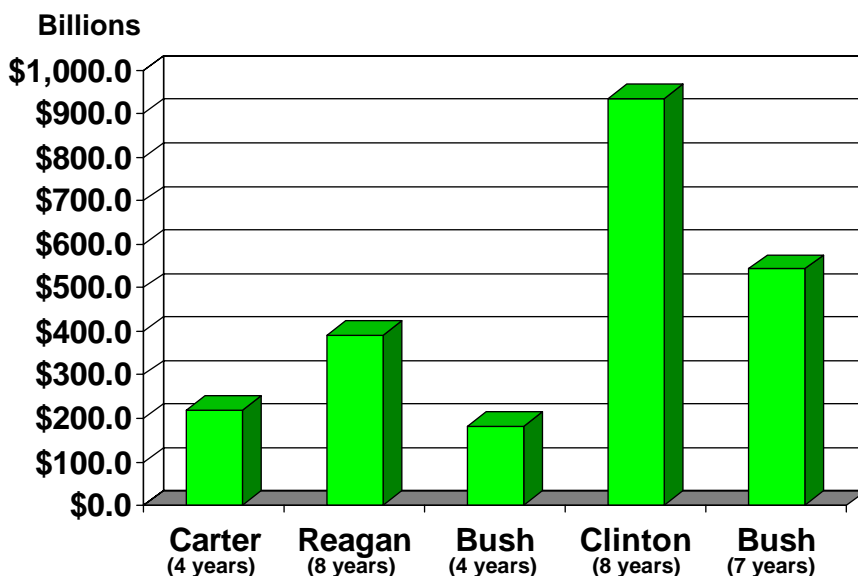


Figure 3-2. Dollar Growth in Annual Government Revenues by President²

² The figures represent the difference between the annual government revenues in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through the fourth quarter of 2007.

When one looks at the percentage growth in government revenues by President (calculated by taking ending revenue minus starting revenue and dividing the difference by starting revenue), it is clear that Presidents Carter, Reagan, and Clinton saw large percentage gains in revenues during their presidencies (see Figure 3-3). Neither President Bush saw such gains during their presidencies.

Depending on your personal beliefs, growing government revenues may be a good or bad thing. No matter what you believe with respect to growing revenues, it should be recognized that not all growth is the same. If GDP is \$1 trillion and the government collects \$300 billion in tax revenues, tax revenues would represent 30 percent of GDP (\$300 billion/\$1 trillion). However, if GDP is \$2 trillion and the government collects \$500 billion in revenues this would represent 25 percent of GDP (\$500 billion/\$2 trillion). Thus, even though more taxes were collected in the latter scenario, they were a smaller percentage of total GDP. This would represent a cut in tax rates.

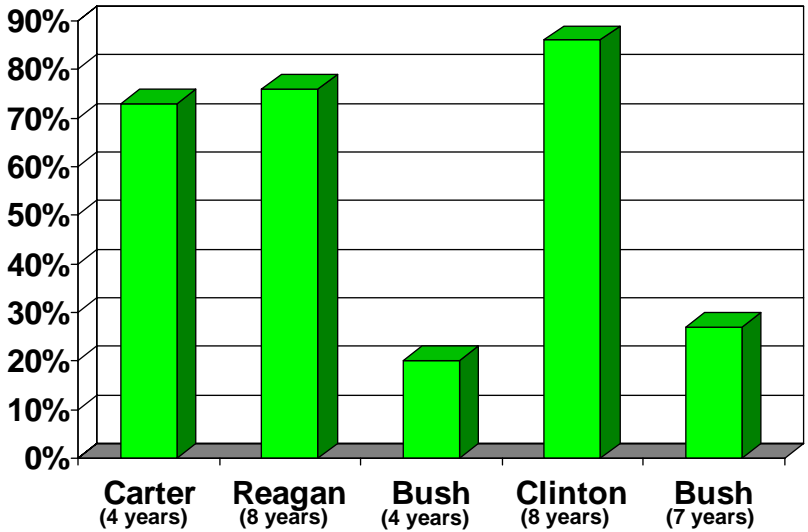


Figure 3-3. Percentage Growth in Annual Government Revenues by President³

³ The figures represent the percentage growth in annual revenues over the course of each President's term. For President George W. Bush, the term is through the fourth quarter of 2007. Calculated by taking the difference in annual revenues over the course of each President's term and dividing by the revenues at the end of the previous presidency.

Table 3-1 summarizes the total revenues collected and the GDP figures for the final year of each presidency (2007 figures are shown for President George W. Bush). Then, the revenues as a percentage of GDP are shown in order to allow for some comparison across Presidents. What is clear is that in the final year of President Clinton's term, government revenues were highest as a percentage of the GDP among the last five Presidents.

Table 3-1. Revenue and GDP in the Final Year of Each Presidency⁴

President	Revenues	GDP	Revenues/GDP
Ford	\$298 billion	\$1.89 trillion	15.8%
Carter	\$517 billion	\$2.92 trillion	17.7%
Reagan	\$909 billion	\$5.25 trillion	17.3%
Bush	\$1.09 trillion	\$6.48 trillion	16.8%
Clinton	\$2.03 trillion	\$9.95 trillion	20.4%
Bush	\$2.57 trillion	\$14.07 trillion	18.3%

Finally, Table 3-2 presents a summary of the growth in annual government revenues over the term of each President. For example, under President Carter, the government collected \$219 billion more in annual revenues in his last year in office than it did in the last year of the Ford presidency. This represented a 73 percent growth in government revenues. Table 3-2 also summarizes the growth in GDP so that one can see how the revenue growth compared with the GDP growth over the term of each President.

In a world in which nothing changes, we would expect to see revenue growth (or shrinkage) at the same pace as GDP growth (or contraction). But we do not live in such a world and the fact is that things do change – the economy fluctuates, government priorities change, inflation increases and decreases, tax rates change, etc. They all have an impact on how much revenue the government generates. Generally speaking, if you believe that more government programs should be enacted, then you are more likely to want to see greater government revenues to pay for such programs. If you believe the government is too large, you are more likely to want to see government revenues grow at a slower pace or even shrink. Rather than argue about which is better, or advocate one philosophy over another, what is safe to say is that it should be the goal of any politician – liberal or conservative – to ensure that there are enough revenues to cover spending requirements and any new or proposed programs.

⁴ For the current President Bush, the figures are for the seventh year of his term in office.

Table 3-2. Revenue and GDP Growth by President⁵

President	Annual Gov't Revenues Growth	GDP Growth	% Increase in GDP over Term	% Growth in Annual Gov't Rev. over Term
Carter (4 years)	\$219 billion	\$1.032 trillion	55%	73%
Reagan (8 years)	\$392 billion	\$2.337 trillion	80%	76%
Bush (4 years)	\$192 billion	\$1.230 trillion	23%	20%
Clinton (8 years)	\$934 billion	\$3.470 trillion	54%	86%
Bush (7 years)	\$543 billion	\$4.120 trillion	41%	27%

More broadly, in the absence of other information (e.g., government spending, budget deficits, national debt, unemployment, a falling dollar, inflation, etc.), it is impossible to determine if the government is collecting too much, too little, or just enough. Thus, one cannot, and should not, make a determination about which President held office during the best or worst periods of performance fiscal performance based solely on the information contained within Tables 3-1 and 3-2. The revenue information is just one set of numbers and they must be considered in the context of other financial figures. One of these other figures is government spending, which is discussed in the next chapter.

⁵ The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Chapter 4

FEDERAL GOVERNMENT SPENDING

One thing that all Americans know is that the federal government spends money. Every year, the President sends a proposed budget to Congress. While the budget provided by the President sets the agenda for government spending, it is not the final budget. Congress debates it and makes changes to the proposed budget, usually adding money for their own priorities. Once both Houses of Congress have passed the budget, they send the approved budget bill to the President who signs it into law or vetoes it. If it is vetoed, Congress can either work with the President to change the bill, or it can overturn the veto by voting to pass the budget over the President's objections. (Overturning a veto requires super majority votes in both the House and Senate.) Once the bill has been signed into law by the President, or Congress overturns a presidential veto, the money for the budget is appropriated (i.e., committed) and the spending begins for the fiscal year. On top of the budgeted amount, supplemental spending bills are approved throughout the year. These spending bills are often needed to cover emergency war funding or federal relief efforts after natural disasters such as tornadoes, floods, or hurricanes.

The end result of all of this spending is that the U.S. government is the single largest customer in the world. It purchases billions of dollars worth of goods and services from private-sector contractors. It is also the largest charity in the world. It pays out billions in foreign and domestic aid programs each year. The taxes and revenues that the government collects and generates are used to pay for this aid, contractor products and services, salaries for all federal workers and members of the military, and the thousands of other federal programs every year. The government pays for everything from the salary of the President, to the rebuilding of Iraq, to basic research conducted at the National Science Foundation, to education grants to fund Head Start programs for pre-school children, to border

security, and everything in between. All of these programs and salaries result in the enormous amount of money spent by the federal government. In 2008, federal spending will exceed a staggering \$3 trillion.

Figure 4-1 illustrates the annual amounts spent by the U.S. government from 1976 to 2007. Clearly the bar graph shows that there have been steady increases in spending, punctuated by a noticeable increase in spending in recent years. Naturally, because of such things as cost of living increases for salaries and inflation effects on the costs of goods and services, it is not surprising that spending increases year after year.

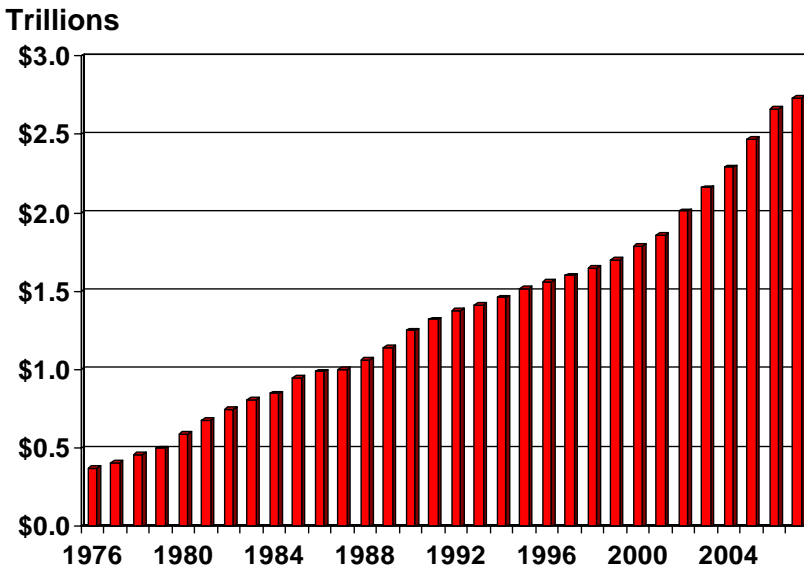


Figure 4-1. Federal Government Spending (1976-2007)¹

WHERE DOES ALL THE MONEY GO?

The major spending categories for the federal government are shown in Figure 4-2. Defense spending is the single largest category of federal spending. Social Security and Medicare/Medicaid spending closely follow. As the baby

¹ Historical spending figures can be found at the Congressional Budget Office website (“www.cbo.gov”). The spending figures discussed in this book and illustrated in the figures can be found at “http://www.cbo.gov/showdoc.cfm?index=1821&sequence=0”.

boomers continue to age and retire, Social Security and Medicare/Medicaid will grow rapidly in coming decades. However, one category of spending that Americans should start to pay attention to is interest on the national debt (discussed in greater detail in Chapter 6). The national debt has exploded in recent years and now stands at over \$10.5 trillion. As the historically-low interest rates that we have today rise, and the debt continues to grow, the interest payments required to finance the debt will make up a greater and greater percentage of total federal spending. Unlike other government spending priorities and programs such as defense, Social Security, and Medicare, we get nothing for interest payments. That money just goes to pay creditors for allowing us to borrow money in the past.

Some complain that too much is wasted on unnecessary federal programs. One favorite target for many critics is money sent to foreign countries as part of aid programs. But, the reality is that these programs make up an extremely small amount of total federal budget spending. Not including war costs, which are accounted for in the Department of Defense (DOD) budgets, the total amount of spending on international aid programs in 2007 was \$34.7 billion, a large number to be sure, but this amounts to just over one percent of total federal spending in 2007.

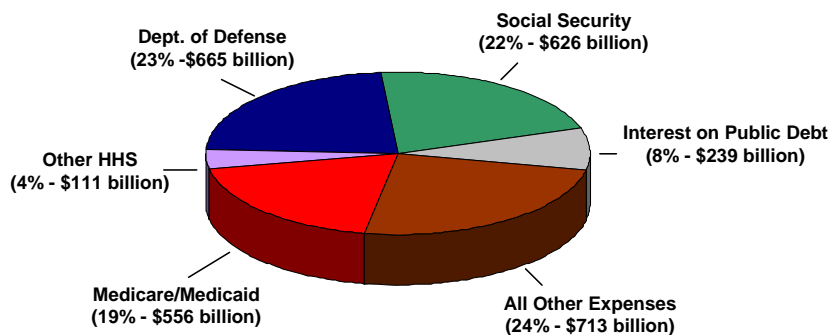


Figure 4-2. Major Categories of Federal Spending (2007)²

² Based on the 2007 Treasury Department report entitled, *The Federal Government's Financial Health*. The report is available online at "<http://www.gao.gov/financial/citizensguide2008.pdf>".

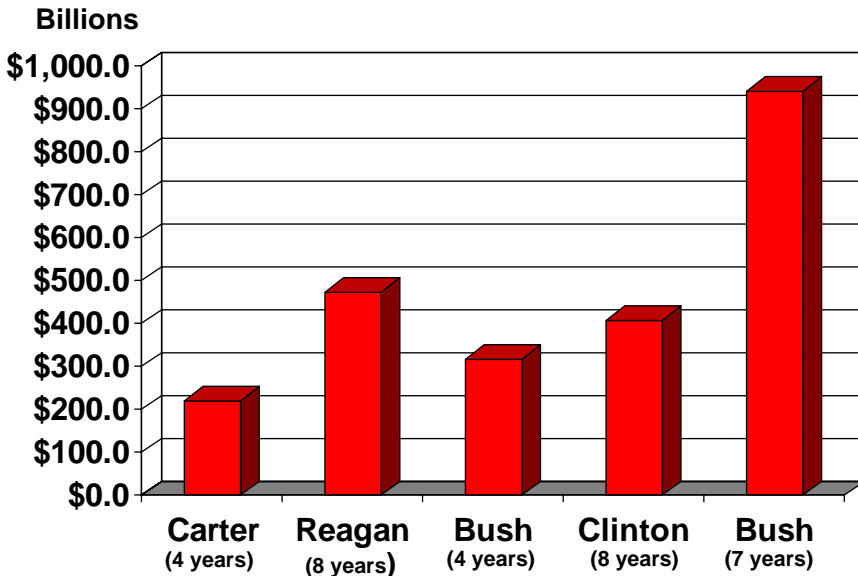


Figure 4-3. Dollar Growth in Annual Government Spending by President³

Figure 4-3 shows the dollar increases in the annual amounts spent by the government during the last five presidencies. By the time President Reagan left office, annual spending by the federal government had increased by nearly \$500 billion over the amount spent in the final year of the Carter presidency. Over the course of President Clinton's term, total annual spending increased by \$400 billion per year. But these increases were modest when compared to the \$1 trillion in additional spending that has already been added to annual government budgets under the current President Bush.

In Figure 4-4, we can see the percentage growth in government spending by President. President Reagan's eight years in office ended with an 80 percent increase in annual federal government spending. By comparison, President Clinton's eight years in office ended with federal spending growing by 30 percent – about the same percentage as the growth in spending during the four years of the first President Bush's term.

³ The figures represent the difference between annual government spending in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through the fourth quarter of 2007.

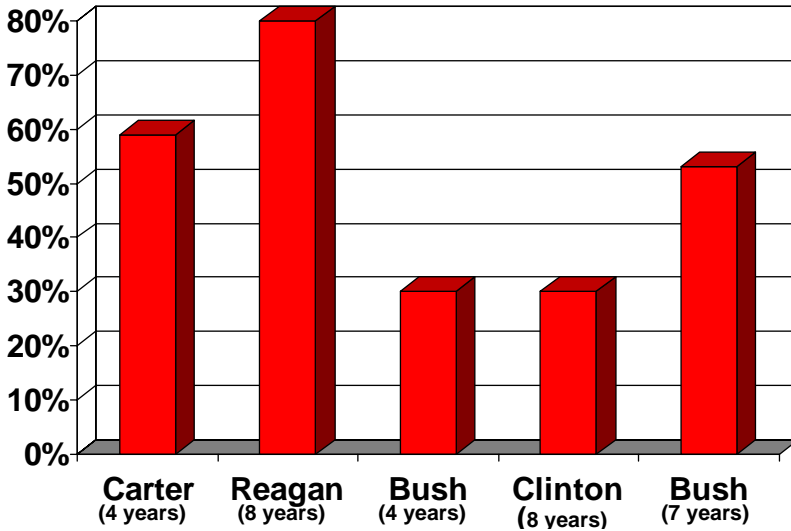


Figure 4-4. Percentage Growth in Annual Government Spending by President⁴

DISCRETIONARY VERSUS PROGRAMMATIC SPENDING

Spending can be divided into two categories – *discretionary spending* and *programmatic spending*. Programmatic spending is spending that is required by law. For example, Social Security beneficiaries receive certain payment amounts that have been established by Congress. As the U.S. population grows, life expectancies extend as a result of drug and medical breakthroughs, and the number of older Americans increases, more money will be required for Social Security beneficiaries; however, the amount paid to each beneficiary remains the same. Congress and the President cannot choose to change the financial benefits for retirees without first passing a new law that legally changes benefit amounts. However, discretionary spending does change from year to year and reflects changing priorities within the government. Presidents can make requests – as President Bush does to fund the war efforts in Iraq and Afghanistan, or to fund cleanup efforts after Hurricane Katrina. Or, Congress can fund new programs. The

⁴ The figures represent the percentage growth in annual spending over the course of each President's term. For President George W. Bush, the term is through the fourth quarter of 2007. Calculated by taking the difference in spending over the course of each President's term and dividing by the spending at the end of the previous presidency.

system of checks-and-balances requires that both Congress and the President approve new discretionary spending before it can actually be spent. The end result is that programmatic spending increases are “automatic” while discretionary spending amounts change from year to year.

As shown in Figure 4-2, just over 40 percent of federal spending now goes toward paying Social Security and Medicare/Medicaid benefits. Given their rising costs, there are growing concerns about the long-term sustainability of these programs. The fiscal issues surrounding the Social Security program are discussed in Chapter 13, but the next portion of this chapter will focus on the discretionary spending differences between the last several Presidents. By looking at how much growth in discretionary spending occurred under each President (see Figure 4-5), and what the additional discretionary spending was used for, we can learn more about the priorities of each President.

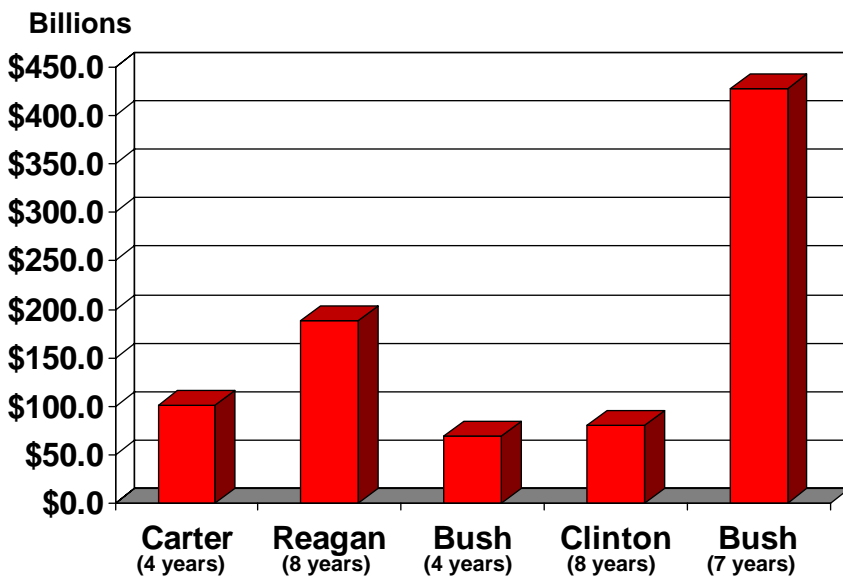


Figure 4-5. Dollar Growth in Annual Discretionary Spending by President⁵

Among the last five Presidents, discretionary spending has increased by the largest dollar amount under George W. Bush. In 2007, the federal government spent more than \$400 billion more in annual discretionary spending than when

⁵ See note 3 in this chapter, except this is for annual discretionary spending rather than total spending.

President Clinton left office in January 2001. When we look at the percentage increases, we can see that there is a major difference in the increases in discretionary spending between the presidencies of George H. W. Bush and Bill Clinton, and the presidencies of Jimmy Carter, Ronald Reagan, and George W. Bush (see Figure 4-6). The latter group saw annual discretionary spending increase by over 50 percent over the course of their presidencies. These increases were far greater than the more modest 15 percent increases during the presidencies of George H. W. Bush and Bill Clinton. It should be noted that the increase in discretionary spending under Jimmy Carter occurred over four years, making it likely that had he served out a second term, he would have overseen the largest percentage increase in discretionary spending among the five Presidents. On the other end of the spectrum, while discretionary spending increased 15 percent during both the first Bush presidency and the Clinton presidency, the Clinton presidency was twice as long. Thus, discretionary spending grew by the slowest pace under President Clinton.

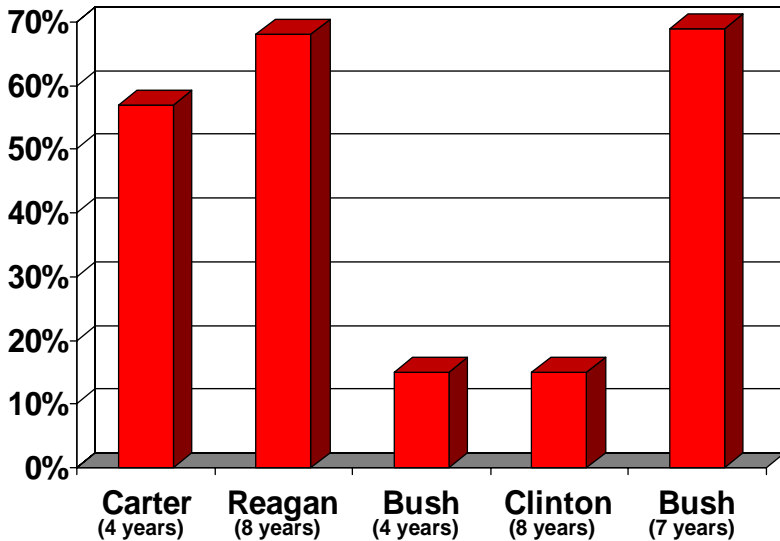


Figure 4-6. Percentage Growth in Annual Discretionary Spending by President⁶

⁶ See note 4 in this chapter, except this is for annual discretionary spending rather than total spending.

Not all discretionary spending is the same and there are times when federal spending must increase to cover priorities. For example, during times of war, greater discretionary spending is needed to cover military costs. Figure 4-7 shows defense spending in the final years in office of the past five Presidents. Clearly, we can see the military buildups during the Reagan years and the current Bush presidency.

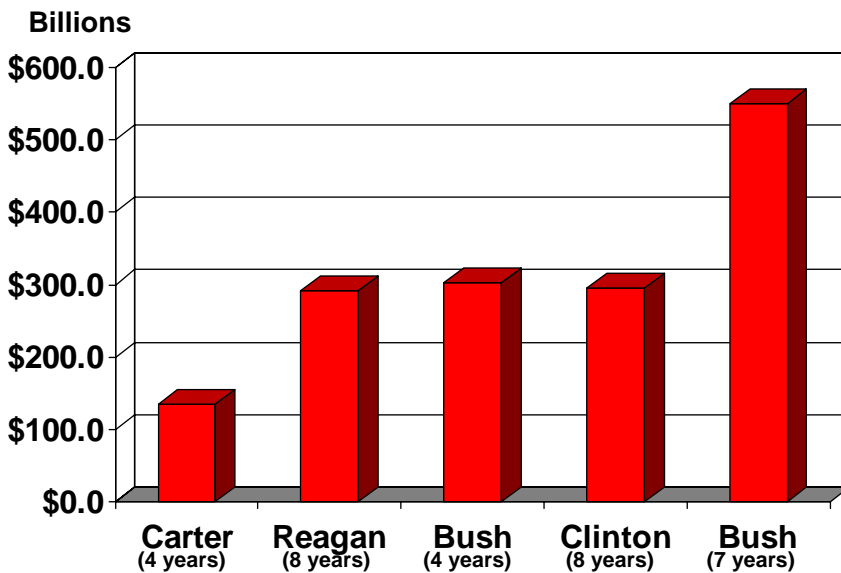


Figure 4-7. Defense Spending by President in Final Year of Term⁷

The percentage changes in defense spending over the course of each President's term in office can be seen in Figure 4-8. Again, we can see that for President Reagan and the current President Bush, defense spending was a major priority. During the Reagan presidency, there was an arms race with the former Soviet Union, and whether one agrees or disagrees with the U.S. policy on Iraq, the fact is that we are there and the military must be funded.

To put the U.S. defense spending into some context, according to CIA estimates, U.S. military spending amounts to about half of all defense spending throughout the world.⁸ Even the \$300 billion defense budgets under Presidents

⁷ For the current President Bush, the total defense spending figure for the final year is from 2007.

⁸ Data available at the [globalsecurity.org](http://www.globalsecurity.org/military/world/spending.htm) website. See "http://www.globalsecurity.org/military/world/spending.htm".

Reagan, Bush, and Clinton would amount to one quarter of all military spending in the world today (2008).

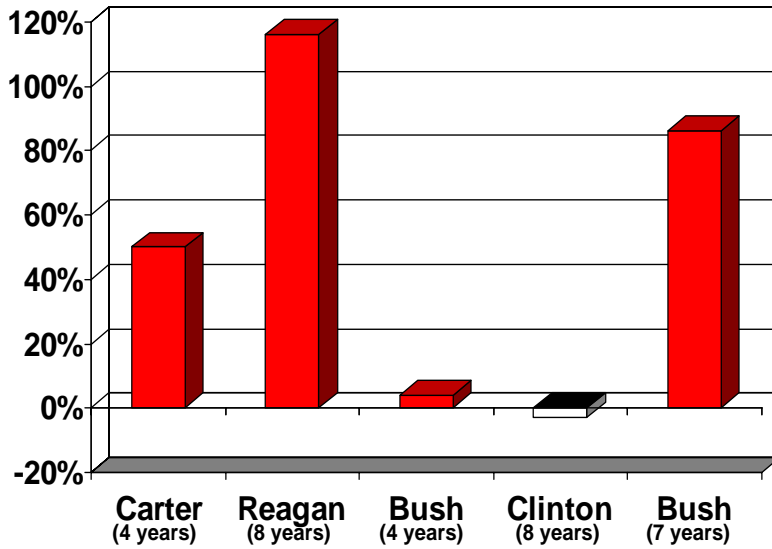


Figure 4-8. Percentage Growth in Annual Defense Spending by President⁹

Non-military domestic discretionary spending is a favorite target of conservatives (again, this does not include programmatic programs such as Social Security and Medicare). These expenditures usually occur as a result of new federal programs that require additional funding. However, as can be seen in Figure 4-9, in terms of dollars, domestic spending has increased during all five of the last presidencies. The increased spending under the current President represents the largest dollar increase. After seven years in office, the government under the leadership of the current President Bush now spends about \$150 billion more on an annual basis than it did when President Clinton left office.

⁹ See note 4 in this chapter, except this is for annual defense spending rather than total spending.

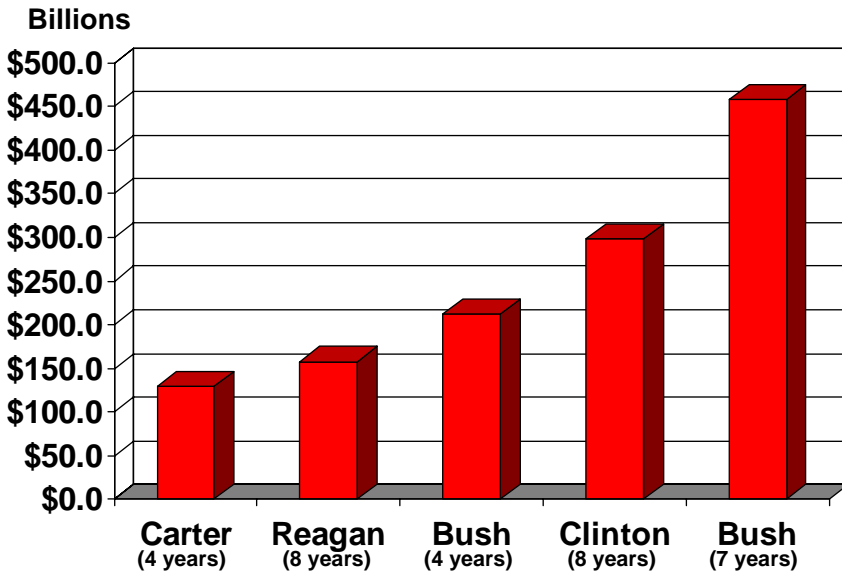


Figure 4-9. Discretionary Domestic Spending by President in Final Year of Term¹⁰

In terms of percentage increases in discretionary domestic spending, the four years of the Carter Administration resulted in the largest gain (see Figure 4-10). Growth in this spending remained relatively flat over the eight years of the Reagan Administration, but has steadily increased over the course of the last three Presidents. During the eight year term of President Clinton, discretionary domestic spending increased by 41 percent. The first seven years of the current President Bush has seen such spending increase by 53 percent (with one year left in his term). Under the former President Bush, discretionary domestic spending increased by 34 percent, but given that it was over just four years compared to President Clinton's eight years, one can see that this increased spending occurred at a faster pace.

Spending has increased steadily and significantly throughout the terms of the last five Presidents. It is hard to objectively argue that one party or one President has been able to control spending. This fact becomes clear when we look at spending as a percentage of GDP. Table 4-1 provides a summary of the spending figures and the GDP figures for the final year of each presidency (2007 figures are

¹⁰ For the current President Bush, the total discretionary domestic spending figure for the final year is from 2007.

shown for President George W. Bush). These figures again allow us to compare across Presidents.

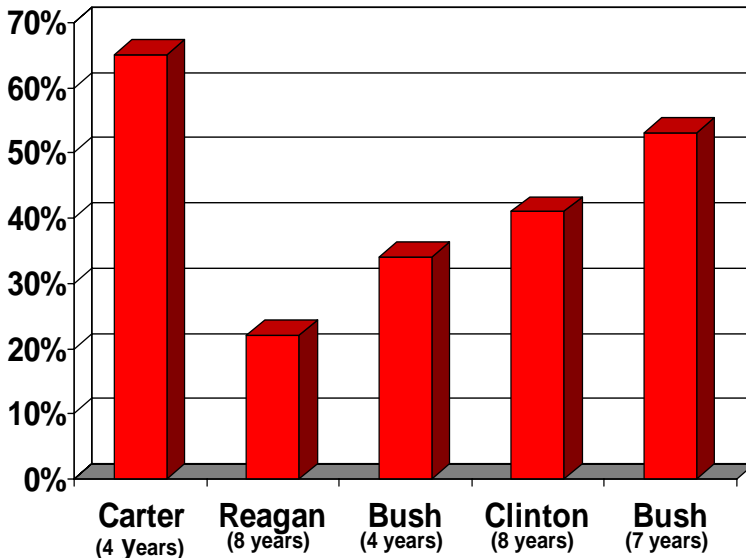


Figure 4-10. Percentage Growth in Annual Discretionary Domestic Spending by President¹¹

Table 4-1. Federal Spending and GDP in the Final Year of Each Presidency¹²

President	Spending	GDP	Spending/GDP
Ford	\$372 billion	\$1.89 trillion	19.7%
Carter	\$591 billion	\$2.92 trillion	20.2%
Reagan	\$1.06 trillion	\$5.25 trillion	20.2%
Bush	\$1.38 trillion	\$6.48 trillion	21.3%
Clinton	\$1.79 trillion	\$9.95 trillion	18.0%
Bush	\$2.73 trillion	\$14.07 trillion	19.4%

¹¹ See note 4 in this chapter, except this is for annual discretionary domestic spending rather than total spending.

¹² For the current President Bush, the figures are for the seventh year of his term in office.

There was a bump up in spending relative to GDP with the first President Bush, followed by a significant drop under President Clinton. The trend under the current President is up, with higher spending. What should be clear from the table is that in the final year of President Clinton's term, government spending was at the lowest rate relative to GDP among the five presidencies. The numbers are all fairly close; however, given the enormous size of GDP a one or two percent difference is significant. One percent of a \$10 trillion GDP is \$100 billion. So had President Clinton's spending amounted to 20 percent of GDP (instead of 18 percent), we would have seen another \$200 billion in spending.

Finally, Table 4-2 presents a summary of the growth in annual government spending over the term of each President. For example, under President Carter, the government spent \$219 billion more in annual revenues in his last year in office than it did in the last year of the Ford presidency. This represented a 59 percent growth in government spending. As in Chapter 3, Table 4-2 also summarizes the growth in GDP so that one can see how the spending increases compared with the GDP growth over the term of each President.

Table 4-2. Federal Spending and GDP Growth by President¹³

President	Annual Gov't Spending Growth	GDP Growth	% Increase in GDP over Term	% Growth in Annual Gov't Spending over Term
Carter (4 years)	\$219 billion	\$1.032 trillion	55%	59%
Reagan (8 years)	\$474 billion	\$2.337 trillion	80%	80%
Bush (4 years)	\$317 billion	\$1.230 trillion	23%	30%
Clinton (8 years)	\$408 billion	\$3.470 trillion	54%	30%
Bush (7 years)	\$941 billion	\$4.120 trillion	41%	53%

As a general rule, growth in spending should not outpace GDP growth. Ideally, the nation's economy is growing faster than the government is spending.

¹³ The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

If this is the case, then more money is being made and kept by individual citizens and the private sector than is being spent and committed by the government. We can see in Table 4-2 that under Presidents Carter and Reagan, spending growth stayed pace with GDP growth. During President Clinton's term, GDP growth was far greater than growth in spending – again, this is desirable. But, during the two Bush presidencies, spending increased significantly faster than GDP growth.

Now that we have looked at government revenues and spending, we can begin to examine how well (or poorly) our government has functioned from a fiscal standpoint under the last five Presidents. In the following chapter, the difference between government revenues and spending is explored further. When the government spends more than it takes in, it is called a budget deficit. On the other hand, when revenues are greater than spending, we have a budget surplus. The actual budget deficits and surpluses for the U.S. government over the last 30 years are shown and discussed in the next chapter.

Chapter 5

FEDERAL BUDGET DEFICITS AND SURPLUSES

The U.S. economy is difficult for most people to fully comprehend. Even highly-regarded economists and non-partisan policy analysts differ on what is best for the economy. However, one thing that most economists agree on is that significant ongoing deficit spending is bad economic policy. The reasons for this are explored in this chapter.

What is deficit spending? Quite simply, when the amount of money the government spends in a given year is more than the amount of money that the government generates in revenues for that year there is a deficit (i.e., the government engages in deficit spending). If the government spends less than it takes in during the year, there is a budget surplus. Unfortunately, since 1950 there have only been nine years when our government has operated with a surplus.¹

Integrating the spending and revenue figures from the prior two chapters, Figure 5-1 shows the historical budget deficits and surpluses since 1976. Clearly, and unfortunately, Figure 5-1 shows that deficits are normal for the U.S. government. However, it is also clear that fiscal performance, in terms of the federal budget, was best during the Clinton presidency. In fact, every year of President Clinton's term in office saw improved figures for the budget. He inherited a budget deficit of \$290 billion in the final year of the first President Bush, and following eight straight years of improvement, left office with a record budget surplus of \$236 billion. Thus, the Clinton Administration oversaw an improvement to the annual budget of \$526 billion. For this year (2008), President Bush has projected a deficit of 2.9 percent of GDP, which would amount to more

¹ Timothy Bitsberger, "Treasury Debt Management" U.S. Department of Treasury (October 2, 2003). The information was accessed at "<http://www.ustreas.gov/press/releases/reports/bitsbergerpresentation.pdf>" on June 16, 2008.

than \$400 billion.² Should the actual federal budget figures for the current fiscal year end with a \$400 billion deficit as they are currently projected, this would result in a \$636 billion deterioration in the budget situation for the U.S. government since President George W. Bush took office.

Table 5-1 allows us to compare the relative sizes of the deficits at the end of each president's term in office (and the surplus at the end of President Clinton's term), by calculating the deficit as a percentage of GDP.

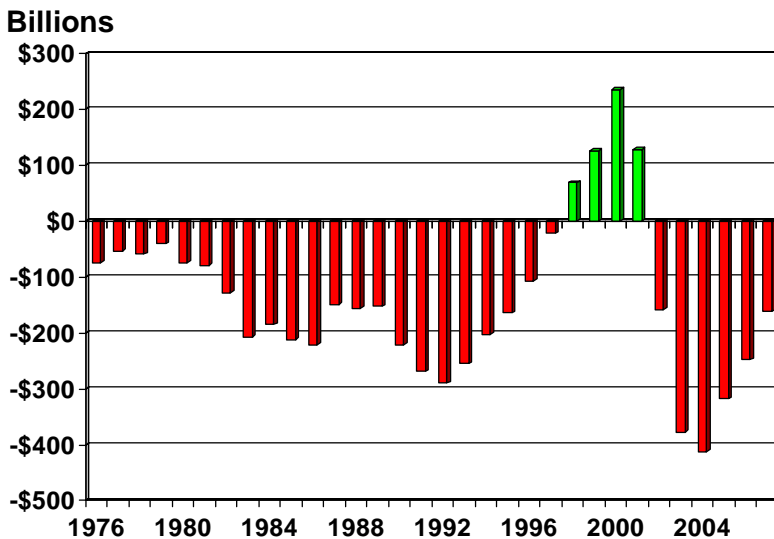


Figure 5-1. Annual Federal Budget Deficits and Surpluses (1976-2007)³

Again the figures in Table 5-1 illustrate the significantly better budget situation that President Clinton left at the end of his term. During his eight-year term, the deficit went from 4.5 percent of GDP to a surplus representing 2.4 percent of GDP – by any objective measure that is a remarkable turnaround. One other item that is somewhat surprising is that under President Carter there was significant improvement in the budget over the end of the Ford presidency. Given the memory Americans have of the economic conditions during the Carter Administration, it may also be surprising to realize that the budget situation was better than the budget left by President Reagan. To further illustrate these points

² See White House Fact Sheet on the President's Budget (February 4, 2008). Available at "<http://www.whitehouse.gov/news/releases/2008/02/20080204.html>".

³ See CBO website at "<http://www.cbo.gov/showdoc.cfm?index=1821&sequence=0>".

and to compare the budgets between presidents, Table 5-2 provides a summary of the budget changes and GDP growth over the terms of each president.

Table 5-1. Deficits and GDP in the Final Year of Each Presidency⁴

President	Deficit	GDP	Deficit/GDP
Ford	\$74 billion	\$1.89 trillion	3.9%
Carter	\$74 billion	\$2.92 trillion	2.5%
Reagan	\$155 billion	\$5.25 trillion	3.0%
Bush	\$290 billion	\$6.48 trillion	4.5%
Clinton	(\$236 billion)*	\$9.95 trillion	(2.4%)*
Bush	\$162 billion	\$14.07 trillion	1.2%

* In 2000 when President Clinton left office there was a \$236 billion budget surplus which is why the figures are negative

Table 5-2. Deficit and GDP Growth by President⁵

President	Annual Budget Deficit Growth	GDP Growth	% Increase in GDP over Term	% Increase in Annual Budget Deficit over Term
Carter (4 years)	\$100 million	\$1.032 trillion	55%	0.1%
Reagan (8 years)	\$81 billion	\$2.337 trillion	80%	110.3%
Bush (4 years)	\$135 billion	\$1.230 trillion	23%	87.0%
Clinton (8 years)	(\$526 billion)*	\$3.470 trillion	54%	(181.4%)*
Bush (7 years)	\$398 billion	\$4.120 trillion	41%	168.6%

* In 2000 when President Clinton left office there was a \$236 billion budget surplus which is why the figures are negative (i.e., they represent reductions in deficits that resulted in the surpluses)

⁴ For the current President Bush, the term is only through his first seven years in office.

⁵ The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Ideally, GDP growth should be faster than growth in budget deficits. From Table 5-2, we can see that this occurred only during the Carter and Clinton Administrations. By contrast, the current President Bush took over an economy that had been booming throughout the 1990s and has overseen another turnaround in the budget that is as bad as Clinton's turnaround was good. GDP growth was strong under President Clinton, and the economy had produced significant government revenues. Spending grew slower than both GDP and government revenues, so it would appear that spending was under control. The end result was a record budget surplus.

Some argue that the economy was slowing when President Clinton's term ended. This is true; however, the economy was still growing at a solid pace. The fact is that GDP grew by 6.3 percent in 1999, 4.6 percent in 2000, 2.7 percent in 2001, and 3.6 percent in 2002, so it is difficult to see how one can argue that the economy was in trouble – even with the 9/11 attacks on the nation. Yet, the U.S. has returned to the several hundred billion dollar deficits that were common throughout the 1980s and early 1990s. This should be a concern for all Americans.

There are fairly obvious reasons for the budget deterioration under President George W. Bush. The 9/11 attacks and Hurricane Katrina did have a significant negative economic impact on the nation, but realistically, we have to expect that hurricanes and disasters will occur – they are nothing new (although the scope and magnitude of the 9/11 attacks were grotesquely unique). If you look back at the Clinton Presidency, we had the first World Trade Center bombing, the Oklahoma City bombing, and Hurricane Andrew. The first President Bush dealt with the Exxon Valdez spill and instability in China with the Tiananmen Square student protests. President Reagan had an escalating arms race with the Soviets, Black Monday's stock market crash, and he was shot. Likewise, President Carter dealt with the oil embargo which caused a major energy crisis, as well as the Iran hostage situation. The point is that things happen during every presidency – we cannot use them as excuses for economic performance.

Beyond the disasters, the real reason budget deficits under President Bush have replaced the surpluses at the end of President Clinton's term can be traced back to the tax cuts combined with record increases in federal spending. The tax cuts slashed government revenues such that the first four years of the Bush Administration (2001-2004) saw government revenues fall below the 2000 revenues in the final year of the Clinton Presidency. Government revenues in 2004 (\$1.88 trillion) were 7.2 percent lower than in 2000 (\$2.03 trillion). Over that same period, spending increased from \$1.79 trillion in 2000, to \$2.29 trillion in 2004. This represents a 28 percent increase in spending. Military spending was

up 54 percent (\$295 billion in 2000 to \$454 billion in 2004), and discretionary domestic spending was up 36 percent (\$299 billion in 2000 to \$408 billion in 2004).

It should not be surprising to anyone that increasing spending by 28 percent at the same time as a 7.2 percent reduction in revenues resulted in large deficits. Just as it would not make sense for a person to immediately go on a dramatic spending spree after he/she took a pay cut, the same rationale should hold for our government – a major cut in revenues should be accompanied by a spending freeze or even spending cuts in order to maintain fiscal responsibility. The result of not holding the line on spending after the tax cuts were implemented led to federal deficits.

To cover the cash shortfalls that result from the annual budget deficits, our government borrows money from private investors, large banks, and foreign central banks (through treasury bills, government bonds, and other securities). The deficit for each year gets added to our national debt. These issues are discussed further in the next chapter.

Chapter 6

U.S. NATIONAL DEBT

There is confusion about the budget deficit and the national debt – they are linked but they are also two very distinct numbers. Budget deficits refer to the annual cash shortfalls that occur year after year (see previous chapter), but the national debt is the total amount the federal government owes. The national debt is the end result of the deficit spending. All of the deficits add up to make up the total national debt.

Many people do not realize that the U.S. has a national debt, and those who do rarely know how large it actually is. Most Americans are probably not concerned about it because it seems abstract and irrelevant to their daily lives. However, it is real money that is owed by our government, and thus, by the American people to various creditors. It has been growing at a rapid pace in recent years, and if this trend does not change, it will become more and more difficult to finance the debt. This is problematic because as the costs to finance the debt increase, there are likely to be significant impacts on future government spending and services.

As of October 23, 2008, the U.S. government owed over \$10.5 trillion (\$10,524,112,985,802.87 to be more precise¹), and it is growing by more than \$1.5 billion per day.² This means that every man, woman, and child living in America is saddled with over \$30,000 in government debt. The facts about the debt and complex issues it raises are explored further in this chapter.

¹ U.S. National Debt to the penny can be found on the U.S. Treasury Department website at “<http://www.treasurydirect.gov/NP/BPDLogin?application=np>”.

² See the U.S. National Debt Clock at “http://www.brillig.com/debt_clock/”.

WHO DOES THE GOVERNMENT OWE?

As discussed in the last chapter, in most years, the federal government spends more money than it collects in revenues (deficit spending). Contrary to what many people think, the government cannot just print more money to cover the shortfall and solve the problem. This would negatively impact the value of the dollar and result in inflation (discussed further in Chapter 10). So the government borrows money to pay for the deficit spending. It sounds odd – the government borrowing money – but it is true. There are numerous creditors who hold U.S. federal government debt. These creditors include individual Americans, banks, insurance companies, mutual funds; increasingly, foreign investors and foreign central banks; and even the government itself. Debt held by the government is referred to as *intragovernmental holdings*, and all of the other creditors make up *debt held by the public*.

Intragovernmental holdings currently make up approximately 44 percent of the total national debt (\$4.3 trillion).³ The government borrows money from itself on a regular basis. Sounds confusing and it seems counter-intuitive, but it is really quite simple. The government collects money that is specifically earmarked by law for special programs. Social Security is one such example. According to Congressional Budget Office figures, in 1986, the government collected \$16.7 billion more in Social Security taxes than it paid out in Social Security retiree benefits.⁴ This grew steadily throughout the latter 1980s and 1990s, and in 1998, the government collected almost \$100 billion more in Social Security taxes than it paid out. Last year (2007), the Social Security surplus had grown to \$186.5 billion. In total, these hundreds of billions of dollars in excess Social Security taxes have been collected and make up the Social Security Trust fund. According to the annual report prepared by the Social Security Administration, at the end of 2007, the Trust held more than \$2 trillion in assets.⁵

However, in reality, the \$2 trillion has already been spent by our government – but not on Social Security benefits. Through both Republican and Democratic presidential administrations, as well as when Congress has been controlled by Republicans or by Democrats, the federal government has used the Social Security tax surpluses to pay for annual government programs. Technically, the money has been “borrowed” and has been secured by what amounts to a federal

³ See TreasuryDirect website at “<http://www.treasurydirect.gov/NP/BPDLogin?application=np>”.

⁴ See CBO website (www.cbo.gov) at “<http://www.cbo.gov/showdoc.cfm?index=1821&sequence=0>”.

⁵ Summary of Social Security Administration Trustees’ Annual Report. See “<http://www.ssa.gov/OACT/TRSUM/index.html>”.

promissory note to pay the borrowed amount back at such time as it is needed. That is, when the annual collected Social Security taxes do not cover the required Social Security benefits payments in a given year, the federal government will be required to begin to pay back the borrowed money. (This and other issues surrounding Social Security are discussed in greater detail in Chapter 13.)

The U.S. Treasury Department refers to the other 56 percent of the total national debt (\$6.3 trillion) as “debt held by the public.” Essentially, this is the amount that is held by various investors, mutual funds, foreign banks, etc. More specifically, this debt is made up of various short- and long-term U.S. Treasury securities. The U.S. Treasury Department issues out these bills, notes, bonds, and securities with the promise of paying back investors, with interest, at some later date (anywhere from four weeks to 20 years). Traditionally, investors like U.S. Treasury securities because they provide a guaranteed return on money with little risk of losing the invested amount. This is due to the fact that they are backed by the full faith and credit of the U.S. government.

WHY CAN'T THE GOVERNMENT JUST PRINT MORE MONEY AND PAY OFF THE DEBT?

The bottom line is that our government cannot just print more money to pay off the debt because global markets and economies around the world would be thrown into chaos. Most global transactions are pegged to the dollar. That is, foreign currencies are compared to each other relative to the value of a dollar. When goods and services are imported, exported, and otherwise traded across national borders, their relative value is tied to the dollar. Printing another few trillion dollars would destroy the value of the dollar. If the dollar became worthless or lost significant value as a result of newly printed dollars being used to pay off the national debt, the relative values of products and services would become unknown and would need to be re-established. At a minimum, the confusion would have two major immediate negative impacts. First, inflation would explode. As the value of the dollar plunged, firms would simply charge more for their products and services. This would be especially true of imported products. American consumers would be forced to pay rapidly rising prices, but it is unlikely that salaries would rise at the same rate. In recent months, the dollar's value has fallen dramatically, and as a result, we are seeing higher prices for health care, education, clothing, food, gas, etc. Flooding the market with trillions of new dollars would make the current inflationary effects look tame.

The second major effect would be that there would be outrage on the part of foreign banks and governments because they would have to scramble to bring stability to global transactions. There would be no confidence in the value of a dollar and foreign transactions would be pegged to a different currency, such as the Euro or the Japanese yen – which would further boost the value of those currencies relative to the dollar. The resulting loss of confidence in American financial markets would be devastating. Investors would immediately seek shelter in non-American currencies and investments, and those investors who would be willing to invest in American banks would expect very high returns. In other words, we would see much higher interest rates. Obviously, the increased rates would have significant and negative effects on businesses, as they would face higher costs to borrow money for expansion efforts. For individuals, the results would be equally negative as they would face higher credit card rates, car loan rates, and home mortgage rates.

HISTORICAL GROWTH OF THE NATIONAL DEBT

Debt accumulation as a broadly accepted government policy really took hold after President Carter. The national debt grew to over \$1 trillion in the early 1980s and has been growing fairly steadily since then. Figure 6-1 shows the growth of the national debt over the last 30 years. There was a period in which debt accumulation slowed considerably in the late 1990s, but since 2001, the growth in the national debt has occurred at a torrid pace.

Figure 6-2 shows the annual figures for national debt as a percentage of GDP from 1976 to 2007. There was a steady increase throughout the 1980s into the mid-1990s. This was followed by a dip and the U.S. is again in a period of rising debt as a percentage of GDP.

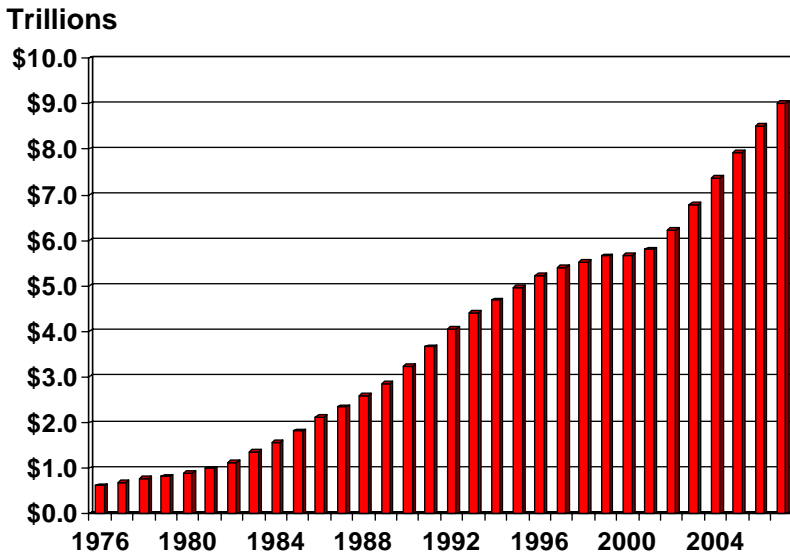


Figure 6-1. Growth of the National Debt (1976-2007)⁶

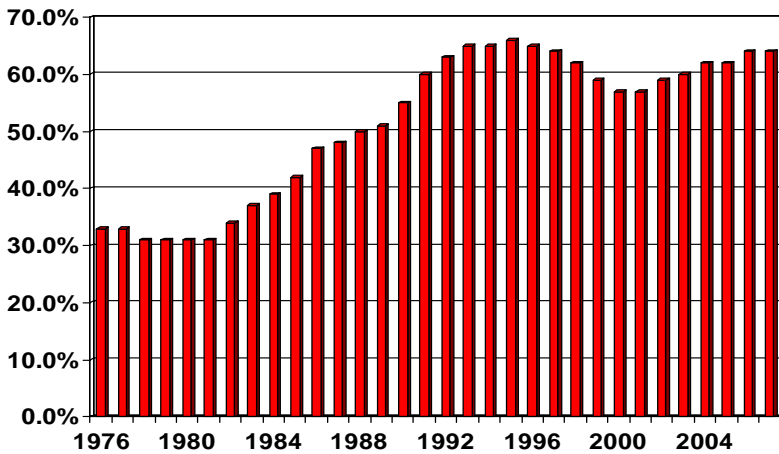


Figure 6-2. National Debt as a Percentage of GDP

⁶ National debt figures can be found at the U.S. Treasury Department website (“www.treas.gov”). The national debt figures discussed in this book and illustrated in the figures can be found at “http://www.treasurydirect.gov/govt/reports/pd/histdebt/histdebt.htm”.

Figure 6-3 segments the debt accumulated during the last five presidential administrations. In terms of total dollars, it is clear that the national debt has increased by the greatest amount under President George W. Bush. During the first seven years of his presidency, the national debt increased by over \$3.3 trillion. This is more than the national debt accumulated during the Clinton (\$1.6 trillion) and first Bush presidencies (\$1.5 trillion) combined.

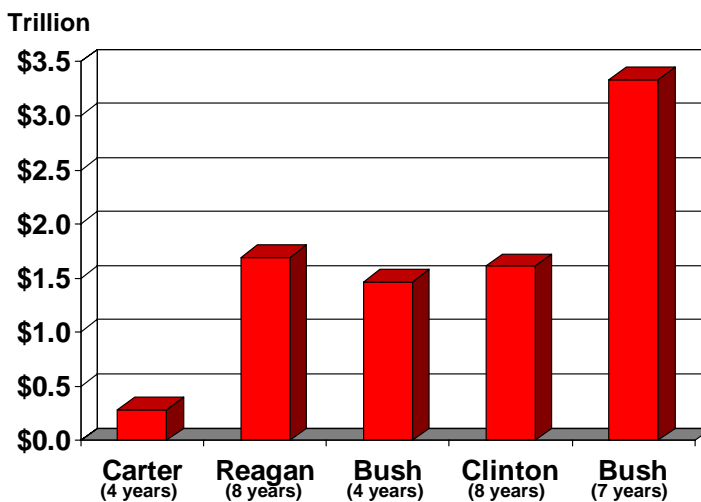


Figure 6-3. National Debt Accumulation by President

Debt in terms of total dollars is not necessarily the best way to compare debt accumulation during the last five presidential administrations. This is due to the fact that a dollar in the 1970s is not the same as a dollar in the 2000s. The country has a far larger economy today than ever before, and as such, more debt can be managed, financed, and absorbed by the economy. For example, a \$1 million loan to Bill Gates or Tiger Woods is very different than the same loan to an average American. The reason is obvious – both men have more assets to collateralize the loan, and more capital and income from which to pay back the loan. The same is true for the government. As the U.S. economy grows, there is greater capacity to finance debt, so it is not necessarily surprising that debt increased by the largest dollar figure under the current president because the economy is larger than ever. Thus, in order to better compare debt accumulation during the last five presidencies, we need to look at the percentage increases of debt and the debt as a percentage of GDP.

Figure 6-4 summarizes the percentage growth rate of the national debt during the last five presidencies. At one end of the spectrum, we can see that during the Reagan years, the national debt exploded by 187 percent. At the other end, it grew by 40 percent under President Clinton. In fact, because GDP grew much faster than the national debt during President Clinton's term, the Clinton presidency was the only in the last 30 years in which Americans saw the debt as a percentage of GDP drop significantly.

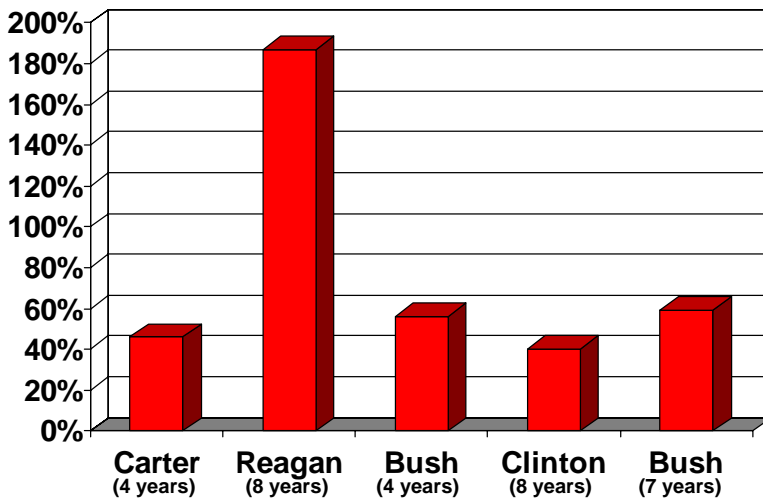


Figure 6-4. Percentage Growth of National Debt by President

Dividing the national debt by the GDP yields a good indicator of how manageable the national debt is. Figure 6-5 shows that at the end of the Carter presidency, the national debt stood at about 30 percent of GDP. By the end of the Reagan presidency, the national debt had grown to half of GDP. It grew further under the first President Bush, shrunk under President Clinton, and has again risen under President George W. Bush.

Economists can quibble about what a “reasonable” or even “desirable” debt load may be, and when an economy is carrying too much debt. However, most would agree that reducing overall debt, or at least reducing it as a percentage of GDP are desirable goals. That is why it is useful to pay attention to trends over time. Toward this end, Figure 6-6 illustrates the changes in the debt as a percentage of GDP over the terms of each of last five presidents.

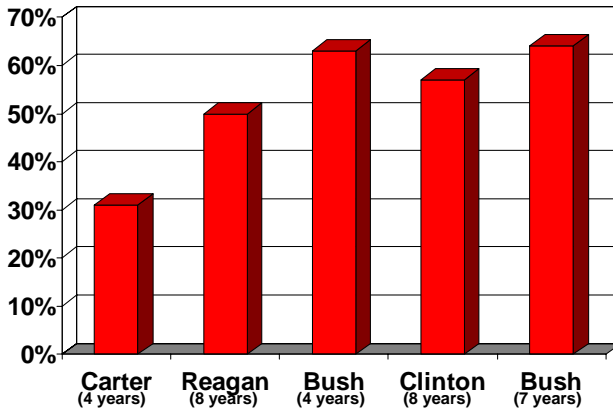


Figure 6-5. National Debt as a Percentage of GDP by President

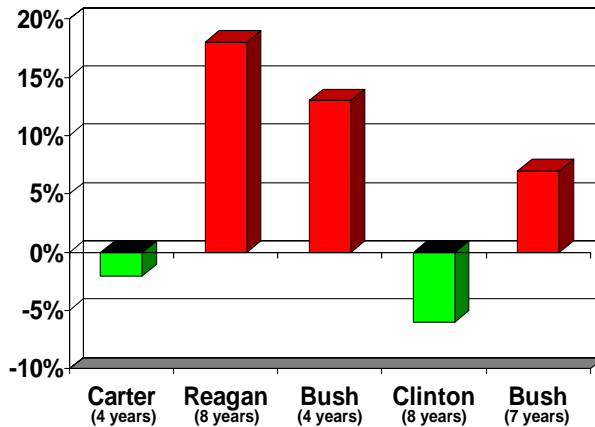


Figure 6-6. Change of National Debt as a Percentage of GDP by President

Presidents Carter and Clinton left office with debt as a percentage of GDP having been reduced from the time they took office. For Presidents Reagan, George H.W. Bush, and George W. Bush, the national debt grew faster than GDP which is why they left office (or will likely leave office, in the case of the current President Bush) with debt as a percentage of GDP having gone up.

To close out the chapter, Table 6-1 summarizes the national debt and GDP numbers at the end of each president's term. What jumps out is the growth in the national debt as a percentage of GDP over the last 30 years. More specifically, the

12 years of the Reagan and Bush presidencies saw the figure double. Consistent with Figures 6-2, 6-5 and 6-6, debt as a percentage of GDP eased back at the end of the Clinton presidency, but it has risen dramatically under the current President Bush.

Table 6-1. National Debt and GDP in Final Year of each Presidency⁷

President	National Debt	GDP	Debt/GDP
Ford	\$620 billion	\$1.89 trillion	32.8%
Carter	\$908 billion	\$2.92 trillion	31.1%
Reagan	\$2.60 trillion	\$5.25 trillion	49.5%
Bush	\$4.06 trillion	\$6.48 trillion	62.7%
Clinton	\$5.67 trillion	\$9.95 trillion	57.0%
Bush	\$9.01 trillion	\$14.07 trillion	64.0%

The actual GDP growth and debt accumulation figures in total dollars are shown in Table 6-2. What should be obvious is that better fiscal performance is indicated by debt growing at a slower pace than GDP growth. As shown in Figure 6-6 and the financial figures in Table 6-2, this was accomplished only during the Carter and Clinton Administrations.

Table 6-2. National Debt and GDP Growth by President⁸

President	National Debt Growth	GDP Growth	% Increase in GDP over Term	% Increase in Nat. Debt over Term
Carter (4 years)	\$0.287 trillion	\$1.032 trillion	55%	46%
Reagan (8 years)	\$1.695 trillion	\$2.337 trillion	80%	187%
Bush (4 years)	\$1.462 trillion	\$1.230 trillion	23%	56%
Clinton (8 years)	\$1.610 trillion	\$3.470 trillion	54%	40%
Bush (7 years)	\$3.664 trillion	\$4.120 trillion	41%	65%

⁷ For the current President Bush, the figures are for the seventh year of his term in office.

⁸ The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Chapter 7

U.S. NATIONAL DEBT HELD BY FOREIGNERS

This chapter builds on the discussion and figures in the previous chapter. In addition to the explosion in debt over the last 30 years, there is an even more alarming trend – the willingness on the part of the federal government to borrow enormous sums of money from foreign investors. The national debt is a growing problem, but the rapid rise in debt owed to foreigners threatens the very sovereignty of the United States.

As discussed in the previous chapter, much of the money the U.S. government raises to finance the national debt and pay for the deficit spending is raised through the sale of U.S. Treasury securities (i.e., government bonds and government notes). However, the massive accumulation of national debt and the record deficits we have seen in recent years requires the government to borrow heavily from foreign governments and foreign central banks through the sale of Treasury securities to the public. Quite simply, there are not enough investors or U.S. banks who are willing and/or able to fund our nation's debt and deficits.

As of August 2008, foreigners held over \$2.7 trillion in U.S. government debt (i.e. U.S. Treasury securities).¹ Consider what this really means – Americans owe \$2.7 trillion to foreign governments, foreign sovereign wealth funds (i.e., mutual funds and investment funds owned by foreign governments), and foreign central banks. While still not necessarily in our nation's best interest, it might not be so bad if all of our debt was held by our friends and allies in the world – but this is simply not the case. We owe China \$541 billion and Russia \$74.4 billion. We are not allies with these countries, and often oppose each other on various geopolitical matters. We owe nearly \$180 billion to OPEC nations which include openly-hostile nations to the U.S. Mexico and Caribbean banking centers hold

¹ The U.S. Treasury Department provides a summary of the *Major Foreign Holders of U.S. Debt* that is updated monthly. Available online at "<http://www.treas.gov/tic/mfh.txt>".

over \$180 billion in U.S. debt. While the latter group is more friendly toward us, the debt they now hold makes it more difficult for the U.S. to demand assistance with problems such as illegal immigration or drug trafficking should they choose not to cooperate.

Figure 7-1 illustrates the growth in the U.S. debt held by foreigners from 1976 to 2007. As can be seen in the figure, there have been two periods of dramatic growth – the mid-1990s and from 2001 to the present.

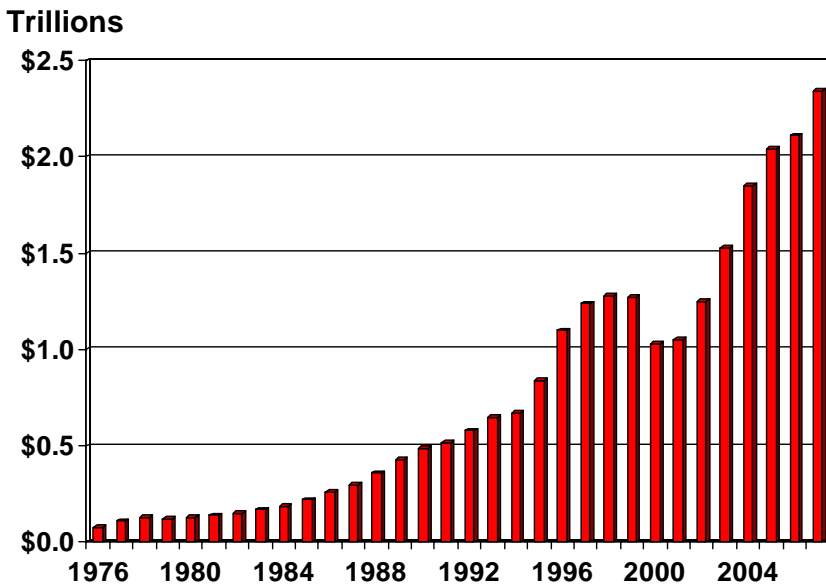


Figure 7-1. Debt Held by Foreigners (1976-2007)²

The overall size of the debt held by foreigners is enormous, but the rapid increase – especially since 2000 – is truly breathtaking. At the end of 2000, China, Hong Kong, and Taiwan combined held less than \$135 billion in U.S. Treasury Securities and OPEC (which includes Iran) held less than \$50 billion. Today, China, Hong Kong, and Taiwan combined now hold over \$600 billion and OPEC now holds over \$150 billion of our debt. Russia held no U.S. debt just two years ago. But, the Russian government has steadily been buying up U.S. Treasury securities and it now holds \$60 billion of the U.S. national debt. These shifts in

² Based on U.S. Treasury Department figures available on the St. Louis Federal Reserve Bank website at “<http://research.stlouisfed.org/fred2/data/FDHBFIN.txt>”.

the balance of economic power are happening so rapidly that most Americans probably are completely unaware that such shifts are taking place.

The debt accumulation figures are just as bad – if not worse – when they are considered with respect to U.S. GDP (see Figure 7-2). At the end of the 1970s, foreign-held debt was about four percent of GDP. By the end of the 1980s, it had more than doubled to nearly nine percent of GDP. Following President Clinton's term in 2000, it had again ticked up to about 10 percent of GDP. However, at the end of 2007, the figure had jumped to over 16 percent of GDP and there is no real end in sight because the economy has weakened in recent years. With tax revenues shrinking but spending continuing to rise, the dependence on foreign cash to cover the growing budget deficits is increasing.

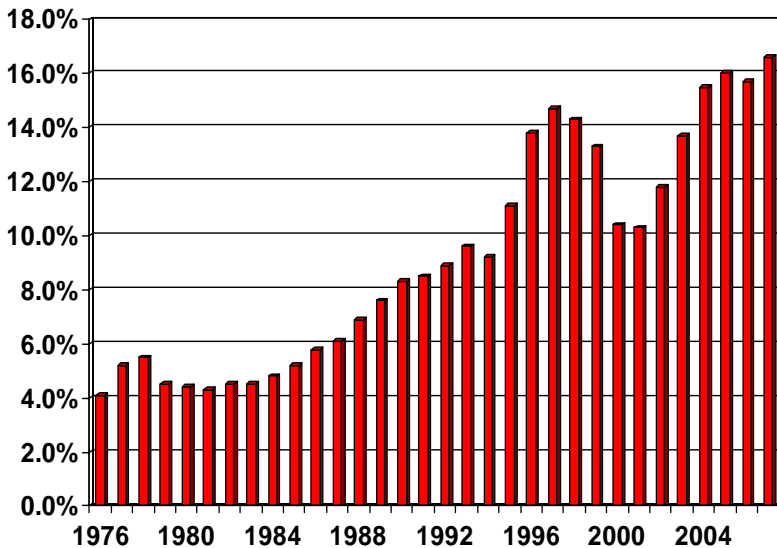


Figure 7-2. Debt Held by Foreigners as a Percentage of GDP (1976-2007)

The greatest increase in the debt held by foreigners has come under the current President Bush (see Figure 7-3). In 2000, when he took office foreigners held about \$1 trillion in U.S. government debt. Seven and a half years later, the foreign-held debt has ballooned to \$2.6 trillion. In fact, the accumulation of foreign-held debt under the President George W. Bush has dwarfed the total accumulation of such debt under all previous presidents combined.

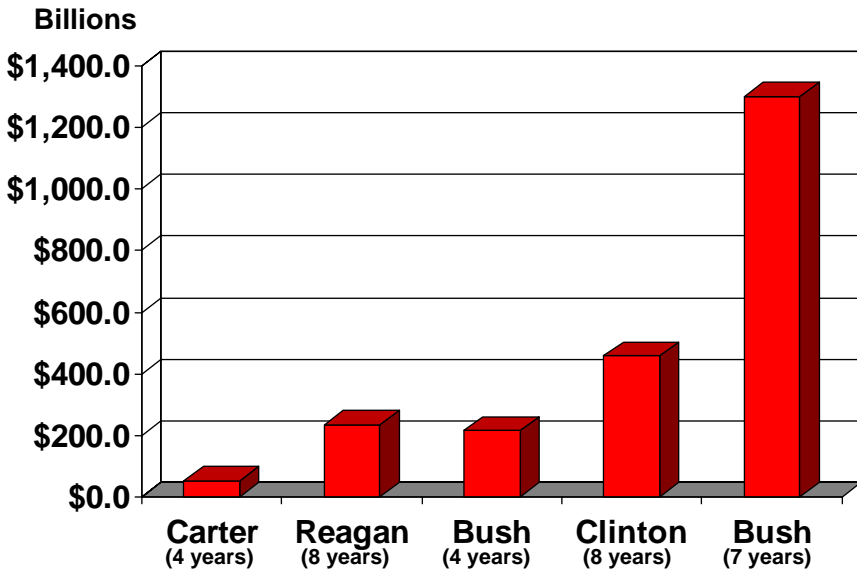


Figure 7-3. Dollar Increase in the Debt Held by Foreigners by President

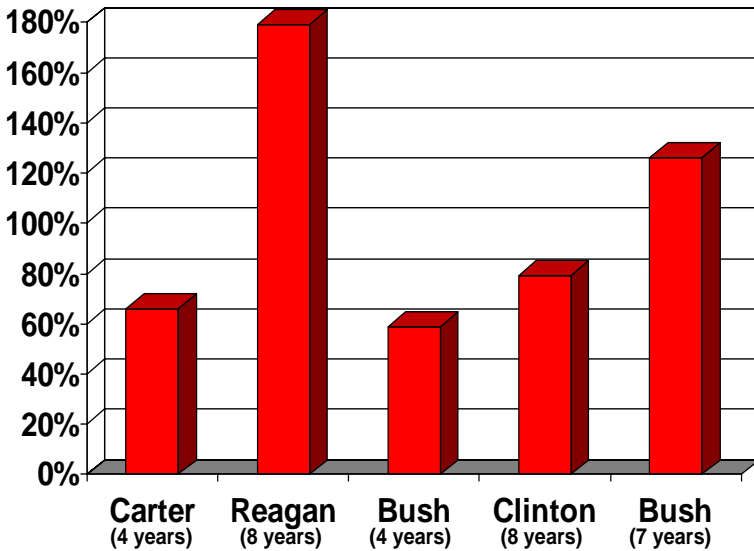


Figure 7-4. Percentage Growth in the Debt Held by Foreigners by President

The percentage growth of debt held by foreigners under each President is slightly more favorable for the current President Bush (see Figure 7-4). It shows that this debt accumulation increased by a far greater percentage during the Reagan presidency. However, it should be noted that the data only includes the first seven years of President George W. Bush's term. If one includes the accumulation of this debt in 2008, the percentage rises significantly for President Bush. In fact, it has increased by more than 30 percent through May 2008. At the current pace of accumulation, by the time President Bush leaves office, he may very well overtake President Reagan's dubious position as having had the greatest percentage growth in foreign-held debt among the last five U.S. Presidents.

Finally, Table 7-1 summarizes the total debt held by foreigners and GDP at the end of each president's term. Comparing the figures for the last five presidencies, it is apparent that foreign debt as a percentage of GDP has risen steadily over the last 30 years. However, by far, the percentage increased by the greatest amount under President George W. Bush.

Table 7-1. Foreign-Held Debt and GDP in the Final Year of Each Presidency³

President	Foreign-Held Debt	GDP	Foreign-Held Debt/GDP
Ford	\$78 billion	\$1.89 trillion	4.1%
Carter	\$130 billion	\$2.92 trillion	4.5%
Reagan	\$362 billion	\$5.25 trillion	6.9%
Bush	\$577 billion	\$6.48 trillion	8.9%
Clinton	\$1.0 trillion	\$9.95 trillion	10.1%
Bush	\$2.3 trillion	\$14.07 trillion	16.3%

In an effort to better analyze the fiscal performance of the government, with respect to accumulation of foreign-held debt during each president's term in office, the growth percentages for GDP and the debt held by foreigners are shown in Table 7-2. Common sense would suggest that better fiscal performance is realized when foreign-held debt does not grow as fast as GDP. However, as shown in Table 7-2, this has not happened during the terms of any of the last five Presidents.

³ For the current President Bush, the figures are for the seventh year of his term in office.

Table 7-2. Foreign-Held Debt and GDP Growth by President⁴

President	Foreign-Held Debt Growth	GDP Growth	% Increase in GDP over Term	% Inc. in Foreign-Held Debt over Term
Carter (4 years)	\$52 billion	\$1.032 trillion	55%	66%
Reagan (8 years)	\$233 billion	\$2.337 trillion	80%	179%
Bush (4 years)	\$215 billion	\$1.230 trillion	23%	59%
Clinton (8 years)	\$458 billion	\$3.470 trillion	54%	79%
Bush (7 years)	\$1.3 trillion	\$4.120 trillion	41%	126%

⁴ The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Chapter 8

U.S. CURRENT ACCOUNT

Every year, the U.S. exports finished goods and services and imports finished goods and services. When the nation imports more than it exports there is a trade deficit. When exports exceed imports, the U.S. enjoys a trade surplus. As a general rule, it is better to export more than the country imports. When this happens, the country is drawing in more capital and accumulating wealth from outside countries. If, on the other hand, the country imports more than it exports, there is a net flow of U.S. wealth out of the nation and to other countries that the U.S. has a trade deficit with.

The federal government tracks what is known as the *current account* for the nation.¹ The current account is essentially a measure of the net flow of dollars in and out of the country. It is primarily made up of our trade balance (trade exports minus trade imports), but also includes such things as interest earned on foreign investments less interest paid out on U.S. debt held by foreigners as well as foreign aid (also subtracted from the current account). Just as with the trade of goods and services described above, when the current account is positive, the country enjoys a current account surplus. When it is negative, the U.S. has a current account deficit. At a minimum, the U.S. should remain neutral with respect to the current account. However, a measure of a nation's economic power and financial strength is a positive current account (i.e., a surplus). Essentially, this means that products and services from within national borders are desired by customers around the world, and it also means that little debt is owed to foreign entities.

¹ Current account figures can be found at the U.S. Bureau of Economic Analysis website ("www.bea.gov"). The current account figures discussed in this book and illustrated in the figures can be found at "http://www.bea.gov/international/bp_web/simple.cfm?anon=71&table_id=1&area_id=3".

Unfortunately, there has been a remarkable downward shift in our nation's net current account position over the last three decades. Figure 8-1 shows the U.S. current account from 1976 to 2007. What is clear from this figure is that there has been a rapid deterioration in the current account, and the nation now has a net outflow of dollars and U.S. wealth to the tune of about \$750 billion per year. Over the long-term, this is unsustainable. It poses a serious threat to our economic strength both domestically and around the world.

As a percentage of GDP, the current account deficit has steadily increased to over five percent of GDP (see Figure 8-2). Unfortunately, with the nation's rapid increase in debt held by the public and the debt owed to foreigners (discussed in the last two chapters) it is likely that U.S. government interest payments on that national debt will continue to rise. In addition, over the first half of 2008, oil prices increased by about 50 percent. Given our significant oil imports, this will further tilt the trade imbalance in favor of foreign oil producers. The rising national debt and high oil prices are not likely to change over the next few years. If there are no significant improvements for the U.S. on these two factors, the U.S. current account balance will not improve and will likely continue to erode.

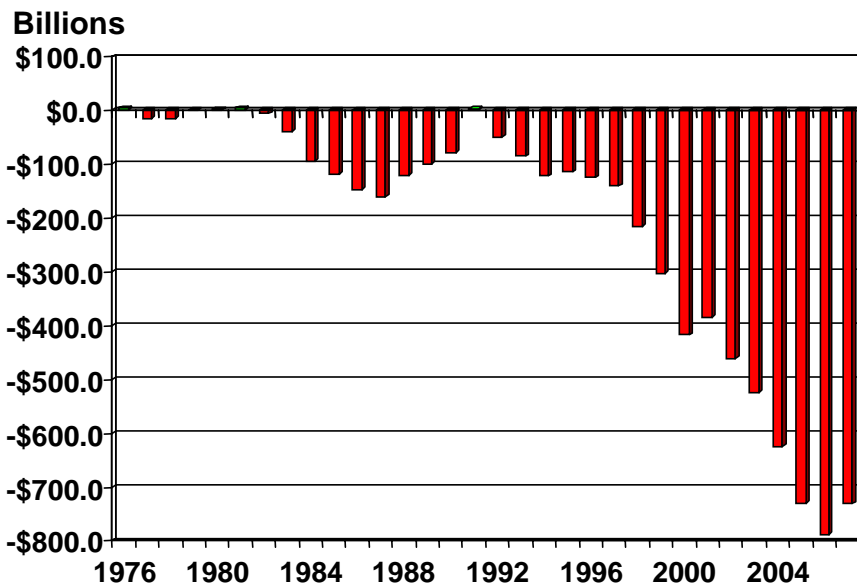


Figure 8-1. U.S. Current Account (1976-2007)

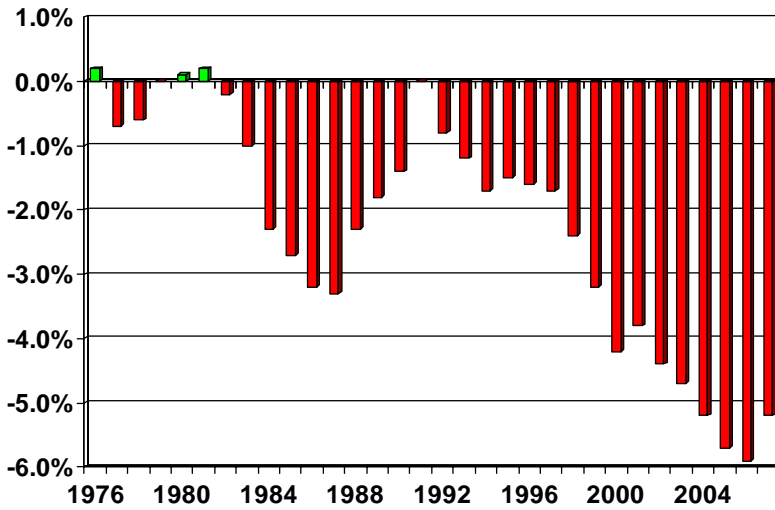


Figure 8-2. U.S. Current Account as a Percentage of GDP (1976-2007)

Up until the early 1980s, the U.S. had no significant imbalance with foreign countries. The nation largely enjoyed a neutral and often small current account surplus from year to year. However, this all changed under President Reagan. It worsened by the end of President Clinton's term, and it has continued to worsen under President George W. Bush (see Figure 8-3).

Figure 8-4 illustrates the percentage changes in the current account over the course of the last five presidencies. While the last two presidents saw the largest declines in the current account in terms of absolute dollars, there is no question that the largest percentage shift in the current account occurred during the Reagan Administration. During those eight years, the U.S. current account deficit grew by more than 5000 percent. This figure dwarfs the declines during the other four presidencies.

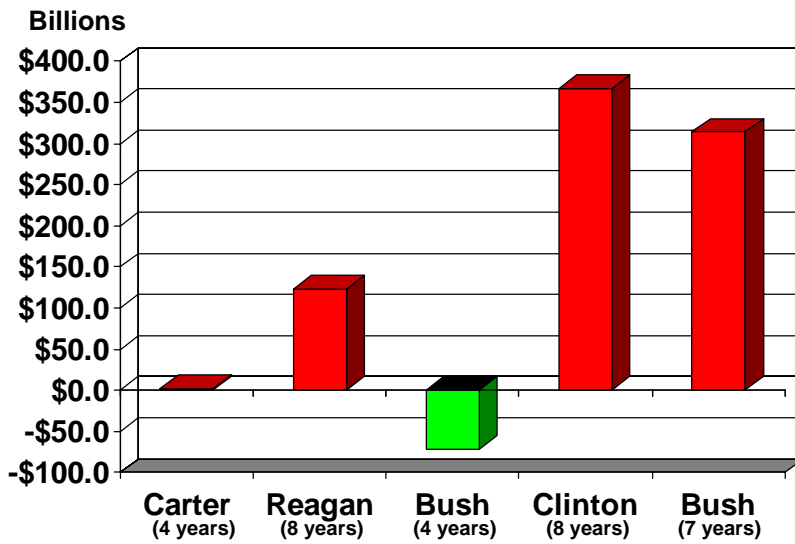


Figure 8-3. U.S. Current Account Changes by President²

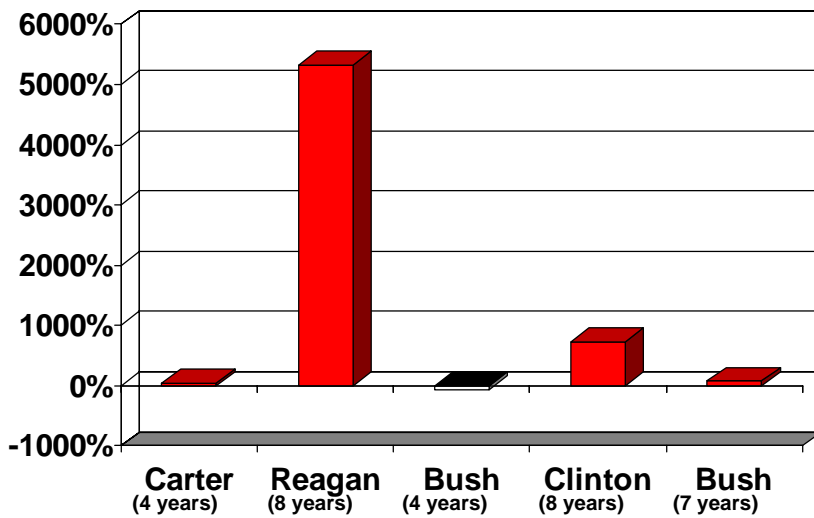


Figure 8-4. Percentage Change in U.S. Current Account Deficit by President

² The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Changes in the current account relative to changes in the GDP are provided in the final two tables of this chapter. Table 8-1 summarizes the current account and GDP at the end of each president's term. Comparing the figures for the last five presidencies, and as shown in the earlier figures, one can see that there has been significant erosion in the U.S. current account. The erosion has occurred at a far faster pace than growth in GDP over the same period in time. The largest negative shift, in terms of dollars, occurred over the eight-year term of the Clinton presidency. During those years, the current account as a percentage of GDP fell from a deficit that was less than one percent of GDP to a deficit that was over four percent of GDP.

**Table 8-1. U.S. Current Account and GDP
in the Final Year of Each Presidency³**

President	Current Account	GDP	CA/GDP
Ford	\$4.3 billion	\$1.89 trillion	0.2%
Carter	\$2.3 billion	\$2.92 trillion	0.1%
Reagan	(\$121.2 billion)	\$5.25 trillion	(2.3%)
Bush	(\$50.1 billion)	\$6.48 trillion	(0.8%)
Clinton	(\$417.4 billion)	\$9.95 trillion	(4.2%)
Bush	(\$731.2 billion)	\$14.07 trillion	(5.2%)

Among the last five presidents, the current account improved only under the first President Bush (see Table 8-2). Under President Carter, the current account worsened by 46 percent. However, the U.S. still maintained a surplus and GDP improved by a faster rate than the decline (55 percent). This would suggest that during the Carter presidency the net change in the current account was manageable. For the other three presidents the worsening current accounts grew by a greater percentage than the percentage gains in the GDP, which can only be interpreted as negative performance with respect to current account.

³ For the current President Bush, the figures are for the seventh year of his term in office.

Table 8-2. U.S. Current Account Changes and GDP Growth by President⁴

President	CA Change	GDP Growth	% Increase in GDP over Term	% Change in CA over Term
Carter (4 years)	(\$1.2 billion)	\$1.032 trillion	55%	(46%)
Reagan (8 years)	(\$123.5 billion)	\$2.337 trillion	80%	(5329%)
Bush (4 years)	\$71.5 billion	\$1.230 trillion	23%	59%
Clinton (8 years)	(\$367.3 billion)	\$3.470 trillion	54%	(734%)
Bush (7 years)	(\$313.8 billion)	\$4.120 trillion	41%	(75%)

⁴ The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Chapter 9

U.S. UNEMPLOYMENT RATE

High unemployment is obviously a negative economic sign for a nation. However, at the other end of the spectrum, a country that has no unemployment is at risk of inflationary pressure that can also be a real negative for the country. If the labor market is overly tight, employers are forced to respond with rising wages and other incentives (e.g., extended vacations, signing bonuses, superior health benefits) in order to attract the best employees. This can trigger rising prices on goods and services as firms pass on the increased labor costs to clients and customers. In addition, tight labor markets force employers to look for labor outside of the domestic market. Zero unemployment would result in jobs shifting to other labor markets around the world.

Figure 9-1 shows the U.S. unemployment rate at the end of each year from 1976 to 2007. Clearly, there is a cyclical nature to the unemployment pattern as the rate fluctuates over time.

Figure 9-2 shows the change in the unemployment rate from the beginning to the end of each of the last five presidencies. Unemployment fell over the full terms of the Carter, Reagan, and Clinton Administrations. The rate increased under the first President Bush and is rising under the current President Bush. However, by looking at the yearly figures (see Figure 9-1), we can see a more complete story emerge. For example, in the final year of President Carter's term, unemployment rose from under six percent in 1979 to over seven percent in 1980. This likely caused great angst among the voters who soured on President Carter.

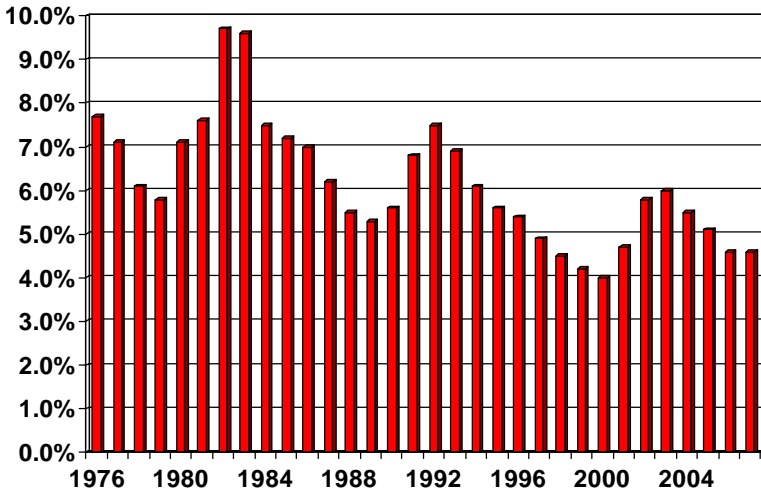


Figure 9-1. U.S. Unemployment Rate (1976-2007)¹

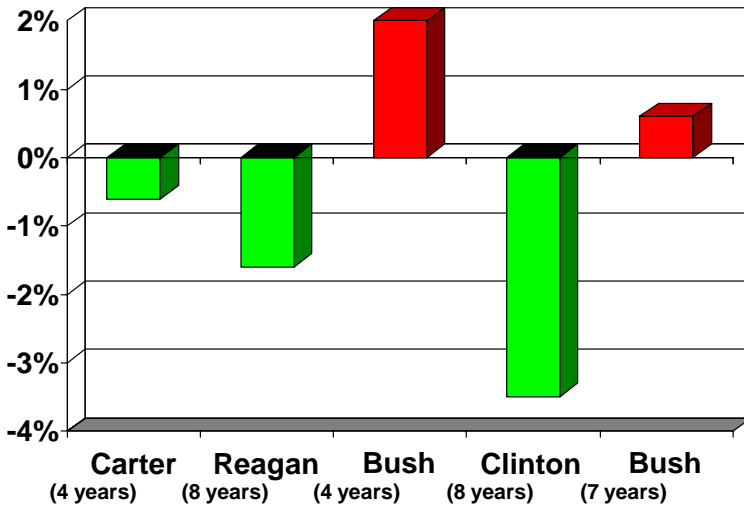


Figure 9-2. U.S. Unemployment Rate Changes by President

¹ Unemployment figures can be found at the U.S. Bureau of Labor Statistics website (“www.bls.gov”). The unemployment figures discussed in this book and illustrated in the figures can be found at “ftp://ftp.bls.gov/pub/special.requests/lf/aat1.txt”.

The rising unemployment rates in 1980 and 1992 likely contributed to the re-election campaign losses suffered by President Carter and President George H.W. Bush. Following a peak unemployment rate in the early 1980s, there was a steady decrease in unemployment. This was also true throughout the Clinton presidency. Just as Presidents Carter and the first President Bush were probably stung by rising unemployment, the falling unemployment rates under Presidents Reagan and Clinton likely helped them remain popular with the American people. Not only do economic policies have impacts on the nation, but they can directly affect a President's approval ratings. The importance of timing should not be overlooked. Had unemployment not shot up in the final years of the Carter and first Bush Administrations, they likely would have been re-elected. On the other hand, their economic policies contributed to the rising unemployment rates, so one should not simply attribute rising or falling unemployment to bad or good luck.

Table 9-1 shows the unemployment rates and GDP at the end of each president's term. Again, while GDP increased during the presidential terms' of each man, there were big differences in the unemployment rates. The far right column shows that during the full terms of the Carter, Reagan, and Clinton Administrations, the unemployment rate dropped by eight percent, 23 percent, and 47 percent, respectively. Both Presidents Bush saw significant increases in unemployment during their terms.

Table 9-1. U.S. Unemployment Rate Changes and GDP Growth by President²

President	Unemployment Rate at End of Term	GDP Growth	% Increase in GDP over Term	% Change in Unemployment Rate over Term
Carter (4 years)	7.1%	\$1.032 trillion	55%	(8%)
Reagan (8 years)	5.5%	\$2.337 trillion	80%	(23%)
Bush (4 years)	7.5%	\$1.230 trillion	23%	36%
Clinton (8 years)	4.0%	\$3.470 trillion	54%	(47%)
Bush (7 years)	4.6%	\$4.120 trillion	41%	15%

² The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Chapter 10

U.S. INFLATION RATE

Inflation is a relatively easy concept to understand, but many people do not understand what it is, or the implications of high versus low inflation. Inflation is related to the constant rise in prices and costs for goods and services in an economy. A gallon of milk today costs more than it did 20 years ago, and will likely cost even more in 20 years. The reason is because inflation makes the value of the dollar go down over time. There are more dollars in circulation and costs tend to rise over time.

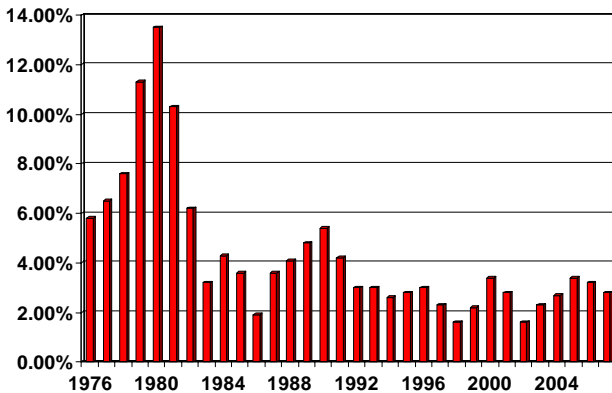


Figure 10-1. U.S. Inflation Rate (1976-2007)¹

¹ U.S. inflation figures can be found at the U.S. Bureau of Labor Statistics website (“www.bls.gov”). The inflation figures discussed in this book and illustrated in the figures can be found at “ftp://ftp.bls.gov/pub/special.requests/cpi/cpiiai.txt”.

The U.S. inflation rate is measured by the Consumer Price Index (CPI), and many of the U.S. government's economic and monetary policies are geared toward maintaining an annual CPI increase of about two to three percent. When the CPI grows by more than three percent, the Federal Reserve Board (Fed) takes action to adjust monetary policies. For example, the Fed may raise interest rates to encourage savings and cut down spending in an effort to cut dollar liquidity in the market. This puts fewer dollars in circulation which tends to increase the value of the dollar (fewer dollars are available to purchase goods and services).

Figure 10-1 shows the annual CPI figures from 1976 to 2007. The numbers represent the percentage change in the CPI from the previous year. While there is some fluctuation from year to year, inflation has been relatively tame since the early 1990s. That is, the annual CPI figures have not gone above four percent since then. Looking further back, inflation has been largely under control since the early 1980s. Prior to then, the country experienced the pain of double digit inflation for several years.

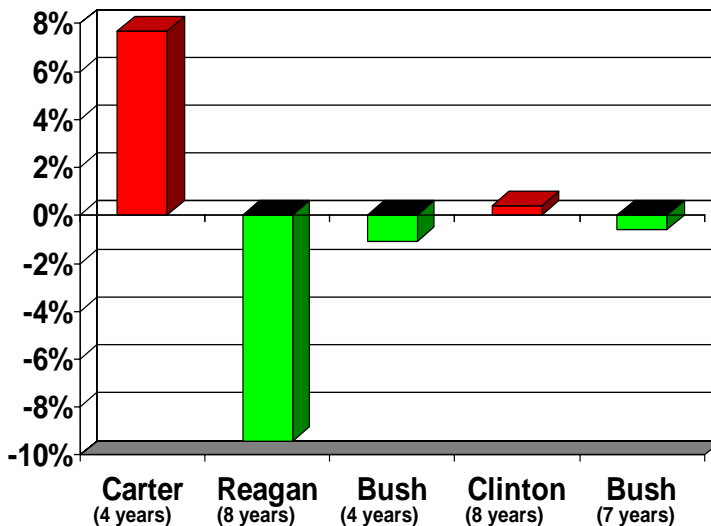


Figure 10-2. U.S. Inflation Rate Changes by President²

² The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Figure 10-2 shows the percentage changes in the inflation rate during the full terms of the last five presidents. For both Presidents Bush and President Clinton, inflation has not really changed. There was a big jump in inflation under President Carter, followed by an even larger drop in the inflation rate under President Reagan. This likely played a major part in the failure of President Carter to win re-election to a second term, as well as contributing to the fond memories many have about President Reagan and his term in office.

Table 10-1 provides a summary of the inflation and GDP growth rates at the end of each president's term. Ideally, one would want to see little to no inflation growth (or even a reduction in the inflation rate), combined with significant GDP growth. This has been the case for four of the last five Presidents. Only President Carter held office during a significant rise in inflation. Making matters worse for him, there was a large increase in inflation between his third year and his fourth year in office, which all but doomed his reelection bid.

Table 10-1. U.S. Inflation Rate Changes and GDP Growth by President³

President	Inflation Rate at End of Term	GDP Growth	% Increase in GDP over Term	% Change in Inflation Rate over Term
Carter (4 years)	13.5%	\$1.032 trillion	55%	133%
Reagan (8 years)	4.1%	\$2.337 trillion	80%	(70%)
Bush (4 years)	3.0%	\$1.230 trillion	23%	(27%)
Clinton (8 years)	3.4%	\$3.470 trillion	54%	13%
Bush (7 years)	2.8%	\$4.120 trillion	41%	(18%)

³ The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Chapter 11

U.S. MISERY INDEX

An unofficial measure of the health of the U.S. economy is what is known as the *misery index*. The index is simply the sum of the unemployment rate and the rate of inflation. Obviously, as it increases the misery of the average American goes up.

Using the data presented in the two previous chapters, the misery index can be calculated for the nation. Figure 11-1 illustrates the misery index over the last 30 years. We can see that following the 1980 peak of 20.7 percent there was a steady decline in the misery index for six years. After a modest increase, it again fell through most of the 1990s. For more than a decade, this misery index has remained fairly manageable and has hovered between six and nine percent.

The misery index grew rapidly during the Carter Administration, and declined significantly under Presidents Reagan and Clinton (see Figure 11-2). Again, the changes in the misery index are likely to have contributed to President Carter's failed re-election bid. It undoubtedly played a major part in why President Carter is not remembered as a strong president. At the other end of the spectrum, the falling misery indices over the courses of the Reagan and Clinton presidencies are likely to have greatly contributed to the fond memories and enduring popularity of both men.

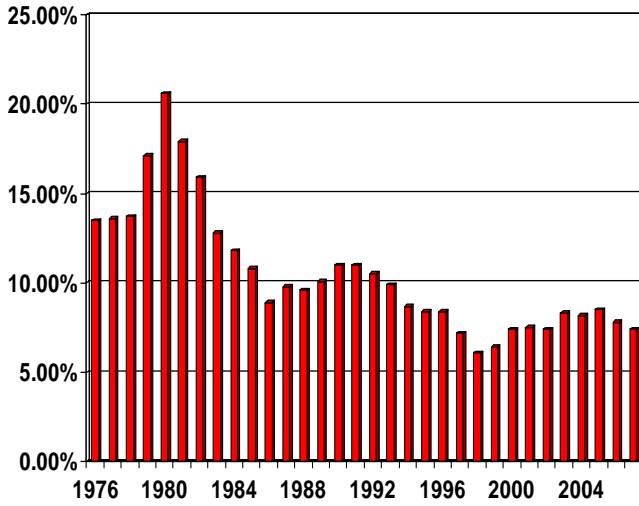


Figure 11-1. U.S. Misery Index (1976-2007)¹

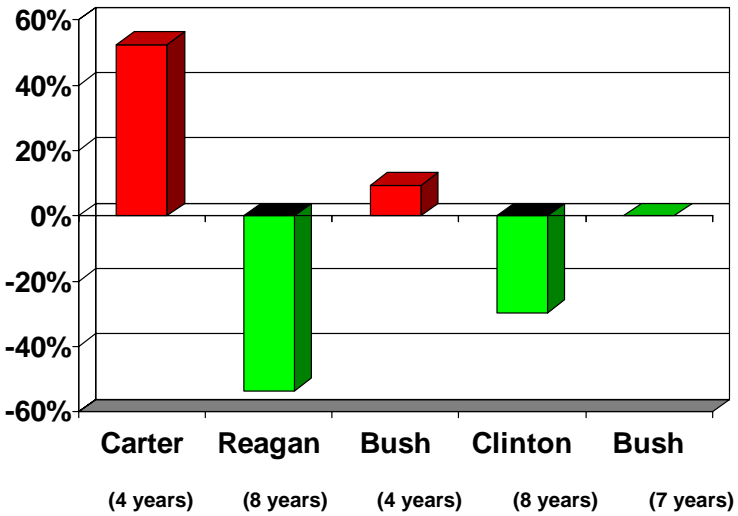


Figure 11-2. U.S. Misery Index Changes by President

¹ The figures and graphics in this chapter are based on adding the figures used in Chapters 9 and 10.

Table 11-1 provides a summary of the misery index changes and GDP growth rates at the end of each president's term. For President Carter, all of the gain in GDP was offset by an equally significant gain in the misery index. For President Reagan, and to a lesser degree President Clinton, the substantial growth in GDP was enhanced by the significant shrinking of the misery index. For both Presidents Bush, the misery index hovered with little to no change, and GDP growth was more moderate for both men.

Table 11-1. U.S. Misery Index Changes and GDP Growth by President²

President	Misery Index at End of Term	GDP Growth	% Increase in GDP over Term	% Change in Misery Index over Term
Carter (4 years)	20.6%	\$1.032 trillion	55%	53%
Reagan (8 years)	9.6%	\$2.337 trillion	80%	(53%)
Bush (4 years)	10.5%	\$1.230 trillion	23%	9%
Clinton (8 years)	7.4%	\$3.470 trillion	54%	(30%)
Bush (7 years)	7.4%	\$4.120 trillion	41%	0%

² The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Chapter 12

STRENGTH OF THE U.S. DOLLAR

In many countries around the world, it is relatively common for consumers to purchase goods and services in dollars. The dollar is the world's currency and the fact is that most financial transactions and major commodities trading around the world are done by using the dollar to set prices. When the dollar is strong, goods imported into the U.S. are cheaper because the dollar can purchase more in foreign markets than it can when the dollar is weak. When the dollar falls, imported goods become more expensive and U.S. exports tend to rise because U.S. products become cheaper to foreign customers.

Countries that have stronger currencies have a great advantage in the global marketplace. Firms and investors from such countries are able to buy up foreign assets in markets that have currencies that are devalued against their currency. Thus, when the U.S. dollar is strong, American corporations can span the globe and buy up foreign firms/assets, but when the dollar falls, it is the foreign firms that have the advantage. When the dollar falls, foreign firms buy up U.S. firms/assets at a cheaper price. For all of the above reasons, there is great interest, both in the U.S. and around the world, in the value of the dollar.

There are a number of ways to track the value of the U.S. dollar. One can find actual exchange rates and trade currencies on foreign exchange (forex) markets for individual currencies around the world. For example, on any given day, up-to-the-minute exchange rates are readily available and one can convert dollars into euros, Chinese yuan, British pounds, Japanese yen, Indian rupees, Russian rubles, or whatever currency one may be interested in. However, while the individual currency exchange rates may be important for tourists who plan to visit individual countries, country-by-country exchange rates do not give an overall sense of how the dollar is faring across the globe. Consider that the Indian economy may be

growing and the rupee may gain against the dollar, but at the same time it could be possible for the Japanese yen to fall against the dollar.

To address the issue of how to better value the dollar relative to the world economy, there are indices that consider the dollar's strength against a basket of foreign currencies. These indices use weighting schemes to give certain currencies – such as the euro or the Japanese yen – more weight than other nation's currencies. The basic idea of such an index is to provide those who are interested in the broader value of the dollar (i.e., currency traders, Wall Street analysts, policy makers) with an easy way to see the global value of the dollar. One example of such an index is the U.S. Dollar Index on the N.Y. Board of Trade (ticker symbol DX-Y.NYB). Currency traders and investors can see the value of the dollar and publicly trade futures on the dollar.

The purpose of this chapter is to focus on the macro-level changes in the value of the dollar over time. To do that, this chapter illustrates the changing value of the dollar based on the Federal Reserve Bank of Atlanta's trade-weighted dollar index.¹ It has been used to track the value of the U.S. dollar against foreign currencies for several decades. Figure 12-1 illustrates the changing value of the dollar index from 1976 to 2007. The figure clearly shows that the dollar has gone through cyclical changes with two peaks in value over the last 3 decades. Just to be clear, there is a very high correlation with the figures in the U.S. Dollar Index described in the previous paragraph and you would find exactly the same trend.

¹ For more information on the index, visit the Federal Reserve Bank of Atlanta website and read the 1999 Economic Review article on the subject at ["http://www.frbatlanta.org/filelegacydocs/acree.pdf"](http://www.frbatlanta.org/filelegacydocs/acree.pdf).

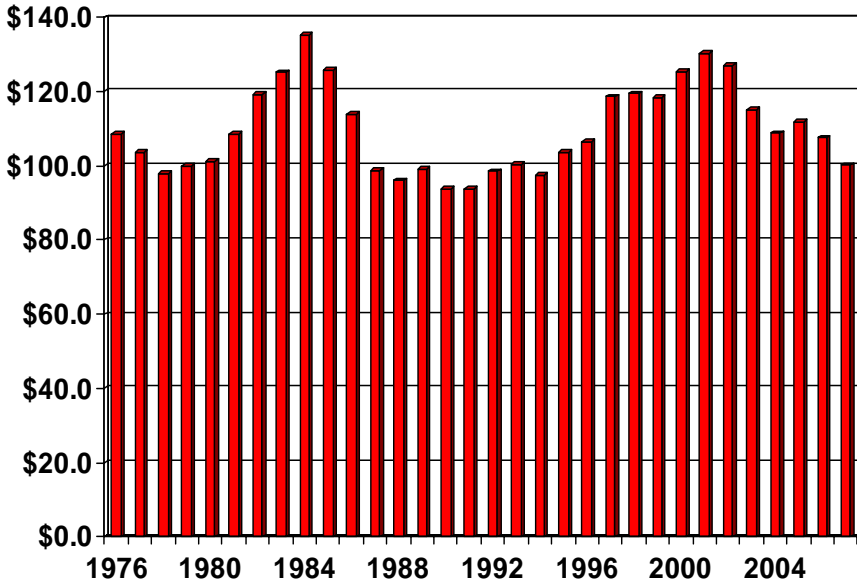


Figure 12-1. U.S. Dollar Index (1976-2007)²

In terms of absolute dollar value changes, Figure 12-2 shows that the dollar gained considerably over President Clinton's term in office and has since declined dramatically. Figure 12-3 illustrates the percentage changes over the course of each president's full term in office. Again, we can see that the Clinton Administration enjoyed the greatest percentage increase in the value of the dollar.

To compare the performance of the dollar across the presidential terms, Table 12-1 is offered. It shows GDP growth and the changing value of the Atlanta Fed's dollar index over the terms of each of the last five presidents. The best case scenario is when GDP growth is high and the dollar strength improves dramatically. This only occurred during the Clinton presidency.

² Data available at the Federal Reserve Bank of Atlanta website at "http://www.frbatlanta.org/DollarIndex/user/dsp_indexes.cfm".

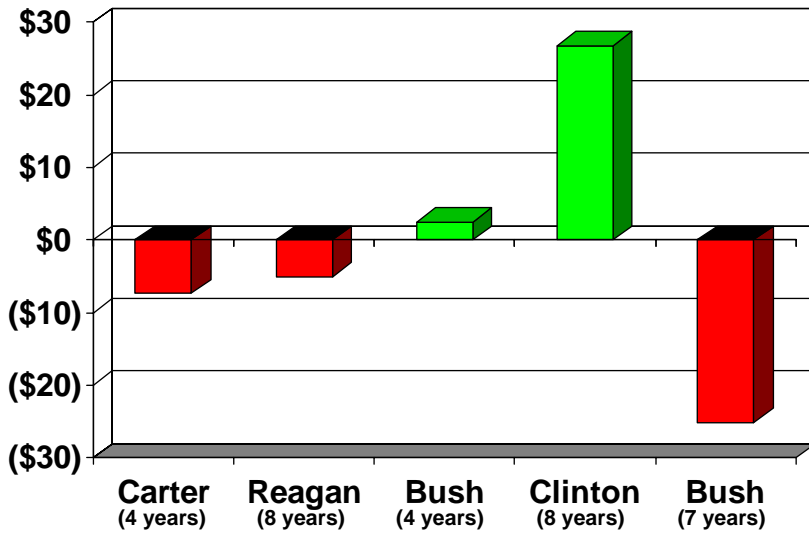


Figure 12-2. U.S. Dollar Index Changes by President

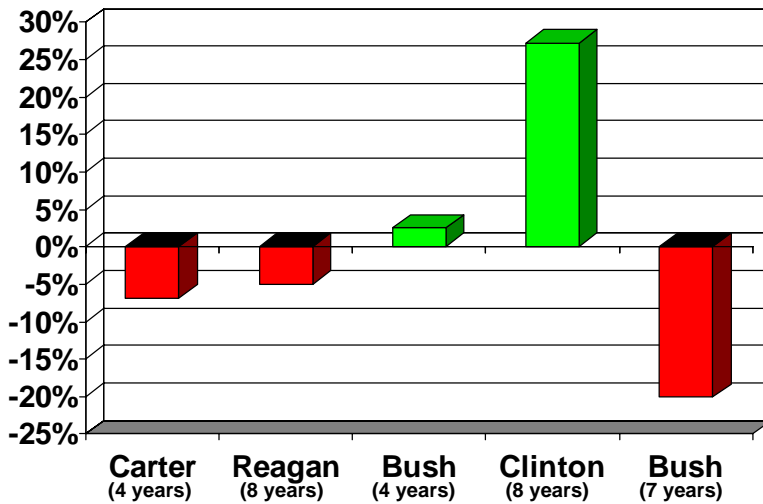


Figure 12-3. Percentage Change in U.S. Dollar Index by President

Table 12-1. U.S. Dollar Index Changes and GDP Growth by President³

President	Dollar Index Change	GDP Growth	% Increase in GDP over Term	% Change in Dollar Index over Term
Carter (4 years)	(\$7.36)	\$1.032 trillion	55%	(7%)
Reagan (8 years)	(\$5.04)	\$2.337 trillion	80%	(5%)
Bush (4 years)	\$2.43	\$1.230 trillion	23%	3%
Clinton (8 years)	\$26.84	\$3.470 trillion	54%	27%
Bush (7 years)	(\$25.15)	\$4.120 trillion	41%	(20%)

³ The figures represent the difference between the figures in the final year of each President's term and the final year of the prior President's term. For President George W. Bush, the term is through 2007.

Chapter 13

SOCIAL SECURITY

Social Security is one of the most popular and successful federal programs in the history of the nation. It provides a basic safety net for millions of Americans. Signed into law in 1935, monthly benefits checks were first issued in January 1940.¹ Since that time, Social Security has allowed older Americans to retire with a guaranteed monthly check. But retirees are not the only beneficiaries. Social Security has also helped disabled workers and children who have lost a parent by paying out benefits to help ease their financial burdens.

As described in Chapter 3, the program has its own dedicated funding stream through FICA taxes (employees currently pay 6.2 percent of their revenue up to \$102,000 and employers match the 6.2 percent). To be clear, the money that current workers are now paying into the system is not being held in a savings account until they need their benefits. Rather, this money is used to pay benefits to today's retirees and other program recipients. It is expected that future workers will provide the tax revenue to pay the Social Security benefits for today's workers when they are entitled to receive them. This system of financing Social Security benefits works fine as long as enough money comes into the system to pay out the benefits. But, as the median age of the U.S. population continues to rise, there will be fewer workers contributing to the Social Security program per retiree. For this reason, there is a very serious question about the long-term viability of the program. This is discussed further in this chapter.

From 1976 to 1982, Social Security operated at a deficit. That is, more was being issued out in benefits than was being brought in through FICA taxes. Faced with the impending collapse of Social Security, President Reagan and a Democratic Congress came together and raised the FICA payroll tax by two

¹ For more information about the history of Social Security, visit the Social Security Administration website at "<http://www.ssa.gov/history/pdf/2007historybooklet.pdf>".

percent. Not only did this change allow the program to generate enough revenue to pay benefits, but it created significant surpluses in the Social Security program. (i.e., more is collected in Social Security taxes than is paid out in benefits). Currently the program is very well funded. In 2007, the federal government collected almost \$190 billion more than it paid out. Figure 13-1 illustrates the annual surplus government revenue from Social Security from 1983 to 2007.

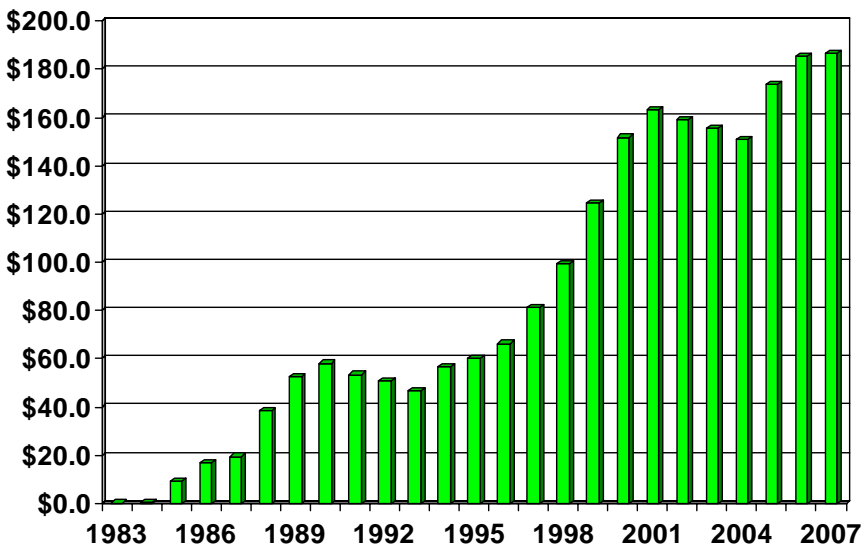


Figure 13-1. Social Security Surpluses (1983-2007)²

Figure 13-1 should be comforting as it would appear that the Social Security program is flush full of cash – but it is not. The money that is collected by the government for Social Security is dedicated to the program by law. Technically, it cannot be spent on other government business; however, it is being spent on other day-to-day government operations in a round-about way.

Surplus FICA taxes that are dedicated to Social Security go into two trust funds: (1) the Old-Age and Survivors Insurance (OASI) Trust Fund, which is used to pay retiree and survivor benefits; and (2) the Disability Insurance Trust Fund, which pays disability benefits. But the Trust Funds are nothing more than

² Historical Social Security surplus figures can be found at the Congressional Budget Office at “<http://www.cbo.gov/showdoc.cfm?index=1821&sequence=0>”.

accounting artifacts used to keep track of the amount of excess money collected. The money is not sitting in an account just waiting to be paid out to beneficiaries. Rather, in its infinite wisdom, the government takes the excess money and purchases U.S. Treasury securities. The excess FICA tax revenue is turned into cash that the government spends, and the Trust Fund is left holding U.S. Treasury bonds that promise to pay back the principal plus interest at some later date. Thus, the government is writing IOU's to itself in what amounts to an enormous shell game. Since the money is essentially being loaned to the U.S. government, it becomes part of the intragovernmental holdings that make up a sizeable portion of the national debt (see Chapter 6). Currently the two Social Security Trust Funds are holding a combined \$2 trillion in U.S. Treasury securities. This accounts for about 21 percent of the total U.S. national debt.

What should concern all Americans is the fact that the SSA projects that in 2017 the program will no longer generate a surplus. At that point, the government will be required to dip into the funds that are technically in the Trust accounts to make benefit payment. This will immediately cause two major problems. First, the government will no longer have the tax revenue produced by excess FICA tax collections that it has grown accustomed to spending as part of its normal annual operating capital. Without the expected Social Security surplus funds for this year, the nation's current projected budget deficit would be far higher than "just" \$400 billion; it would be closer to \$600 billion.

The second major issue – and the more important issue – is, where will the government find the money to repay the Trust funds? Again, the \$2 trillion owed back to the Social Security Trusts has already been spent. After 2017, not only will the government no longer have the revenues generated by the Social Security surplus to spend, but the government will have to commit money to pay back the SSA in order to allow Social Security benefits to be paid without interruption. The debt owed to the SSA is backed up by the full faith and credit of the United States government, and the federal government has never defaulted on a loan. However, that does not change the fact that there is no account which can be tapped, nor is there any real source of new income that will be able to cover the \$2 trillion. As such, it is likely that the government will be forced to raise taxes, borrow even more money from the public, and reduce benefits. Obviously, none of these options are desirable – but they will be necessary.

As citizens, we should be concerned about the viability of the Social Security system and look to politicians in Washington to address the growing financial issue. At a minimum, the government should start to weigh options and take actions in order to prepare to repay the Social Security Trusts. However, even if the government finds a way to pay back the money that it owes, the SSA projects

that the Trust Funds will be completely depleted by 2041. This may seem a long way off, but the longer the nation waits to address the problems, the more costly and painful it will be to maintain Social Security (assuming Americans want to maintain the system). The only thing that is clear is that if no changes are made to the program it will fail.

Chapter 14

DISCUSSION: WHERE THE U.S. IS NOW AND PRIORITIES FOR THE FUTURE

There are normal economic cycles, and looking back over the financial figures during the last five presidencies, we can find high points and low points. That said, Presidents and Congress are not helpless bystanders hoping for prosperous economic times. They have the power to impact the economy through public policies. Government actions can soften economic hardships during downturns and keep the economy from overheating when GDP is rising. We should expect our government to take appropriate actions, and through elections we must hold our elected representatives responsible.

As we come to the end of the current Bush presidency, Americans should be concerned about the economic condition and financial stability of the nation. The 1990s saw significant improvement of many of the key fiscal measures discussed in this book, but changes in U.S. economic policies in the 2000s have reversed those improvements. The rapidly rising economy, rising tax revenues, modest spending increases, budget surpluses, low unemployment, and tame inflation that Americans enjoyed a decade ago are nothing more than rapidly fading memories.

On virtually every major economic factor, the U.S. economy is worsening and we are now in the midst of a serious and debilitating global credit crisis. Even more unsettling is the fact that we do not know where the bottom actually is. As bad as things are, they could very well get much worse. Toward this end, most of the financial numbers discussed in the book only include figures through 2007. If we just look at the 2008 figures that are available, we see a nation that is sinking into even greater financial trouble. The economy is slowing and is likely already in recession. With fluctuating energy costs and rising commodities prices, inflation is increasing faster than at any point in the last three decades. Housing foreclosures are reaching record levels and unemployment is ticking up. The

budget deficit is rising as government spending increases and tax receipts fall. With all of the taxpayer bailouts for financial firms, the budget deficit for next year is projected to be as high as \$1 trillion. The national debt continues to grow at an unsustainable level, and foreigners are accumulating that debt faster than ever before. The trade deficit continues to hover near an all-time high. Clearly, there are many reasons to be pessimistic.

To begin to solve these problems, government leaders and policy makers need to understand what each of the numbers mean and how they are inter-related. Working to improve one number will have effects on other numbers. Some of the inter-relationships are more obvious than others, such as the fact that the annual budget deficits add up to make up the total national debt. Thus, before the national debt can be reduced, deficit spending must not only end, but budget surpluses must be created that can be applied toward paying down the debt. Another simple example is that when the economy slows, tax revenues tend to shrink which negatively impacts the budget. Other relationships are not necessarily as clear, such as how the value of the dollar and interest rates are impacted by government policies. Deficit spending and unsustainable debt accumulation send a message to international bankers that the U.S. is not serious about fiscal policies and maintaining the value of the dollar. When the national debt grows unusually high relative to the GDP (as it has in recent years), foreign investors begin to worry that the U.S. will begin printing more money to make payments. At some point, this devalues the dollar and investors expect a higher return (i.e., higher interest rates) to hedge against depreciation of their investments. Thus, it becomes more expensive to finance the debt.

In addition, as the dollar falls, there are many different impacts that affect the U.S. current account. With a falling dollar, U.S.-made products become cheaper around the globe. This usually results in increasing U.S. exports which would improve the U.S. current account. However, when the dollar is weak, foreigners also tend to buy U.S. assets (i.e., companies, property, equipment) at a cheaper price, which is obviously undesirable. New infusions of foreign debt capital through the sale of U.S. Treasury securities may be necessary for the U.S. to finance its overall national debt. Again, this may require higher interest rates in order to entice and secure foreign investment. As this happens, there is a greater outflow of cash in the form of interest payments, which has a negative effect on the U.S. current account. So while a falling dollar can help reduce the trade deficit, it also leads to foreign purchases of U.S. assets and higher interest payments on the national debt. These types of contradictions can confuse voters and allow incumbent politicians to spin their records by “cherry picking” the

numbers they want to highlight. This is why it is important to understand all of the numbers and how they correlate with each other.

Make no mistake, a strong dollar is preferable to a weak dollar, and the fact is that the fiscal policies of our government have put the dollar at risk against other major currencies. The falling dollar contributed to rising oil prices. Oil is a global commodity that is bought and sold around the world in dollars, and with a devalued dollar, oil producers expected more dollars. The weak dollar has allowed firms in other nations to take advantage of favorable exchange rates to purchase American assets at bargain prices in this country. It is not surprising that we see foreign firms and sovereign wealth funds buying up landmark buildings in New York. No one should have been shocked to see InBev, the Belgian-based multinational beverage firm, successfully buy out Anheuser-Busch – the iconic American beer company. The Indiana Toll Road is now being leased to a Spanish firm for the next 75 years (for a total \$3.8 billion). These are just a few examples, but when the dollar was stronger, these transactions simply would not have taken place. With the weaker dollar, American assets have become affordable, and even cheap. Such purchases are happening all around us and with greater frequency.

One segment of the economy that foreigners are gaining control of that could prove damaging for Americans is the nation's financial institutions. The housing and credit collapse has sent commercial and investment banks scrambling for cash. As a result, billions of dollars in foreign-owned cash have flowed into U.S. commercial banks, Wall Street investment firms, and even mortgage lending institutions such as Freddie Mac and Fannie Mae. With foreigners now holding large equity (ownership) stakes in the largest American financial firms, virtually every American who has a loan for personal property (house, car, boat, etc.) or a mutual fund or stock account with an investment firm now owes money in some way to foreign creditors. This has further facilitated the transfer of wealth away from the U.S. and has put America's sovereignty in jeopardy.

CAPITALISM AND THE SHIFTING ECONOMIC WORLD

Many of the problems that we are facing today can be traced to a basic ignorance of capitalism and the changes that are happening in the global economy. There seems to be an adherence to the mythic belief that the U.S. is the greatest economic power in the world and it always will be. The former is true for the time being, but the latter is certainly debatable. The future is uncertain, but what is certain is that other nations are seeing tremendous growth in their economies. If history has taught us anything it is that empires and great powers

rise and fall. There is no guarantee that the U.S. will remain the world's greatest economic power. Yet, this belief is held by many and it is perpetuated (falsely) by the public policies chosen by our leaders in Washington. The out-of-control spending is more fitting for an economy that is growing rapidly, than for one that is slowing and which is already burdened with tremendous debt.

Capital will always flow to the most efficient markets. That is, capital will be invested where goods and services can be produced with the greatest profit margins. There is no place for national identity or borders within capitalism. As trade barriers have fallen and communications technologies have improved, the world has grown smaller and capital has flowed across the globe. We see the effects of global capitalism playing out all around us. Jobs are being outsourced and foreign firms are buying America's most-recognized companies. American corporations were once revered around the world, but are increasingly struggling to compete against well-financed and rapidly improving firms in foreign markets.

As described above, and in Chapter 8, we are in the midst of a period of rapid outflow of American wealth to other nations. Americans need to accept that the world is catching up to the U.S., and in some economic sectors foreign nations have surpassed the U.S. Too many Americans do not fully appreciate what this means. Many hold on to the notion that U.S. workers and U.S. firms are just better than their foreign counterparts. However, the growing power of foreign economies and foreign firms tells a very different story.

One indicator of the impact of the shifting global landscape on U.S. competitiveness is that in the past, the best and brightest students from around the world came to the U.S. to earn college and graduate degrees. They then stayed in the country because the best job opportunities and standards of living were here in America. The net inflow of human capital fostered the spirit of American entrepreneurship, innovation, and ingenuity. But this is no longer the case. Great and growing opportunities and rising standards of living are commonplace around the world.

Most Americans are well aware of the blue-collar manufacturing jobs that have moved out of the U.S. and across the globe. However, what should be more alarming is that the next wave of great innovations in information technology or biotechnology is just as likely, if not more likely, to come from India as it is to come from the U.S. A Japanese firm may be the one that develops and patents a nanotechnology advance that radically alters the electronics industry. Europeans may come up with the next great green energy solution that shifts the world from fossil fuels to an alternative, clean and renewable energy. This would have been far less likely 25 years ago, but today it is a reality of the global economy.

Quite frankly, there has to be a major shift in thinking in Washington. Our leaders need to better understand the growing problems themselves, and then they need to lead and tell the American people the truth. For decades the U.S. has been the undisputed economic superpower in the world, but this is changing. Our public policies need to reflect the realities of the global economy or we will not be able to compete effectively. It requires a dose of economic reality and discipline that has been sadly missing in Washington.

THE NEED FOR FISCAL DISCIPLINE

Many of the problems that the nation is now facing are long-term problems that have been exacerbated by the recent explosion in government spending combined with tax cuts. We cannot have our cake and eat it too. At a minimum, the government has to work to balance the federal budget. Every program and every federal agency should be scrutinized. It goes without saying that waste, fraud, and abuse must be eliminated, but that is not enough. The looming and growing financial burdens of the national debt and programs such as Social Security require careful evaluation of all government programs and spending priorities. Any programs that cannot demonstrate clear value for American people – value that far exceeds the amount spent on the program – should be eliminated.

In addition, the use of supplemental spending bills to fund the wars in Iraq and Afghanistan has to end immediately. Supplemental spending bills fall outside of the normal budget process and should only be used for emergencies. The bulk of war costs should be added into the federal budget so that it can be scrutinized and audited in a manner consistent with other normal annual government expenditures. Tens of billions of dollars that have been committed to fighting in Iraq and Afghanistan have been lost, pilfered, wasted, or are otherwise unaccounted for. This would be far less likely if Congress required the President to include his projected war costs in the annual budget.

Finally, targeted earmarks that are kept hidden from public scrutiny and which often only benefit narrow special interests must be stricken from spending bills. But, diligence on the part of the government to eliminate earmarks, useless programs, war profiteering, and general mismanagement of funds, is likely to only cut tens of billions to perhaps a few hundred billion dollars from the budget. This would be a good start, but much more has to be done to balance federal budgets. Nothing should be off the table including raising taxes, slowing increases to large entitlement programs such as Medicare and Social Security, and freezing budgets

for federal agencies. Any solution will likely require a combination of strategies to address the growing fiscal crisis.

At a more fundamental level, the American people have to carefully consider the meanings of fiscal discipline and sound economic policy. Fiscal discipline does not simply mean cutting taxes. Certainly, cutting taxes can boost business spending, which can spur the economy, but there is a point at which taxes can become too low to cover the spending priorities of the American people. At the other extreme, if taxes are too high it can stunt the economy and prevent technological innovations. The problem is that the equilibrium point is not fixed; it fluctuates with the normal economic cycle. The end result is that there are times to raise taxes and there are times to cut taxes. When new priorities require federal resources to be expended, such as the rebuilding of the Gulf Coast after Hurricane Katrina or going to war in Afghanistan after 9/11, taxes should be raised to cover these expenses. When the economy goes into recession, or the government generates significant excess tax revenues, serious consideration should be given to tax cuts and/or rebates.

With respect to debt, it can be an important part of a disciplined and responsible economic policy. Debt, in and of itself, is not necessarily a bad thing and there are times when deficit spending is appropriate; however, it must be for a limited time and it should offer a clear, long-term benefit for the American people. Consider a high school graduate who goes on to college to earn a degree. That student may accumulate a fair amount of debt during his/her college years, but upon graduation the student's investment in developing skills and knowledge should open up new opportunities that yield higher paying jobs. The student must then pay back the debt and as long as the investment results in a high enough paying job to pay back the loan and still earn a living, it would be a valuable and worthwhile investment. Obviously, the key to successful deficit spending is that it is temporary and limited by the future value of the investment that one is spending borrowed money on. This is the lesson that many politicians have not learned, otherwise the federal government would not engage in the structural deficit spending and borrowing practices that it has engaged in year after year.

Fiscal discipline is not a partisan issue. Both Republicans and Democrats should consider the fiscal implications of their priorities before promoting them. President Reagan is remembered for his sweeping tax cuts, but the reality is that when the federal deficits exploded and Social Security was on the verge of collapse, he worked with Congress to implement significant tax increases. Most notably, Social Security was not only saved, but it began to generate significant tax surpluses that will pay for the program for decades. This was a good example of fiscal discipline and sound economic policy.

On the other side of the political spectrum, the 1993 tax increase pushed by President Clinton and his White House just squeaked through Congress (Vice President Al Gore had to cast the deciding vote in the Senate to break a tie), but it generated new revenues for the federal government that improved the budget situation of the federal government every year of the Clinton presidency. In his final year in office, the federal government generated a record surplus of \$236 billion and was actually paying down the principal of the national debt. Fiscal discipline in Washington is not an oxymoron and it can be done. But it requires political will and commitment.

We are now seeing the myriad of problems that occur when taxes are cut but spending increases to the point of creating record deficits. Discipline and sound fiscal policy occurs when there is a balance between the spending priorities of the nation and the tax policies used to generate government revenues. If we, as citizens, want good schools, or better roads and bridges, or universal health care; if we believe that prosecuting a war on global terrorism and occupying Iraq are noble causes; if we want to prevent the spread of AIDS or help end global hunger and poverty; then we have to be willing to make the sacrifices to pay for these endeavors. We certainly should not be continuously borrowing money from foreign countries and passing the costs to future generations of Americans if they are such important priorities.

BROAD FISCAL POLICY RECOMMENDATIONS

There are no magic solutions to the growing fiscal challenges, it just requires leadership and shared sacrifice. Without going into too much detail, this section outlines some of the economic policy goals that should be pursued by the federal government. How the government achieves these goals is left up to politicians and public policy experts.

The most pressing issue is that the federal government must balance its budget and has to stop borrowing money. To do this, the government needs to slow the rate of spending, if not cut spending, and raise taxes in order to balance annual spending (including supplemental spending bills) with annual tax revenues. The 2008 deficit was \$440 billion, and next year it will likely be at least twice as large. Finding ways to close the gap is a major challenge, and it will likely take years to get there.

On top of closing the budget gap, the government has to stop using Social Security surplus tax revenues (almost \$200 billion for this year) as part of its operational revenues. We know that in less than a decade FICA taxes for the

Social Security program will no longer generate surplus revenues and the government will have to begin repaying the Social Security Trusts the \$2 trillion that it owes. The government should begin to wean itself off of the Social Security surplus now, and it should set the surplus money aside. It would be wise to invest a portion of the money into a mix of private and foreign held interest bearing accounts. This would allow the Social Security Trusts to hold diversified investment vehicles and reduce the amount the federal government will be required to pay back. It could also help to shore up faltering American financial institutions that are being forced to secure foreign investment to avoid going into bankruptcy.

Any surplus Social Security tax revenue that is converted into U.S. Treasury securities should not be spent on new federal programs, or even current federal programs. Instead, surplus revenues would be better utilized if they were used to pay down the national debt, particularly to foreign-holders of U.S. debt. To prevent undue outside influence on American interests, and to maintain a clear sense of national sovereignty, we need to reduce the amount of money owed to foreigners.

Ultimately, government solutions to the fiscal challenges facing the nation will create a more favorable climate for the private sector. Fiscal discipline demonstrated by a balanced budget and reduction of the national debt would send an unambiguous signal to the country and the rest of the world that the U.S. government is serious about managing its finances. This would stabilize the dollar which would help tamp down rising global food and oil prices and allow U.S. firms to purchase foreign assets at a better exchange rate. As energy and food prices dropped, the U.S. economy would improve as American consumers would have more disposable income to spend on goods and services. This would obviously help publicly-traded companies on the U.S. stock markets, as they would achieve higher sales and profit figures. This additional capital could be used to expand and invest in new markets around the world. It would also help to prevent foreigners from purchasing controlling interest in U.S. firms and acquiring American assets by making them more expensive in the global market.

There are cascading benefits to improving U.S. government fiscal policies. But, obviously, the devil is in the details. Choosing the spending priorities is not easy. What would a single-payer universal health care program cost? Should defense spending be cut? How much money should be committed to environmental causes? Do we need to increase or decrease funding for education programs? On the tax side, who should be taxed? Are there products that should be taxed at a higher rate? How much additional tax revenue is needed and for how long? These are vexing questions that must be answered because the federal

government has limited resources. They require careful consideration and actions on the part of the President and the Congress. We need our politicians to lead and to make the tough choices we elect them to make. If they do not or will not, or they make the wrong choices that lead to even poorer fiscal performance, voters must hold them accountable and vote them out. Americans simply cannot afford to wait any longer to see action.

Chapter 15

CONCLUDING THOUGHTS

There are significant challenges facing the nation – the global credit crisis, the ongoing war on terror, fluctuating oil prices, rising costs of health care, global warming, a crumbling infrastructure, etc. – but none of these are as challenging as the worsening economic condition of the country. The reason is that all public policies and government initiatives are impacted by the economy. Without resources and money, options to address any other challenge are limited.

We now live in a truly global economy and American firms must compete in that arena. The top competitor may not be located just down the street, but half a world away. In recent years, there has been rapid shift in the wealth of nations. The U.S. has gone from the greatest creditor nation in the world, to its largest debtor nation over the course of several decades. This is one of the results of the steady decline in the fiscal performance of the federal government.

As shown in the figures provided in this book, there is plenty of blame to go around. Presidents from both political parties have held office and both Houses of Congress have been controlled by Democrats and Republicans at various times during the last 30 years. There have been ups and downs during the presidential terms of all of the last five Presidents, but the bottom line is that the economic problems facing the nation have grown. Rather than try to assign blame, it is better to now recognize that the financial outlooks for the U.S. for both the near term (next five years) and the longer term are not encouraging. Recognizing this to be true, and understanding how and why it has happened, is the first step to solving the problem. Only then can economic proposals that change the fiscal fortunes of the nation emerge.

Serious leaders must now brace the country for real economic sacrifice. Americans have elected leaders who have spent far beyond the nation's means, and have financed the deficit spending through debt – increasingly owed to

foreigners. Unfortunately, the hyper-partisan nature of politics in Washington DC makes it even more difficult to agree on solutions that can address the problems. Vitriolic debate and the constant spin in an effort to score political points add another layer of difficulty to the implementation of reasonable solutions. The result is that politicians bicker about small matters, while all the while the macro-level economic figures worsen.

The primary goal of this book was to provide an honest and unbiased look at the financial performance of the government over the last 30 years. With this knowledge, policy makers, analysts, and students of government can see where the nation now stands and the major fiscal challenges facing the nation. Ultimately, we have a choice. We can allow the nation to sink further into the fiscal morass it finds itself in, or through a shared sense of sacrifice and commitment to turn the fortunes of the nation around, we can face the challenges head on. Much work needs to be done and now more than ever, we need bold leadership in Washington that is willing to be honest with the American people, make tough economic decisions, and which offers innovative government solutions. Without significant changes in U.S. economic policies, and a more engaged populace to hold politicians responsible, we should not expect any change in the fiscal fortunes of the nation and the U.S. will find itself struggling to compete in the global economy.

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