Why Deficits Matter

Jason Furman
Senior Fellow and Director of The Hamilton Project
The Brookings Institution
December 2007
The Key Problem

- Budget deficits reduce our nation’s saving.

- Lower national saving reduces our future standard of living.
Step 1: Budget Deficits
Reduce Saving

($ billions in 2006)

Personal saving: \(-100\)
Business saving: \(500\)
State & local govt. saving: \(0\)
Federal govt. saving: \(-150\)
Net national saving: \(250\)
Lowest Net National Saving Since the 1930s

National Saving as a Percent of GDP
Step 2: The Impact of Lower Savings

Investment = Saving + Foreign Borrowing

So if saving goes down, only two outcomes:

- Investment goes down
- Foreign borrowing goes up
Step 3A: Less Investment Makes Us Poorer

- We end up with fewer factories, less business equipment, fewer computers, etc.

- As a result the nation can produce less. And wages are lower too because workers are less productive.
Step 3B: Foreign Borrowing Makes Us Poorer – And More Vulnerable

- Foreigners will receive the return (interest, dividends, profits) on the investment they finance.

- The trade deficit is increased.

- We are vulnerable to a “hard landing” if investors move money out of the United States.
Largest Foreign Borrowing Ever Recorded

Foreign Borrowing as Percent of GDP

Other Costs of Deficits

- We pay more than $200 billion in interest on the federal debt – twice as much as we spend on education.
- Deficits reduce the discipline of the budget process.
- Deficits increase the uncertainty we face about future federal policies.
- Deficits reduce the flexibility of the government to address future contingencies.
The Temptation to Wait … and the Cost of Waiting

- Most of the problems of budget deficits build up gradually. Unless we have a sudden loss of international confidence, we may avoid a crisis for years to come.

- However:
  - Every extra year of deficit takes a bite out of our future standard of living.
  - Cutting deficits becomes more difficult the longer we wait.