



ECONOMIC UPDATE – FEBRUARY 2011

Dear Client,

### **The Federal Budget: It's a Mess**

If the US federal government were a bank, the FDIC would close them down this Friday night. President Obama submitted next year's budget. The new budget, despite "cutting" the deficit by \$1.1 trillion, will require Congress to pass a large increase in the "debt ceiling."

This college student provides the best perspective I have ever seen explaining how a \$100 billion budget cut compares to the total national debt. It is only 2 minutes and very educational <http://www.wimp.com/budgetcuts/>

In February 2010, the US raised the debt ceiling to \$14.3 trillion (up \$1.9 trillion) and then promptly borrowed every dime it could. Even with the "cuts" proposed by the President (or those being talked about by Congress), the government will spend roughly \$7 trillion more than it receives in income over the next 10 years. Bottom line: The US federal budget is a mess. It's on an unsustainable course. And that's a view that takes all the "spin" at face value.

And believe me -- there is a ton of spinning taking place. The president's budget director Jacob Lew says the new budget will "save" \$1.1 trillion over the next ten years. But about 1/3 of the "savings" will come from higher taxes<sup>[i]</sup>. Under this budget, spending will be 49% higher in 2021 than it is in 2011.

In other words, even after tightening its fiscal belt and confiscating more private resources, the federal government will remain huge and out of control. The President's budget for 2012-2021 forecasts that federal spending will never fall below 22.3% of GDP. Never before in history has the level of non-defense spending been so high for so long.

In effect, the budget proposed by President Obama locks in, like many European states, a deficit of at least 3% of GDP for as far as the eye can see. As a result, growing spending more slowly than GDP or freezing spending is no longer enough. The only way to get government under control is to cut spending outright.

The last time spending grew more slowly than GDP was under President Clinton, when spending fell from over 22% of GDP in 1992 to 18.2% in 2000.<sup>[ii]</sup> The end of the Cold War gave the US a peace dividend, which allowed for defense cuts.

But since President Bush took power in 2000, federal spending has increased by 93%<sup>[iii]</sup> and if we can believe the budgets being proposed in recent days, this spending binge will be locked in place and not reversed.

That's why we're cheered by the open rebellion of many newly elected members of the House to both their leadership's plan and Obama's plan to slow spending. They know that, after the government binge of the past decade, simply slowing the growth of spending or even "freezing" it is not good enough. They are not looking for excuses to cut spending slowly.

Claiming budget savings by freezing spending at today's levels is like an alcoholic who says he's sober because he'll never drink more than yesterday's bender. Trouble is, this alcoholic doesn't even pay his own tab.

Best Regards,



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**References:**

[1] [cbsnews.com](http://cbsnews.com)

[1] CBO

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