

THE \$10 TRILLION HANGOVER

Paying the price for eight years of Bush

By Linda J. Bilmes and Joseph E. Stiglitz
Information graphics by Nigel Holmes

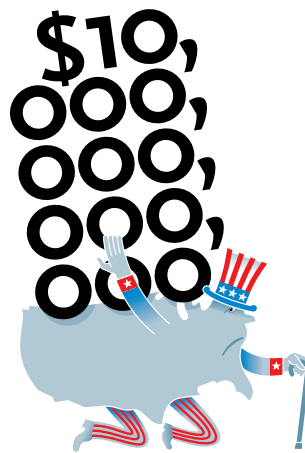
In the eight years since George W. Bush took office, nearly every component of the U.S. economy has deteriorated. The nation's budget deficits, trade deficits, and debt have reached record levels. Unemployment and inflation are up, and household savings are down. Nearly 4 million manufacturing jobs have disappeared and, not coincidentally, 5 million more Americans have no health insurance. Consumer debt has almost doubled, and nearly one fifth of American homeowners are likely to owe more in mortgage debt than their homes are actually worth. Meanwhile, as we have reported previously, the final price for the war in Iraq is expected to reach at least \$3 trillion.

As bad as things are, though, this is just the beginning. The Bush Administration not only has depressed the economy and racked up unprecedented debt; it also has made expensive new commitments to the Medicare Part D prescription drug program, to disability compensation and education benefits for veter-

ans, to replenishing the military equipment consumed in the wars in Iraq and Afghanistan, and simply to paying interest on the debt itself.

The president is not solely to blame for American profligacy, of course. Congress approved inequitable tax cuts and spending binges, and the Federal Reserve and other regulators, along with the mortgage industry and millions of consumers, share responsibility for the housing collapse. Nonetheless, the outgoing administration has made a series of unwise economic choices that together will add up to a burdensome legacy.

Using conservative assumptions, we calculate that the bill for Bush-era excess—the total new debt combined with the total new accrued obligations—amounts to \$10.35 trillion. This legacy will have long-term consequences for America's prosperity, but it also will weigh heavily and immediately on the Obama Administration, which will need to spend money fast to get the economy moving again.



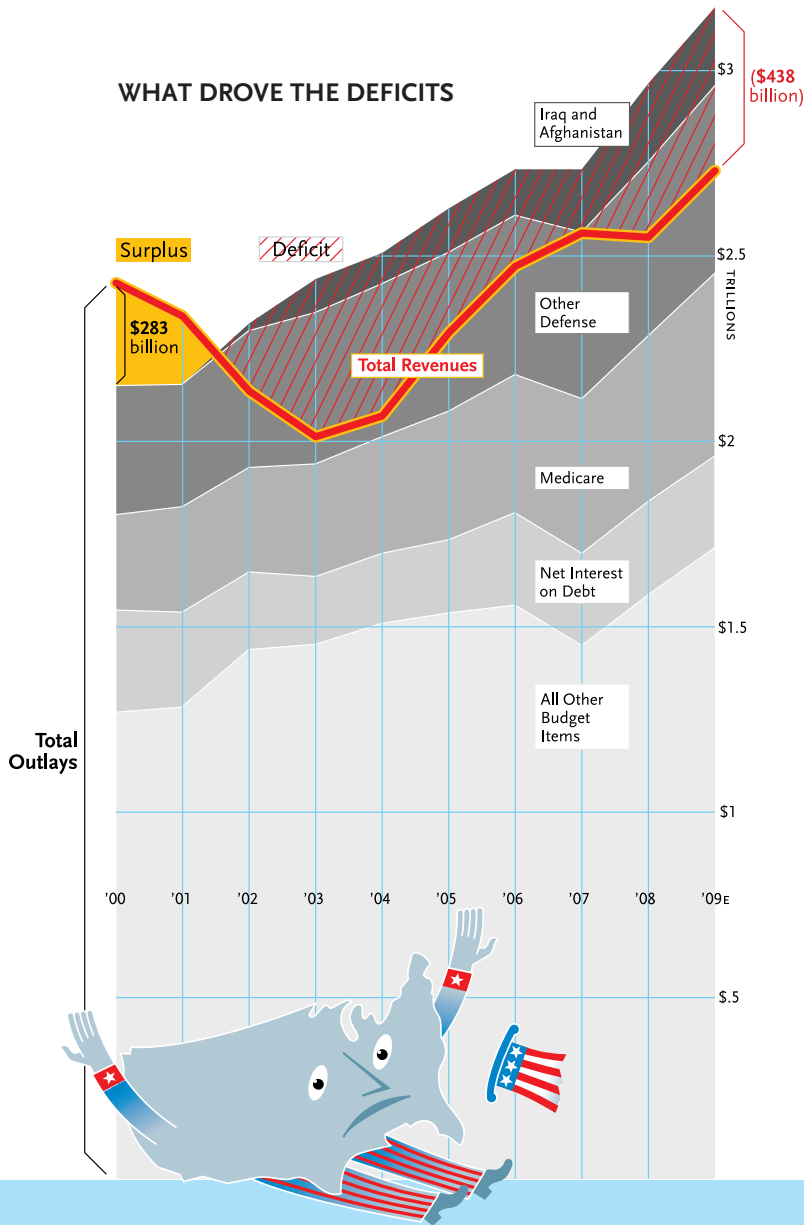
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When George W. Bush took office, he inherited a budget surplus of \$128 billion and a bright fiscal future. The Congressional Budget Office, the nonpartisan government agency responsible for estimating future expenditures and revenues, projected a cumulative budget surplus of about \$5.6 trillion between 2002 and 2011, if the country stayed on track—which of course it did not. What happened instead was that the administration successfully pushed for not only two rounds of massive, inequitable tax cuts but also a 59 percent surge in government spending. The result has been the largest budget deficits in U.S. history, and estimates of the current deficit are climbing even as we go to press. In September, *before* the financial meltdown, the CBO projected the deficit for fiscal 2009 to reach \$438 billion—about the same level as it was in 2008—but in October, Peter Orszag, the director of the CBO, predicted the deficit would reach \$750 billion, and we believe that number could go higher still. Such increases are the result of several factors:



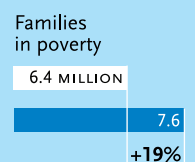
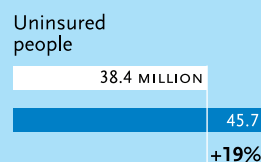
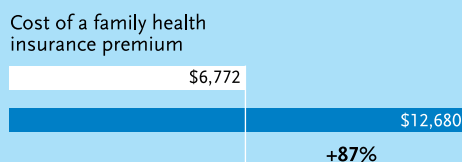
Iraq and Afghanistan The combined annual costs of the wars in Iraq and Afghanistan, including indirect costs, have shot from \$20 billion in 2001 to more than \$208 billion this year.

Other Defense But government spending on the rest of the military has grown more quickly than at any time since the Vietnam War. Part of that growth is attributable to indirect costs of the Iraq war (such as the growing recruitment budget), but much of it stems from an unrelated spending spree on acquisitions, weapons systems, and research.

Medicare Entitlement spending has risen even faster than projected, in part because of another major initiative of the Bush Administration: the 2006 launch of Medicare Part D. This new provision, which provides prescription drug coverage for seniors, added \$47.4 billion to the cost of Medicare in 2006—a jump that accounted for almost 12 percent of total Medicare spending.

Net Interest on Debt All of the new debt incurred to pay for the foregoing did not come free. Net interest, which fell in the early part of the Bush Administration as a result of Clinton-era belt-tightening, has begun to climb back toward record levels, and now is the fourth-largest spending category in the federal budget.

ARE YOU BETTER OFF? BEFORE BUSH AFTER BUSH

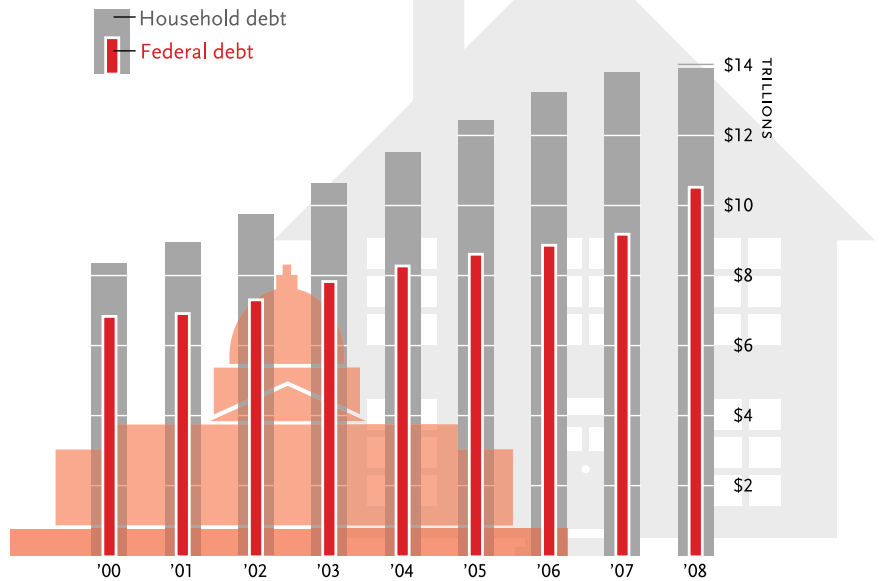


The result of deficit spending is debt. When President Bush took office, the national debt was \$5.7 trillion. Now it is \$10.6 trillion—and Congress voted in October to raise the debt ceiling to \$11.3 trillion, the seventh such hike since President Bush took office and the second since last July. If, as is quite likely, we reach the new ceiling by January 20, the outgoing president will have managed to amass more debt than all of his predecessors combined.

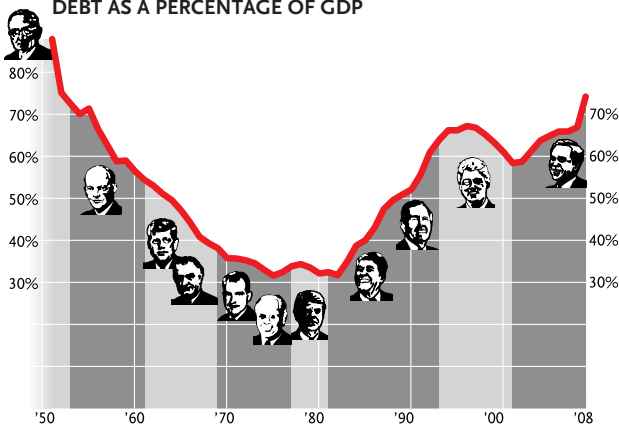
And even that number may be too small. When the federal government took over Fannie Mae and Freddie Mac, it also assumed *their* \$5.4 trillion debt. The accounting procedures used by the International Monetary Fund, and endorsed by the CBO, normally require that such debt also be taken into account, which means that the total national debt now may be as high as \$15 trillion. (If we account for only the riskiest loans, however, that number would “only” be \$12 trillion.)

But the pain most Americans are feeling right now is much more immediate. The increase in credit-card, automobile, mortgage, and other forms of personal debt—from around \$8 trillion in 2000 (in current dollars) to more than \$14 trillion today—also looms behind the implosion of our financial system. Had the value of assets increased in tandem, that increase might not have mattered, but what is remarkable about America’s debt binge under President Bush is that it primarily served consumption. Homebuyers used easy credit to buy overpriced houses, which they then refinanced to pay for every other kind of consumption, betting that in the end rising housing prices would balance the account. At the same time, household savings rates plummeted, hitting zero or less than zero in some areas. With housing prices in a slump and no money in the bank, the result, according to one estimate, will be more than 5,000 foreclosures per day—more than at any time since the Great Depression.

GROWING DEBT

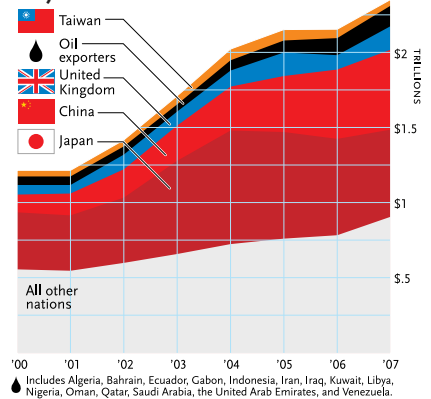


DEBT AS A PERCENTAGE OF GDP

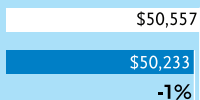


The national debt is now more than 70 percent of the gross domestic product, the highest such proportion in half a century. Where did all this debt come from? To an unprecedented extent, America depends on loans from China, Japan, and the Middle East. The share of public debt that is owed to foreign nationals has risen from 31 percent in 2000 to 46 percent today. This means that every man, woman, and child in the United States owes \$9,000 to some other country.

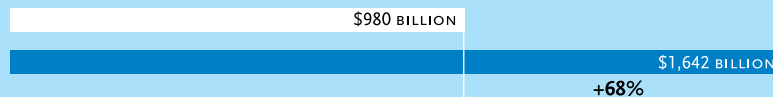
MAJOR FOREIGN LENDERS

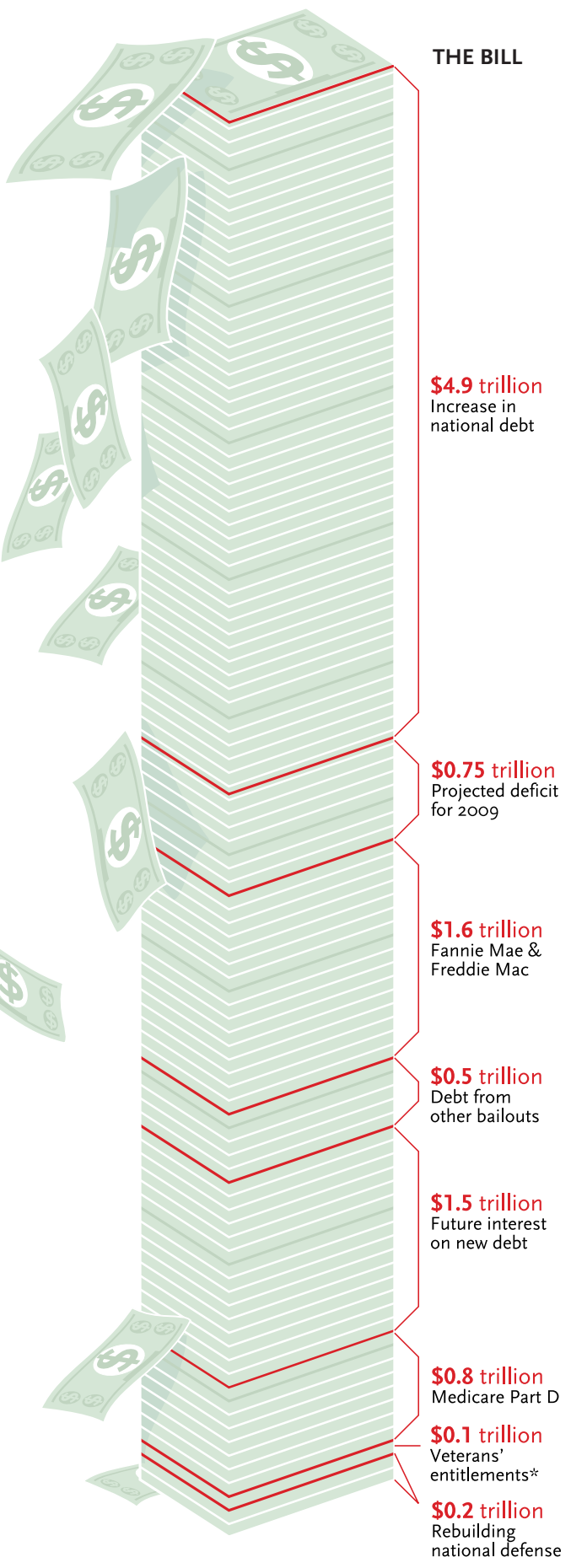


Real median household income



Corporate profits





THE BILL

The national debt has already nearly doubled in the Bush era, but the consequences of the president's policies will continue to be felt for many years to come. We estimate that the total bill to the nation as a direct result of President Bush's policies, in today's dollars, is an amazing \$10.35 trillion. This includes the new debt as well as liabilities that will need to be paid through 2018. We can break this legacy into eight components:

Increase in National Debt Debt has long been a fixture of American governance, of course, but—given the surplus President Bush inherited—even a conservative estimate of the Bush bill requires that we take into account the entirety at least of his addition to that debt. The Bush tax cuts lowered national revenues by about \$1 trillion, even as the government spent nearly \$900 billion in direct operations for the wars in Iraq and Afghanistan and added another \$600 billion to the total spending on “regular” defense, a significant proportion of which is indirectly related to those wars. And because interest accrues on the outstanding debt, interest charges also will rise. It should be noted as well that this increase does not take into account another factor: had Clinton-era policies been kept in place the past eight years, the CBO estimates, the overall national debt actually would have significantly *decreased*. **Cost: \$4.9 trillion**

Projected Deficit for 2009 The rapidly weakening economy means that tax revenues will fall off, even as unemployment benefits and other government spending rise. Congress also is likely to approve a significantly larger stimulus package, possibly in excess of \$300 billion, and more spending on the bailouts already undertaken, as well as new bailouts and subsidies for struggling sectors such as the auto industry. Moreover, even assuming that the United States begins to withdraw combat troops from Iraq, we expect that the war's costs will remain steady at best in 2009, as functions are transferred to private contractors. We also expect that Congress will extend the temporary fix of the alternative minimum tax and will enact some form of additional homeowner mortgage relief. For all these reasons, next year's budget deficit easily could rise to a trillion dollars, so our estimate is a bare minimum. **Cost: \$0.75 trillion**

Fannie Mae and Freddie Mac When the federal government took over these failing residential mortgage giants, it also assumed their \$5.4 trillion in mortgage-backed securities and outstanding debt. Under conventional accounting standards, this entire amount should be counted as part of the national debt. It is difficult to predict, however, how much exposure the United States has really taken on. We have included what is likely to be the *minimum* additional debt that the CBO adds on for these agencies, which is the \$1.6 trillion in risky unsecured debt. The final cost, however, will depend on how far housing prices fall, and how many houses go into foreclosure, which presents the incoming administration with a significant dilemma: if it spends less on stimulus it will need to spend more on Fannie Mae and Freddie Mac. **Cost: \$1.6 trillion**

Debt from Other Bailouts Congress has already provided \$700 billion in authority to purchase toxic mortgages and other assets through the Troubled Asset Relief Program. It also has committed another \$800 billion to bailing out AIG, Bear Stearns, and other financial firms, and it most likely will extend this commitment to other core U.S. industries in the coming year. Although some of this cost will appear in the 2009 budget, much of it will not be accounted for until 2010 or later. Not all of the loans will go sour, so it is difficult to estimate the price tag on these programs. **Cost: \$0.5 trillion**

Future Interest on New Debt The United States spends nearly \$250 billion per year in net interest payments (interest paid on Treasury debt securities less interest received by the Social Security and other trust funds). The CBO projects that the net interest payable on the total debt will over the next decade exceed \$3.35 trillion, of which about \$1.5 trillion is directly attributable to the debt that we have taken on during the past eight years. Even this figure, however, understates the true amount of interest payable, because interest also will accrue on money that will need to be borrowed in the next ten years to pay for obligations incurred in the past eight years. **Cost: \$1.5 trillion**

Medicare Part D The administration's flagship prescription drug benefit program is expected to cost \$800 billion over the next decade. It is possible, though, that the number will be larger. The program has been criticized because, unlike the department of Veterans Affairs, Medicare does not negotiate bulk price discounts with drug companies. In addition, the program coverage contains a “doughnut hole”

*Iraq and Afghanistan

whereby Part D stops paying for drugs after a senior receives prescriptions totaling \$2,700, and doesn't resume coverage until that senior has paid an additional \$3,454 for drugs. Our estimate is based on the assumption that Congress will take steps to close the "doughnut hole" but also will take steps to encourage price negotiation with pharmaceutical companies. **Cost: \$0.8 trillion**

Iraq and Afghanistan Veterans Entitlements For every U.S. serviceman or -woman killed in Iraq, fifteen more have been wounded, injured, or have contracted an illness serious enough to require medical evacuation. More than 350,000 U.S. veterans from the two wars have sought medical treatment from the Department of Veterans Affairs, and nearly 300,000 have filed applications for disability benefits (more than 90 percent of which are likely to be approved). The cost of providing medical care and disability benefits may eventually exceed even the cost of combat operations, and over just the next decade, using the most optimistic assumptions, taking care of these veterans is going to cost at least \$59 billion. The president

also reluctantly signed into law a measure that restored education benefits for new veterans in an updated G.I. Bill, which we estimate will cost \$40 billion over the next decade. **Cost: \$0.1 trillion.**

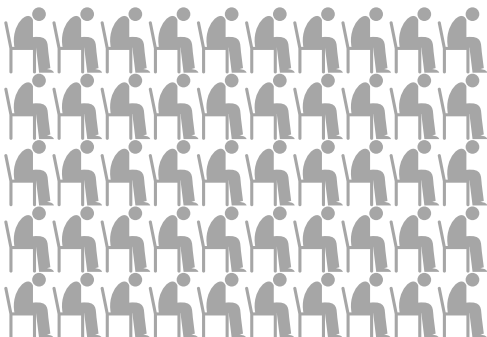
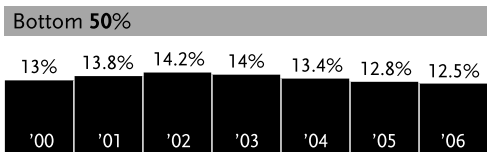
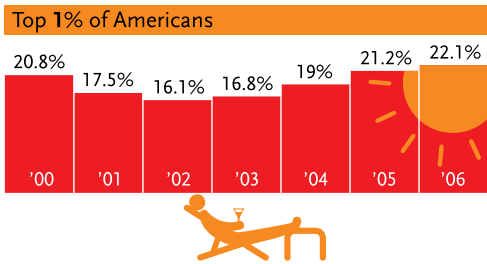
Rebuilding National Defense The armed forces have been severely depleted by the efforts in Iraq and Afghanistan, in terms of personnel, training, and equipment. While we urge spending reductions in some areas of defense (e.g., space-weapons programs and other projects with huge cost overruns), there is no doubt that the military will require a substantial expenditure to "reset" basic military strength. This includes the replenishment of aircraft, vehicles, and weaponry; restoring the National Guard to its previous strength; depreciation of equipment used or abandoned in Iraq; and the costs related to a partial withdrawal from Iraq, including the dismantling of some bases. In addition, the Pentagon will need to spend considerably more over the next decade on military hospitals, recruiting, and bonuses. **Cost: \$0.2 trillion**

The worst legacy of the past eight years is that despite colossal government spending, most Americans are worse off than they were in 2001. This is because money was squandered in Iraq and given as a tax windfall to America's richest individuals and corporations, rather than spent on such projects as education, infrastructure, and energy independence, which would have made all of us better off in the long term.

President Bush did manage, by way of deficit spending, to grow the economy by 20 percent during his tenure. But who benefited from that growth? Between 2002 and 2006, the wealthiest 10 percent of households saw more than 95 percent of the gains in income. And even within those rarefied strata, the gains tended to be concentrated at the very top. According to one study, the nation's 15,000 richest families doubled their annual income, from \$15 million to \$30 million. And in that same period, corporate profits shot up by 68 percent—more than five times the growth seen in the overall economy.

Even as the wealthiest families have increased their holdings, the families at the center of the income spectrum saw their incomes shrink by 1 percent. In 2000, the average weekly earnings of production and non-supervisory workers (70 percent of the workforce) amounted to \$527 (in current dollars). Six years later, their wages had risen a mere \$11, and those same workers have meanwhile seen their net worth (assets minus liabilities) wither as a result of falling home values, higher personal debt, and shrinking savings—factors now being exacerbated by the collapsing stock markets.

WHERE THE MONEY WENT



The bottom half of American workers saw their share of national income decline, even as the wealthiest 1 percent saw an increase in their overall share.

The extraordinary transfer of wealth that has taken place from ordinary households to the super-rich has been made possible by another transfer: borrowing money from future prosperity to pay for current consumption. For example, President Bush provided a much heralded \$600 tax rebate to most families in 2001. But once interest rates return to more normal levels, simply servicing the new debt from the Bush years will require those same families to spend more than \$2,000 a year, year after year, forever.

The Obama Administration, facing the most serious economic crisis in at least a generation, will need to mount an expansionary fiscal policy. The problem is how much the country's debt mountain will crimp our ability to pay for the type of change we just voted for—better health care, public investment in alternative forms of energy, and a renewal of our aging roads and bridges—and that we need in order to rescue the economy.

The global financial crisis is denting the huge foreign exchange reserves of governments that bankrolled the Bush spending spree. Although our major creditors will continue lending to us, even they have their limits. If the world's appetite for U.S. Treasury bonds begins to wane, that would likely drive up long-term interest rates and send the dollar lower, leading to inflation. Historically, governments faced with such impossible debt mountains have resorted to inflation in order to repay their debt more cheaply. But high inflation hits the poorest members of society hardest. Whether we struggle to break our addiction to deficit spending in order to pay off our debts, or wind up inflating them away, the economic mistakes of the George W. Bush White House will cast a long shadow over the next generation of Americans.