Center for American Progress

# Breaking Down the Deficit

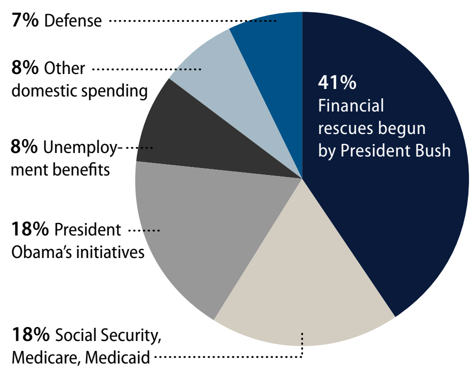
Michael Linden November 17, 2009

The fiscal year ended on October 1, and we can say with certainty that 2009's budget deficit was the largest since World War II, approaching one-tenth the size of the entire U.S. economy. Since we have now the benefit of specific data from the full fiscal year, we can also get a better sense of what actually produced that record high deficit.

The main culprits might not be who you expected. For instance, it turns out that a massive decline in tax revenues had as much to do with the ballooning deficit as any increase in spending. And you might also be surprised to find out that the vast majority of new spending in fiscal year 2009 was actually committed before President Obama even took office. Taking a closer look at both sides of the 2009 balance sheet reveals some important lessons as we face our fiscal future.

Considering all the claims about an "Obama spending spree" it is important to begin by looking at exactly how much money the government spent in FY09. It's true that spending in 2009 was much higher than it was the previous fiscal year, by about $602 billion, excluding payments on the national debt (which actually declined in 2009 because of low interest rates). But it turns out that a huge chunk of that increase actually happened before President Obama took office. In fact, fully 41 percent, or $245 billion, came in the form of the Troubled Asset Relief Program and the rescues of Fannie Mae and Freddie Mac, actions taken in the fall of 2008 under President George W. Bush.

**Sources of increased spending in 2009**




Source: CAP

In other words, before President Obama had even taken office, federal spending was already up by about 9 percent over fiscal year 2008 levels. So the other $350 billion must be that spending spree we've been hearing so much about, right? Not exactly.

Another 18 percent of the spending increase came not from President Obama's pen, but from growth in mandatory programs set in place many years prior to his presidency. Social Security, Medicare, and Medicaid, for example, cost the government $110 billion more in 2009 than they did in 2008. These cost increases weren't the result of policy changes made by President Obama—they stem from longstanding demographic trends and the ever-increasing costs of health care.

Of course, the president did take action to address the most expensive portion of this increase—the rising cost of Medicare and Medicaid—by pushing comprehensive health reform. Such reform is absolutely necessary to rein in these costs, but something that complicated wasn't going to happen in time to affect the 2009 fiscal year that was already 112 days old when the president took office.

Besides Medicare, Medicaid, and Social Security, the other major jump in mandatory spending was in unemployment benefits, which shot up by $51 billion—an 8 percent increase in total spending—with millions of people looking for work.

So where does the big stimulus bill fits into all of this? Unlike TARP or Social Security, stimulus spending is definitely the work of this president and this Congress, right? And didn't it cost $787 billion? Yes, except that about one-third of the stimulus bill wasn't spending at all—it was tax cuts (we'll get to the tax side of the equation in a minute). Also, the spending in the American Recovery and Reinvestment Act, which has already saved or created more than 600,000 jobs, was spaced out over two full years, only seven months of which was in fiscal year 2009. As a result, only about 18 percent of the new spending, or $108 billion, came from ARRA, all of which is temporary.

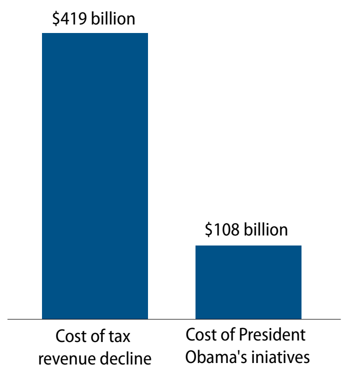
In short, of the $602 billion increase, more than 40 percent was actually passed under President Bush, another 26 percent was automatic spending to pay for mandatory programs set in place long ago, and only 20 percent was for the president's Recovery Act, measures that are helping the economy back to its feet. Not exactly the huge Obama expansion of government that some have been railing against.

Turning our attention to the other side of the balance sheet reveals another surprising fact: The great deficit of 2009 was the result not just of increased spending, but also of dramatically lower tax revenues. In 2009, federal receipts were $419 billion below 2008 levels, a 17 percent drop, which was the largest decline from one year to the next in more than 70 years. Individual income tax receipts decreased by 20 percent, and corporate income tax revenues plummeted by more than 54 percent, which means corporations paid less than half in taxes than they paid the year before.

Of course, the main culprit here is the economic recession. Corporations paid lower taxes because they made lower profits. Individuals paid less in taxes because they lost their jobs, didn't get raises, and didn't make as much on their investments. The tax cuts directed at both families and businesses passed as part of the American Recovery and Reinvestment Act had a part to play here as well—about 15 percent of the decline in tax revenues can be attributed to provisions in ARRA—but the overall trend was driven primarily by the weak economy.

This part of the story, that the deficit was the result of a huge decline in tax revenues just as much as it was driven by increased spending, doesn't get nearly the amount of

**The drop in tax revenues from 2008 to 2009 was four times larger than all American Recovery and Reinvestment Act spending in 2009**




Source: CAP

attention it deserves. After all, tax revenues were down by just about as much spending was up—a drop of 17 percent versus an increase of 18 percent, respectively. In fact, as a share of the economy, total tax revenues in 2009 were at their lowest levels since 1950: just 14.8 percent of GDP and way below the historic average. Indeed, it's worth noting that the overall decline in tax revenues was more than four times as large as the total increase in spending that came out of the American Recovery and Reinvestment Act.

Fiscal year 2009 is officially behind us and so is its record high deficit. But with the economy still weak and more effort needed to create jobs, the deficit in 2010 is likely to be only slightly smaller. This is necessary as deficit spending is critical to get us out of the Great Recession.

The real fiscal problem we face is our long-term budget gap, not the deficit this year or next year. That won't stop some people from claiming the sky is falling right now, but before we allow ourselves to get worked up into a frenzy of fiscal fear, we would do well to remember the lessons of 2009. First, beware those claiming an "explosion in government spending" because their claims aren't backed up by the data. Second, don't forget about the tax side of the balance sheet.

*Michael Linden is the Associate Director for Tax and Budget Policy at American Progress.*