CENTERFOLD

a graphic look at key economic figures

How Our Budget Deficit Drives Up the Trade Deficit

by Paul T. Prentice

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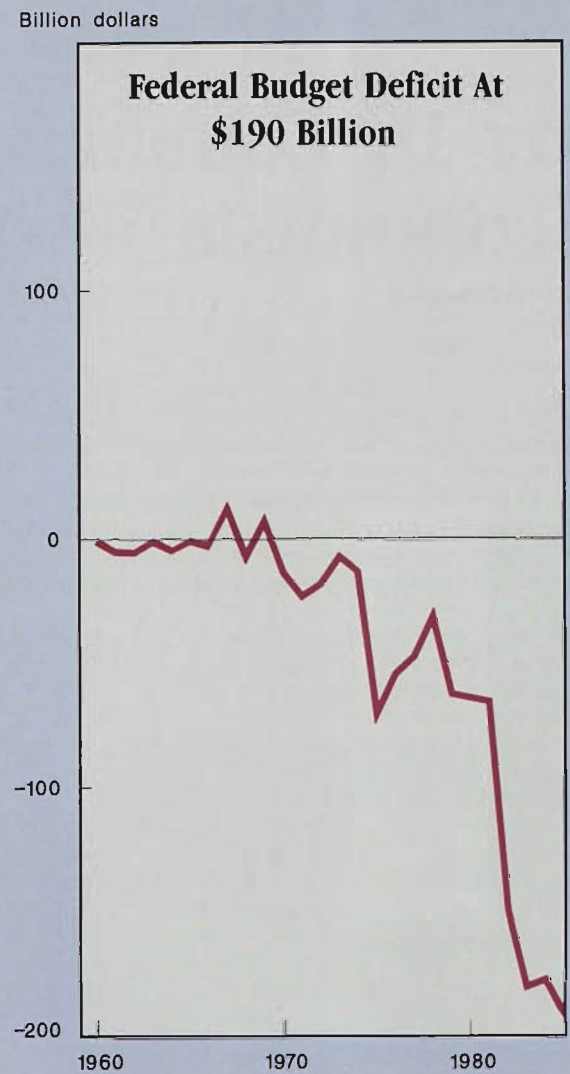
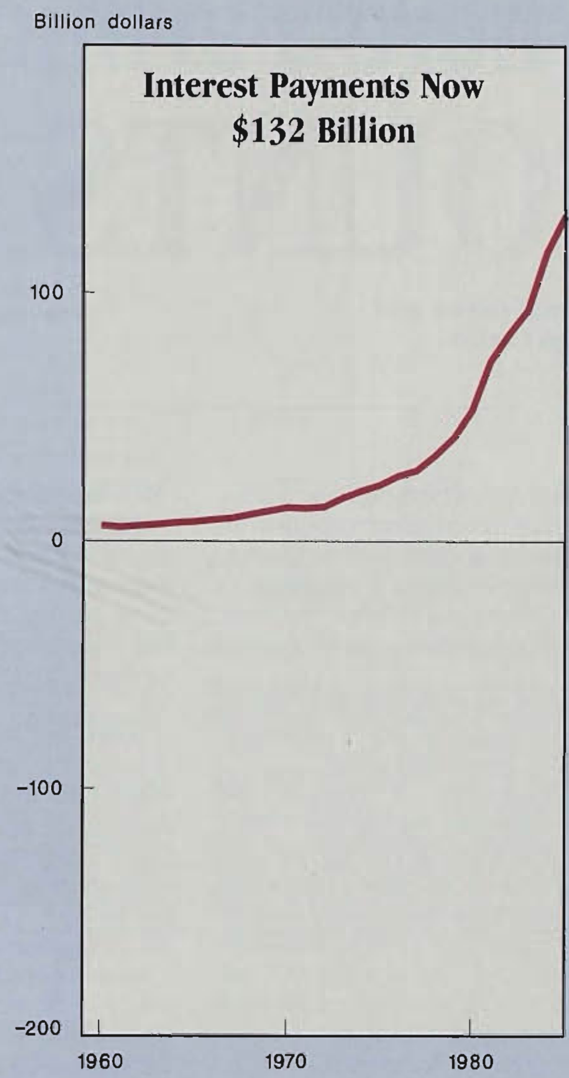
Everybody is talking these days about the deficit in our federal budget. We feature it and two related variables—the U.S. trade balance and interest payments—in three graphs in this centerfold of this, our first, issue of CHOICES. Paul Prentice, in his contributed commentary, argues that the federal budget deficit is a major cause of our trade deficit and that the interest payments associated with the federal debt threaten to collapse the U.S. economy. Do you agree? Or disagree? Send us your views.



The Deficit Soars

- Our annual federal budget deficit is running in excess of $190 billion. It is equivalent to:
  - —4.9 percent of our gross domestic product (GDP) and 5.3 percent of our nonmilitary domestic product.
  - —$796 for every U.S. citizen.
- Previous to the 1980's the largest annual deficit was $73.7 billion (1976). It was equivalent to 4.3 percent of our GDP.



It's Linked to Our Trade Deficit

• A federal budget deficit can be financed in two ways:
—Our government can increase the money supply, or
—It can borrow in credit markets.

• Money supplies are being increased by 9 percent to 12 percent. These increases are contributing to the current inflation rate of nearly 4 percent.

• Increases in the money supply fall far short of the amount of money needed to finance the federal deficit. Thus, our government borrows heavily in credit markets.

• These loans require interest rates high enough to attract money away from other U.S. and foreign uses.

• Higher U.S. interest rates relative to foreign rates attract foreign investors to buy dollars. This increased demand drives up the price of U.S. dollars in terms of foreign currencies such as the West German Deutschmark and the Japanese yen.

• A stronger dollar makes U.S. exports more expensive and imports less expensive for U.S. consumers. U.S. exports fall and U.S. imports rise—increasing the U.S. trade deficit.

• Thus, financing the budget deficit has a spill-over effect on our trade deficit. In fact, it is a major cause of the trade deficit!

It Means Large Interest Payments

• Interest has to be paid on the debt.
—The national debt has accumulated to an astronomical $1.8 trillion. Interest on this debt ballooned to over $130 billion in 1985.
—At one time practically all of the interest on the federal debt was paid to Americans. Today, it goes increasingly to people and institutions in other countries.

• Continuation of current deficits and interest rates for another 5 years would lead to:
—A $3 trillion debt and
—Interest payments of nearly $200 billion each year.

There Are Alternatives

—Balance the budget by raising taxes and reducing government expenditures other than interest on the debt.
—Run a surplus by tightening our belts to the point that some of the federal debt is paid off.
—Let the economy inflate even faster than the present 4 percent per year. If accomplished, debt would be serviced with lower-valued dollars.
—Continue current policies and let interest payments on the debt overwhelm tax availabilities and preclude other government expenditures.