JOINT ECONOMIC COMMITTEE

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Economic Update

Chairman Robert F. Bennett

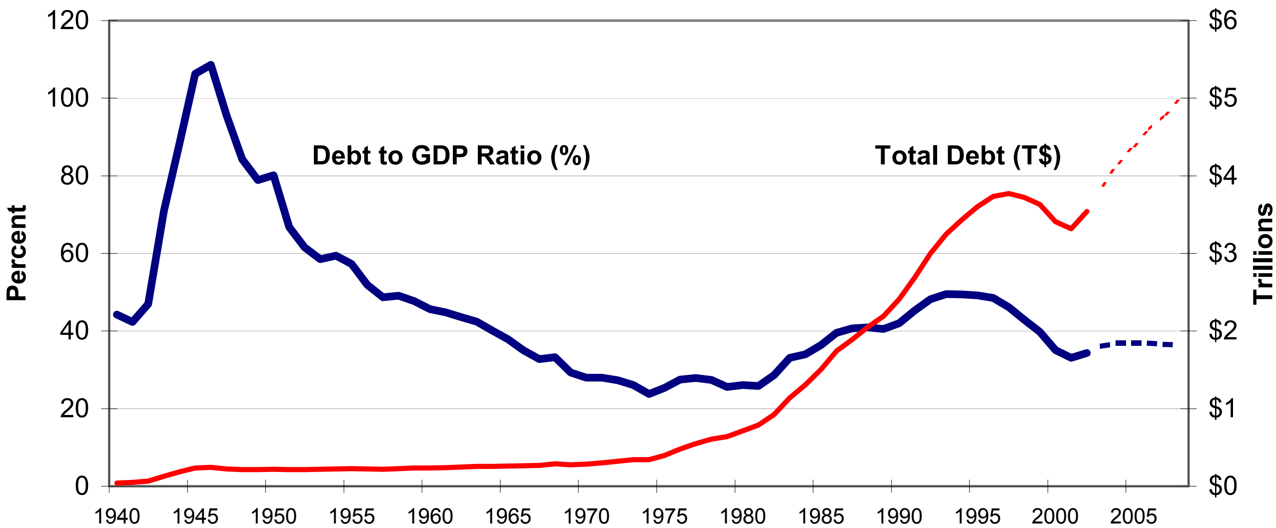
THE PRESIDENT'S BUDGET AND THE FEDERAL DEBT

The President's budget forecasts deficits and increasing public debt over the next several years. In 2003, for example, the federal deficit is predicted to be $304 billion; as a result, the publicly held debt will increase to $3.9 trillion.

Citing these figures, some commentators have expressed concern about the "record" deficits and debt in the President's budget. The deficits and debt are at record amounts in nominal terms (i.e., in current dollars), but this is not an economically meaningful way to characterize them. Because of inflation and the real growth of the economy, a more meaningful way to compare deficits and debt across years is to measure them relative to the size of the economy.

The following chart illustrates the importance of this distinction:

Publicly Held Debt: Total and as a Fraction of GDP



Source: Office of Management and Budget.

The chart focuses on the publicly held debt, rather than the total debt, because the total debt includes debts the government owes to itself (e.g., in the Social Security trust fund). The publicly held debt is a better measure of how government borrowing affects the economy.

The chart illustrates that the debt to GDP ratio will be little changed under the President's plan, despite increases in the nominal amount of debt. The publicly held debt continues to be moderate by historical standards. Future growth in the outstanding debt should be substantially offset by growth in the economy. If the economy grows faster than the Administration forecasts, the debt to GDP ratio may decline significantly.