

# *Of Wolves, Termites, and Pussycats*

## *Or, Why We Should Worry About the Budget Deficit*

*Charles L. Schultze*

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**F**or more than six years now the nation has been unable to muster the political consensus needed to deal decisively with the immense federal budget deficit. One of the reasons is that the public and the Congress are faced with three quite different and conflicting views about the economic consequences of persistent large deficits.

One view often heard on Wall Street, in international financial circles, and among some economists is that continued failure to reduce the U.S. budget deficit threatens to cause an economic crisis, characterized by a plummeting overseas value of the dollar, soaring interest rates, and a severe recession exacerbated by financial disturbances.

In marked contrast, several prominent economists and public opinion makers have recently been arguing that the problem of the budget deficit has been vastly overstated and that excessive concern about it is getting in the way of addressing more serious economic and social problems. Here the left of center finds common ground with the supply-siders of the far right. Robert Eisner, Robert Heilbroner, and the left wing of the Democratic party join Jack Kemp, Arthur Laffer, and other supply-siders. Although they come from different analytic and ideologic backgrounds, they all arrive at a common set of conclusions

deemphasizing the importance of the deficit.

Still a third viewpoint, shared by the majority of economists who have addressed the problem, and among whom I find myself, holds that the consequences of perpetuating large budget deficits will be neither explosive nor harmless. Rather, by reducing sharply the nation's already low rates of saving and investment, the deficits will slowly and almost imperceptibly but inexorably depress the potential growth of American living standards (*projected deficit levels, box, p. 28*).

In an economic bestiary, the conventional Wall Street view of the deficit might be characterized as the wolf at the door; the second view as the domesticated pussycat; and the third as the termites in the basement.

### *Is a Crisis Coming?*

It is not at all inevitable that the maintenance of today's large budget deficits will bring on some kind of cyclical crisis. There *are* risks ahead that could be reduced if the deficits were smaller. Nevertheless, with competent management by the Federal Reserve, the United States can very probably continue to muddle through, maintaining economic stability despite high budget deficits, as it has done for the past six years. Those who worry about a crisis, however, see one coming in the form of a "dollar strike." In this scenario, foreigners, observing that budget and current account deficits remain high, suddenly lose confidence in the U.S. economy and desert the dollar in droves. The dollar's exchange value plummets, import prices soar, and

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the U.S. price level rises sharply. To prevent this one-shot rise in the price level from pushing up wages and turning into a persistent and possibly accelerating wage-price spiral, the Fed has no option but to tighten monetary policy severely, raise interest rates sharply, and put the economy through the wringer of a recession.

This chain of events, while not impossible, is also not very likely. In the years ahead downward pressure on the dollar may well continue, but a precipitous dollar collapse is not at all probable. A failure by the United States to reduce its budget deficit would set off a dollar flight only if international investors began to think that the Federal Reserve might become unwilling to stomach the higher interest rates needed to neutralize any inflationary, excess demand effects of the budget deficit.

But the Fed for the past six years has had both the will and the political freedom to do the unpleasant things needed to deal with budget deficits much larger than those now in prospect. Moreover, at an unprecedentedly early stage of the recovery from the 1982 recession, it showed its willingness to push real interest rates far above their historical norms to keep the pace of expansion within bounds. And with U.S. interest rates already well above those in West Germany and Japan, a sudden plunge in the dollar would likely be self-limiting as dollar assets began to look more and more like a good buy.

All in all, the wolf-at-the-door thesis is not likely to prove out so long as the Fed continues to pursue a credible set of noninflationary policies — a quite reasonable assumption given recent history.

### *The Collapse of National Saving*

That we may be able to muddle through, sustaining large budget deficits without a cyclical crisis, does not mean that the deficits do no harm and that we can ignore them. In addition to providing a stable prosperity today, a successful economy must also make provision for tomorrow. It ought to save a reasonable fraction of its income to invest in increasing the stock of productive capital in the hands of the nation's citizens. This accumulation of wealth will in turn contribute to the growth of national living standards.

Yet the national rate of saving and wealth has fallen substantially in recent years. And it is in this important aspect of economic performance that the high level of the federal budget deficit continues to damage the American economy.

National saving consists of two major components — private saving and government saving. A government deficit represents *dissaving*, since an equivalent amount of private saving is absorbed in financing the deficit, leaving that much less available for national investment. The U.S. *net* national saving rate has fallen dramatically, from an average of 8 percent of national income during the first three decades of the postwar period to an average of 2.6 percent in the last two years. Both elements of saving declined. The private saving rate dropped by about three percentage points, to 6.4 percent in 1987–88. And dissaving from the government budget deficit rose to more than 5 percent in 1986 before falling back to just under 4 percent (see table 1). That means that the United States has been on a

spending spree throughout the 1980s, sharply raising the proportion of its income devoted to the combination of consumption and government spending and correspondingly decreasing the fraction of income it saves for the future.

Had the United States been forced to rely only on its own saving, domestic investment would have fallen as sharply as saving did. But because the country was able to finance a major part of its spending spree by borrowing heavily from abroad, rather than by having to scale back investment here at home, net domestic investment in housing construction and business plant and equipment fell by less than two percentage points, compared with the 5½ point drop in the national saving rate. As a result more than half of America's net domestic investment is now financed, directly and indirectly, from other countries (see table 2).

Had the country adjusted to its lower private and public saving rates by radically cutting domestic investment in productive assets, the nation's productivity growth, which has already slowed, would have slowed even more, further depressing the growth of American living standards. But because we adjusted to the lower saving rate principally by borrowing from abroad, our living standards will suffer for a different reason — out of our future national income we will have to pay a continuing portion to foreign investors in the form of interest payments on the massive overseas debts we have been accumulating.

If we continue to consume this unprecedentedly large fraction of our national income — a fraction that is excessive in comparison either with our own history or with other industrial countries — the future can develop in two possible ways, neither of which is attractive. First, at today's high U.S. interest rates, foreigners might continue to find the United States an attractive place to invest some of their funds. The dollar would not fall, and the U.S. balance of payments deficit, after declining a bit more, would stabilize at a high level. The United States would continue indefi-

nitely to borrow large sums from abroad, steadily increasing the future diversion of national income to overseas interest payments, and further depressing the future path of American living standards.

The second alternative is that foreign investors, despite high U.S. interest rates, might reduce their demand for dollar investments as they perceive a growing risk to the exchange value of their dollar holdings. In that case, the flow of foreign funds into the United States would decline. And then in corresponding amount, we would have to cut back domestic investment here at home to match our own shrunken national saving. The growth of U.S. living standards would suffer, not by further diversion of national income to overseas interest payments, but by a further slowing of the growth in national investment, productivity, and real wages. Either way, so long as the country overspends by running a large budget deficit in conjunction with low private saving, the future growth of the net incomes available to American citizens and their children will be gradually, but surely, eroded.

### *Making Molehills out of Mountains*

Let me turn to the arguments which suggest that the federal budget deficit is not a serious national problem. To start with, a number of people quarrel with the way the budget deficit *or* private saving is defined. With a proper definition, so the argument goes, the national saving and budget deficit problems would be seen to be minimal.

One set of these views, generally associated with Robert Eisner of Northwestern University, comes from the left. There are four strings to Eisner's bow. First, he would adjust the budget deficit for the effect of inflation on the public debt. Because inflation reduces the real value of that debt, some part of the interest payments received by government bondholders — equal to the inflation rate times the public debt — has to be considered not as income to be consumed, but as an asset transfer needed to restore the real value of wealth and consequently to be saved. Under this view, the part of the deficit that is represented by the inflation adjustment is not income, does not increase demand for consumer goods, and does not lower the national saving rate. It should be subtracted from the deficit. If it were, the current deficit would equal 2½ percent of national income, not the 3½ percent commonly cited. By the mid-1990s the inflation-adjusted deficit would fall to about 1 percent of national income.

It may make sense to subtract the inflation adjustment when estimating the "true" size of the budget deficit, as Eisner suggests. But the whole question is irrelevant to the issue at hand. Making the inflation adjustment does not change the estimate of *national* saving one iota. If the inflation adjustment is subtracted from the deficit because it is not truly income to bondholders, than current statistics overstate not only the budget deficit but also the income and the saving of those same bondholders. The Eisner adjustment simply reallocates national saving among its components: less private saving, less government dissav-

### *The Size of Future Deficits*

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**W**ithout a major program of tax increases and spending cuts, the annual federal budget deficit is likely to remain in the neighborhood of \$140–\$150 billion for the indefinite future. This estimate is a bit more pessimistic than the forecast by the Congressional Budget Office, which projects that on a current service basis, the deficit will fall to \$120 billion by 1993 and 1994.

The budget office projection, however, does not take into account any spending increases for a whole range of projects the federal government will be under pressure to fund. My estimate makes a modest allowance for the inevitability of some increases. In a growing economy with a rising population, the government cannot hold an absolute line forever.

**Table 1. Saving in America**  
(As a percent of national income)

	1951-80	1984-86	1987-88
Private saving	9.3%	8.1%	6.4%
Government deficit	-1.3	-5.0	-3.9
National saving	8.0	3.1	2.6

Note: National income equals net national product. Surpluses in state and local social insurance funds, mainly pension funds of state and local employees, are classified as private saving.

Source: Department of Commerce, Bureau of Economic Analysis, *National Income and Product Accounts*.

**Table 2. Investment in America**  
(As a percent of national income)

	1951-80	1984-86	1987-88
National saving	8.0%	3.1%	2.6%
Net inflow of foreign funds	—	3.2	3.5
Net outflow of American funds	0.4	—	—
Domestic investment	7.6	6.2	6.1

Note: National income equals net national product. The domestic investment figure for 1987-88 contains a statistical discrepancy of 0.2 percent.

Source: Department of Commerce, Bureau of Economic Analysis, *National Income and Product Accounts*.

ing, with no net effect on national saving itself. Moreover, the inflation adjustment as a share of national income has recently been the same as it was on average between 1955 and 1980; the increase in the budget deficit since that base period, and its share of the responsibility for the decline in national saving, is just about the same whether the inflation adjustment is made or not.

Second, Eisner argues that some of the federal deficit finances the accumulation of public capital, which adds to the nation's productive wealth. On this account too the true deficit, excluding government capital formation, would be smaller than shown by the current unified budget deficit. To construct such a budget, one must not only subtract gross capital outlays from total government expenditures, but also add depreciation to other operating outlays. Excluding military weapons from the definition of productive capital, which I think is only reasonable, the federal government's net capital accumulation now runs at \$7 billion a year — hardly enough to affect the measured size of the deficit. Net investment by state and local governments is larger — \$22 billion in 1987. But that investment as a share of national income has fallen substantially since the pre-1980 period. Including such investment in the definition of national saving would magnify the size of the recent saving decline.

Third, Eisner and others say that because state and local governments are running a large surplus, the budget deficit for total government is much smaller than the deficit for the

federal government alone. In fact, state and local governments are now running a small deficit in their operating budgets. As defined in the national income accounts, their budgets include the pension funds of state and local employees, which are large surpluses. Were these same employees in the private sector, however, those surpluses would be considered as part of personal saving; it is only a freak of the national income accounting system that treats them as part of the government budget. In table 1, I have reclassified this pension fund accumulation as part of private (personal) saving. In any event, no matter whether these pension fund accumulations are classified as private or as public saving, it does not change in one whit the measure of national saving and the fact of its collapse in recent years.

A final point Eisner and others make is that a substantial reduction in the budget deficit would lead to recession, lower national income, and lower, not higher, saving. According to this view, it is unlikely that the policy mix could be shifted sufficiently toward monetary ease to offset the demand-depressing effect of fiscal restraint. That is reminiscent of Keynesian arguments from 30 to 40 years ago: "You can't push on a string with monetary policy." Whatever its validity in explaining events of the 1930s or the first postwar decade when the U.S. economy was flooded with cash, the argument is sheer nonsense in the current economic environment. If the economy were in a recession,

if monetary policy were already quite relaxed, and if interest rates were at very low levels, then further monetary ease might be unable to offset the effect of a fiscal tightening. But the economy is at or close to full employment, and real interest rates are far above historical norms, conditions under which the old Keynesian fears of the inefficacy of monetary policy to stimulate demand are groundless.

There is indeed a practical limit to the speed at which monetary policy can effectively offset a shift in fiscal policy. The budget deficit ought to be eliminated not all at once but over a number of years. But I lose little sleep worrying that Congress and the president will suddenly agree on an excessively rapid reduction in the budget deficit — it is, to borrow a phrase from Senator Daniel Patrick Moynihan, forty-fifth on my list of fears, following right after my fear of being eaten alive by piranhas.

### *The Bradford Thesis*

In a recent paper David Bradford of Princeton raises another major objection to the analysis underlying the standard observation that the national saving rate has fallen sharply. According to the usual definition, saving is that part of the national output (or income — the two are the same) that is *not* consumed by individuals and government. It is what is available each year to invest in additions to the nation's stock of productive assets — principally residential housing, business plant and equipment, and investment abroad. Bradford argues that this definition is wrong. National saving, he believes, should be defined as the change in the inflation-adjusted market value of the nation's assets. It should therefore count not only annual additions to the stock of assets but also changes in their value, including realized and unrealized capital gains.

His definition paints a very different picture of the recent behavior of the national saving rate. Measured as the change in the real market value of the nation's assets, net national saving averaged 11 percent of national income in the three decades from 1951 through 1980. It also averaged 11 percent in 1985–87. (As might be expected however, annual fluctuations in the saving rate, so defined, were huge; the average annual change in the saving rate was 15 percent of national income, and in several years the saving rate rose or fell by 30 percentage points!)

After all, says Bradford, it is the present value of the stream of future income from wealth that counts. If, for any reason, the market puts an increased value on a given set of assets, that real capital gain represents a legitimate increase in national wealth just as much as an increase in the physical volume of assets does — it presumably represents an increase in the current value of the future stream of national income expected to flow from those assets. The existing cost-based measure of national saving and wealth is therefore inappropriate, either for use in investigating private saving behavior or as a measure of national saving performance.

For purposes of understanding the consumption and saving behavior of individuals, changes in the market value

of their wealth, including capital gains, may be quite relevant. But the aggregate change in the market value of individuals' wealth is not at all a relevant measure of national saving performance.

We are interested in the volume of national saving, and the investment in productive assets that it makes possible, because additions to those assets contribute to future national income and production. But future national income can also change for reasons that have nothing to do with the volume of saving — for example, the future pace of scientific and technological advance may speed up or slow down, or the overseas price of oil may surge or collapse. To some extent expectations about such future developments can affect the current price of corporate stocks, increase or decrease the market value of corporate assets, and so affect the measure of national saving as defined by Bradford. But such developments, however much they affect future national income, have nothing to do with the contribution of current saving and investment to future national income, and hence the capital gains or losses on existing assets these developments generate do not belong in the measure used to evaluate the nation's saving and investment performance.

An even more important objection to the Bradford measure of saving is that the sum of changes in the market value of business enterprises and real estate may have little to do with changes in national productive wealth. Several examples help make this point clear. Legal limits on the supply of taxicabs in New York City, through restrictions on the number of cab medallions, have increased the financial value of those medallions tremendously and thus the wealth of the individuals or businesses who own them. If entry into the taxi business were made free, the financial value of the medallions would collapse, but national wealth would not have fallen; indeed, the future national income would rise. Or, assume a sudden and well-forecasted halt to all new innovations in the United States. The future obsolescence of the existing stock of tangible capital assets would fall to zero, and stock prices of firms owning those assets would soar, but future national production would decline.

To take another case, imagine a sudden large increase in population. Urban land values would skyrocket, even as the disamenities of urban living would increase sharply. This change in market value surely would not mean that the nation had added to its saving, its investment, and its productive wealth. As a final example, suppose that a law were passed prohibiting new entry into any existing line of business. The market value of existing firms would sharply increase, but clearly national wealth would not.

In short, changes in the aggregate of the market value of existing firms and residential real estate often tell little about changes in national wealth. Rather, the proper measure for assessing the nation's saving performance is the definition of national saving used in the Commerce Department's national income accounts — namely, the difference between national income and consumption (by government and bondholders), which, in turn, is equal to the increase in the physical volume of productive assets.

## *The Barro Hypothesis*

Let me turn to a quite different set of arguments that suggest the budget deficit is not a big problem, even from the standpoint of national saving and investment. Represented here are a wide variety of subcategories of different schools of thought. First is the argument put forward by Robert Barro of Harvard, which has some adherents among academic economists. According to this view, infinitely farsighted, ultrarational, and highly beneficent consumers and taxpayers save to achieve long-term, generation-spanning wealth objectives for themselves and their children. Any increases in their immediate disposable income, from a deficit-creating tax cut or transfer payment, are perceived to imply equally large tax increases (plus interest on accumulated debt) to be paid in the future either by themselves or their heirs. They will, therefore, save all of the current increase in income, putting it aside to pay for the future tax increases, to preserve their long-term wealth objectives.

By this reasoning, changes in the budget deficit do not affect national saving, but instead set in motion exactly offsetting movements in private saving. Thus, according to Barro, the recent fall in national saving was not caused by the large growth in the budget deficit, and a reduction in the deficit would not raise national saving.

On the surface, this view is grossly contradicted by the events of the last five years. The increase in the federal budget deficit was accompanied by a decrease, not an increase, in private saving. But the proponents of the Barro

hypothesis have argued that in the absence of the growing federal deficit, private saving would have fallen even further than it actually did. The large rise in stock prices, they say, provided stockholders with large unanticipated increases in their wealth, sharply reducing their incentive to continue saving; thus, had the budget deficit not risen, the personal saving rate would today be even lower than it is.

Douglas Bernheim of Stanford University, in a recent paper for the National Bureau of Economic Research, summarized the theoretical underpinnings and empirical evidence for the Barro hypothesis and concluded, convincingly to me, that it does not stand up. Some additional evidence also contradicts the Barro hypothesis. But let me leave this particular point for the moment and turn to another set of views which holds that the budget deficit is not an important problem.

Some people note that the budget deficit has already fallen from 5½ to 3½ percent of national income and even with no further cuts will drop to 2 or 2½ percent of national income by the mid-1990s. Moreover, they argue, favorable demographic trends will soon reverse the recent decline in private saving. For a long time the country has experienced a falling proportion of adults in the high-saving age group (age 35 to 60). But that group will soon grow much larger as the baby boom ages, and personal saving will return to earlier levels. With the budget deficit declining, and personal saving likely to increase, national saving will not remain at its current low level — certainly it will not remain low enough to warrant incurring the economic costs of the tax increase that would be required to eliminate the budget deficit.

To deal with these arguments three questions must be considered. First, is the personal saving rate only temporarily low; can it be expected to rise again? Second, would a cut in the budget deficit increase national saving, or, as Barro maintains, would it simply result in smaller private saving? Third, what sort of a national saving rate should this country be aiming for, anyway?

The personal saving rate has been falling since the mid-1970s. (Personal saving constitutes about two-thirds of private saving, the remainder being contributed by retained business earnings.) To determine what factors may have been responsible for the decline in personal saving, I fit an econometric equation relating the personal saving rate to other economic developments, including those most often cited as being important saving determinants. I first fit the equation to data for the years 1956 through 1980, and then used the relationships shown there to “forecast” forward the course of personal saving over the next seven years, 1981–87. The relationships developed for the earlier period closely tracked the path of the saving rate since 1980, suggesting that the equation is a good representation of the factors determining saving and permitting me to draw the following conclusions.

— An increase in the budget deficit does raise personal saving and vice versa, but only temporarily. It takes time for taxpayers to adjust their consumption when tax cuts or increased transfer payments raise their income. Very

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soon, though, personal saving returns to its old level. Contrary to Barro's hypothesis, only an insignificant fraction of a permanent increase in the budget deficit is offset by an increase in personal saving.

- A rise in the value of stock prices (adjusted for inflation) does reduce the personal saving rate. About 1 percentage point of the 3¼ percentage point drop in the personal saving rate since 1982 can be attributed to the rise in stock prices since then.
- Changes in the proportion of the population in different age groups do not appear to have been significant factors in changing the personal saving rate. The proportion of high-saving age groups in the population declined steadily from the mid-1960s to 1981, while the personal saving rate rose slightly and then fell. The proportion of high savers stabilized after 1981 and then began to edge up while the saving rate continued to fall sharply. (Not surprisingly, the statistic representing the population share of high savers did not explain any of the fall in personal saving.)

The stock market, the short-run effects of changes in the budget deficits, and other factors incorporated in my equation do not fully account for the drift downward in the personal saving rate after 1975. On the basis of admittedly scanty evidence, this downtrend appears to have halted around 1985. The annual rate of decline was just about the same from 1975 to 1980 as from 1980 to 1985. There are several economic theories about saving motivations which imply that a slowdown in the long-term rate of growth of per capita income will lead to a fall in the saving rate. And after 1973 the growth of per capita income in the United States did slow down. But it is impossible to determine from the data whether or not this decline in income growth is responsible for the downtrend in the personal saving rate.

## Saving Targets

In the short run the saving rate fluctuates substantially, and that fact together with uncertainty about the causes of the 1975–85 downtrend make it difficult to predict the future course of private saving. Nevertheless, at a minimum, there is no warrant to believe either that favorable demographic trends will raise the saving rate or that a large part of today's low rate is a temporary aberration that will soon disappear. Until events demonstrate otherwise, the prudent course is to assume that the personal saving rate will continue somewhere near its present level.

If both the personal and business saving rates stay at roughly their recent level, total private saving will run at about 7 percent of national income, compared with a 9¼ percent average in the 30 years before 1980. What does this projection mean, then, for setting targets for the balance in the federal budget in the 1990s?

Let me start by setting a very conservative, minimal target for national saving, namely, the rate of saving that — on its own without further reliance on overseas borrowing — would be needed to support enough investment to maintain the annual rate of productivity growth at its current level of 1 percent. The rate of growth in output per worker is determined by the pace of technological advance, the increase in workers' skills, and other similar factors, plus the amount of investment in capital goods. We have no evidence to believe that the pace of advance in technology, workers' skills, and other such factors will speed up. Given a continuation of the current rate of advance, we can calculate the specific amount of investment, and therefore the specific amount of saving, that will be needed to maintain the current rate of productivity growth.

The saving rate required in the next decade or so to

**Table 3. Projected Saving Requirements and Availability, 1989–2000**  
(As a percent of national income, with 1956–79 comparison)

Net National Saving	1989–2000	1956–79
<b>Requirements</b>		
To maintain business as usual	5.3%	7.6%
Net foreign investment	—	0.5
Additional saving needed for demographic reasons	2.5	—
<b>Total</b>	<b>7.8</b>	<b>8.1</b>
<b>Availability</b>		
Private saving	7.0	9.5
Federal budget surplus or deficit (—)	0.8	—1.3
<b>Total</b>	<b>7.8</b>	<b>8.1</b>

Note: Budget figures apply to the unified budget, which includes retirement trust funds such as Social Security, Medicare, and federal employee retirement. The total saving available in 1956–79 contains a statistical discrepancy of 0.1 percent.

support the investment necessary to achieve this "business-as-usual" objective will not be as high as the saving rate for the decades before 1980. That is so for three reasons. First, the projected growth of the labor force is lower, so the increase in the capital stock necessary to equip the new workers is less.

Second, the pace of technological advance has apparently slowed since the earlier years, so the opportunities to invest profitably in additions to the stock of capital per worker are less. Third, according to the statisticians at the Department of Commerce, the quality-adjusted prices of computers and related equipment, which now constitute a large fraction of business investment, are falling rapidly, as the speed and capability of computers steadily increase. Each average dollar of saving now buys more capital equipment than it used to, producing more investment bang per saving buck.

To maintain the rate of productivity advance at its current pace, then, net investment needs to run somewhere between 5 and 5½ percent of national income. And if the country is no longer going to rely on an inflow of foreign saving, it will have to save 5–5½ percent of its national income to finance that investment. That investment rate is much lower than the 7.6 percent of national income devoted to domestic investment during the 1956–79 period. But it is much larger than the current national saving rate of 3 percent.

Even so, the business-as-usual saving objective is not ambitious enough by a long shot, because it does not take into account the demographic crunch that will come early in the next century when the baby boomers begin to retire and the ratio of retirees to active workers rises steeply. To avoid putting a major burden on the next generation of workers, the nation's saving, investment, and income growth should be increased over and above business as usual.

The magnitude of the additional saving needed is reasonably well represented by the growing annual surplus in the nation's Social Security and other retirement trust funds. The decision, taken in 1978 and 1983, to have this generation of workers pay for a larger portion of its own Social Security retirement benefits can be translated into economic reality only if the annual surpluses in the Social Security trust funds are used to increase national saving, the stock of national wealth, and the future level of national income above what would otherwise have occurred. In practical terms, that means national saving ought to be increased above the business-as-usual level by the amount of the annual surplus in the Social Security and federal retirement trust funds.

Allowing for some increase in payroll taxes to support hospital insurance under Medicare, which is not now fully funded, those surpluses should amount to about 2½ percent of national income by the mid-1990s, which when added to the business-as-usual requirement of 5–5½ percent, gives a target national saving rate of about 8 percent. This more ambitious objective is approximately equal to the pre-1980 average.

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If the private saving rate is in the neighborhood of 7 percent, as I expect, then achieving an 8 percent national saving rate would require a government *surplus* of about 1 percent of national income, where the budget is defined to include Social Security. Without further action to raise taxes or cut government spending, however, a budget *deficit* of 2 percent of national income is likely out into the 1990s. Therefore, tax increases and government spending cuts amounting to some 3 percent of national income will be needed to achieve this conservatively defined set of national saving targets. And by the mid-1990s that will require almost \$200 billion of budgetary actions.

You might ask why not try to encourage private saving with various tax concessions and incentives. But that is a loser's game. The payoff to such schemes is small, by the estimates of all but enthusiasts, and the revenue losses involved will end up raising the budget deficit by far more than they stimulate private saving, leaving behind a net decrease in national saving.

We have no really powerful tools to raise the national saving rate to a reasonable level other than through eliminating the budget deficit and transforming it into a modest surplus. In turn, I am absolutely certain that goal cannot be accomplished without a relatively substantial tax increase. Unfortunately, neither the American people nor their political leaders yet seem willing to accept one.