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ABSTRACT:

The major problem studied in this paper is the crowding-out effect. The purpose of this paper is to determine whether the crowding-out effect is occurring in the U.S., or around the world, because of U.S. government budget deficits. If it is, the way fiscal policy is handled in this country will probably need changing. To study the problem, interest rates within and outside the U.S. are examined to see if U.S. budget deficits affect them. The paper also looks at both sides of the issue to get a better understanding of what is happening. Research studied includes both popular press items and journals. This allows conclusions to be more complete for they are based on both public opinion and mathematical models. There is one factor that limits this paper, it is the time period during which the crowding-out effect has been studied. The crowding-out effect has been hypothesized for many years, but the likelihood of its occurrence was not very high until the last decade. Therefore, the amount of research done on the crowding-out effect has been somewhat limited. Unfortunately, there are no clear-cut answers about the crowding-out effect. After researching the issue, the crowding-out effect remains as elusive as ever. The effect needs to be studied further until more definitive answers can be found. In the second part of the paper, other possible effects of deficits are studied. These effects highlight the importance of U.S. deficits as they pertain to both the U.S. and the entire world. Only time and more studies will tell if U.S. government budget deficits are helping or hurting the U.S. and the world in the long-run.
For years it has been thought that government budget deficits would lead to economic problems within the borrowing country. The fear was that the government would borrow such large amounts of capital that businesses and private citizens would be crowded out of the credit market. Today, large budget deficits are as common as death and taxes in the United States. Fortunately, the economy seems to be holding up. But, are budget deficits causing problems in the United States economy today? First, the main issue of this paper, crowding-out will be examined. Then, a few general areas of the economy will be examined in an attempt to get a better view of the overall deficit picture.

The first major area of concern with respect to budget deficits is crowding-out. Crowding-out occurs when the government borrows such large amounts of capital that businesses and individuals are crowded out of the credit market. This can be seen simply in supply and demand terms. Since there is only a limited supply of capital available for borrowing, when one entity, such as the government, takes a large portion of the available capital, businesses and individuals are forced to either pay higher rates of interest to borrow, or are forced to
abandon their investment plans for rates are simply too high. Therefore, businesses and individuals are effectively crowded-out of the credit market by the government. With that basic format as a guide, this paper looks at both domestic and international crowding-out. In the past, crowding-out was seen as an issue facing only an individual country. In today's world of rapid information flow and highly integrated capital markets it is necessary to study not only domestic, but also international crowding-out.

The first area of crowding out to be analyzed is the domestic one. There is much evidence to support and refute the crowding-out effect within the United States. The issue has long been debated and if proven true will have a major impact on U.S. fiscal policy.

Evidence on Domestic Crowding-Out

For years now, the U.S. government has spent much more money than it has collected in taxes. When the government does this, it must go to the same capital markets as everyone else does to borrow. Many people have long feared that too much government borrowing would cause a catastrophe in the United States as borrowers were crowded-out. Fortunately, many of the dire predictions never occurred, but many important things may have occurred. Norton (1990) sees one way that, "...the deficit works its evil is through its effects on investment and interest rates." When the deficit rises, if savings do not pick up, the deficit inevitably forces businesses to pay a stiffer price
through higher interest rates. Mufson and Yang (1990) argue that, "the enormity of the deficit means that businesses and homeowners who want to borrow have to compete with the federal government for funds, and that drives up interest rates."

Judis (1992) states that interest rates which were between 1 and 2 percent in past decades have remained stubbornly high today. Today, in the grips of a recession, rates remain above 4 percent. This compares to .7 percent during the 1971 recession and .5 percent during the 1976 recession. With the economic situation the way it is, it seems that long term rates should be significantly lower. Another important factor is that while short-term rates have hit a fifteen year low, long-term rates have not fallen accordingly.

This is important if you consider how short- and long-term rates are set. Short-term rates, which are influenced by the Federal Reserve, are figured first. From this, long-term rates are adjusted by adding risk premiums for such things as expected inflation, default risk, and time to maturity. Apparently, investors do not see rates staying low for long, or investors think that the economy will experience inflation or other problems that will erode capital value. Judis (1992) thinks investors are afraid of future deficits and further slowed private investment. This causes investors to demand higher returns on their investments. Apparently there is enough uncertainty out there that long-term rates are remaining significantly higher than short-term rates. Also, Judis thinks
that in the 1980's large government budget deficits caused higher interest rates by raising the demand for capital.

Business authors are not the only people who believe that deficits raise interest rates. Industry leaders do also. Lee Iacocca (1990) thinks the burden of government debt on American business is heavy, for it means higher capital costs. Computer industry executives agree, reporting that deficits make capital cost very high (Margolis 1990).

Spiro (1990) finds empirical evidence suggesting that deficits significantly affect interest rates. He claims, "that a higher government debt contributes to significantly higher interest rates." This corresponds with a study done by Cebula (1988) that found that, "the budget deficit exerts a significant positive influence on the interest rate."

Another area of evidence about domestic crowding-out deals with the relationship between savings rates and interest rates. Lerner (1992) explains that this is an important measure since the domestic savings pool underwrites all forms of debt from government, to business, to personal. Lerner finds that the ratio of debt to savings has taken off at an astounding rate:

During the 1970's, the deficit as a percentage of personal savings averaged 38 percent. It soared to 117 percent in the 1980's, topped 160 percent in 1991 and in 1992 will likely reach 225 percent.

The numbers are indeed staggering. In 1992, the deficit is two and one quarter times the amount of savings in this country.
This leads to the obvious conclusion of a shortage of domestic funds to accommodate domestic borrowing. Lerner believes that this caused interest rates to increase. Currently, long-term rates in this country are running much higher than the pace of the economy would seem to dictate. This looks to be a preview of things to come. A prolonged shortage of capital and continued high long-term interest rates.

Some examples of possible crowding-out seem to have occurred in the past. Although, none of the extreme consequences that many people predicted came true. There have been a number of studies undertaken that suggest that deficits raise interest rates in the domestic market. According to these studies, the affects have been rather mild compared to the predictions of total economic collapse that were put forth in the early 1980’s. This is not to imply that the possible affects are unimportant, but they are certainly very mild when compared to the predictions. All research seems to indicate that if crowding-out was going to happen, the 1980’s were the time for it. Fortunately, continuous budget deficits during the 1980’s did not cause a full blown domestic crowding-out. Next, opposing views of domestic crowding-out are examined.

Rejections of Domestic Crowding-Out

There are two schools of thought on this subject. The first area completely refutes the crowding-out effect. Just as there are many people who believe that crowding-out is a real phenomenon, there are also those who believe that crowding-out is
simply a misguided theory. Many economists believe that budget deficits have no relationship with things such as interest rates. The evidence they give seems to indicate that a crowding-out is not happening, and never will happen.

In support of this, Passell (1992) claims that, "...Uncle Sam’s borrowing never forced up interest rates in the 1980’s, and never forced business to cut back on investment." Another factor to consider is the government’s borrowing relative to gross national product (GNP). Mufson (1992) states that the national debt was greater than the entire annual output of the U.S. economy after World War II, today it is only 53 percent of the economy’s output. Furthermore, he believes that the U.S. can outgrow its current and past deficits. Many people think that the economy will out pace the deficit thereby limiting its effects and reducing it in relative terms. Another refutation of deficit importance is that the money is owed to ourselves. Because most of the deficit is simply owed to other Americans, it can be re-lent and redistributed throughout the economy. Hence, its effects on the economy will be negligible.

In terms of mathematical models, the domestic view of crowding-out becomes rather suspect. Many people have attempted to prove a relationship between deficits and interest rates but have failed. Many of these models attempt to develop equations that show a significant positive relationship between deficits and interest rates. DeHaan and Zelhorst (1990) have found,
"...that the conclusion that budget deficits raise interest rates is no longer valid." Furthermore, Bundt and Solocha (1990) found the relationship between interest rates and deficits or debt stocks to be insignificant or statistically negative.

A study by Thorton (1990) looked at two competing theories on deficits: the Traditional, or Keynesian view, and the more modern Ricardian equivalence. The study used scatter plots to measure the government deficit against a number of variables for 16 major countries. Among the variables measured was the interest rate. The study yielded very few conclusive results for or against either view. "The most interesting result is the lack of evidence to support the conventional view."

These results, coupled with the fact that more sophisticated empirical studies using U.S. time-series data have also failed to uncover the conventional relationships, should perhaps lead advocates of the conventional view either to rethink their position or present some evidence to support their claim.

A realization that Spiro (1990) and many of those who study the deficit/interest rate relationship are coming to is that traditional economic theory does not predict that larger budget deficits raise interest rates.

Another important issue is that of consistency. Some mathematical models show that there is a relationship between
government deficits and interest rates. During an attempt to duplicate a study, DeHaan and Zelhorst (1990) found that, "...estimation results depend upon the choice of sample period chosen and the interest rate." Furthermore, the authors chose alternative model specifications and showed that the results changed drastically. This is the only article found that tested results in this manner. Although it is the only one, it is still very significant. This reminds us that mathematical models must be able to stand up under scrutiny. It is unfair to speculate about the accuracy of other articles that were reviewed, but it is important to keep in mind that results should not be taken for granted.

No matter which body of evidence is believed, it is important to remember that the evidence of domestic crowding-out is inconclusive. Perhaps the amount of evidence is incomplete. More studies need to be conducted in this area before a conclusion on domestic crowding-out can be drawn.

Before considering the international issue, a second theory on why crowding-out was avoided will be presented. This view argues the U.S. may have avoided domestic crowding-out in the 1980's because foreign investors came to the country's rescue. Indeed, there is evidence that points to this conclusion.

Evidence on Domestic Crowding-Out Avoidance

Norton (1992) finds most of the dire deficit predictions coming in the 1980's when the Reagan Administration decided to cut taxes and increase spending to stimulate growth. But, he
thinks no crunch occurred because large amounts of foreign capital came to the U.S. to fill domestic investment demands. Most of this capital came from, "Asians, Europeans, and Latin Americans." Lerner (1992) agrees that what saved the U.S. in the 1980's was a large amount of foreign dollars coming into the country to purchase U.S. government securities.

Kuttner (1992) believes the general consensus on this issue seems to be that the U.S. was saved because world capital markets had become highly integrated in the 1980's. Therefore, although the government consumed two-thirds of domestic savings, investment remained strong because the U.S. could attract capital from other nations. Unfortunately, the author thinks to attract such capital cost U.S. businesses in the form of higher interest rates. Judis (1992) believes that rates actually came down between 1987 and 1989 because large amounts of capital from other countries were flooding the credit market. Either way, it appears that large amounts of capital were coming to the United States from other parts of the world.

The next question is, will this trend continue into the 1990's and beyond? Will other nations use the United States as their primary investment outlet? Lerner (1992) feels this is unlikely to happen because foreign investors are finding attractive opportunities in their own countries. Furthermore, there are many countries now moving towards market type economies, and some of their demands for capital will undoubtedly be met by
foreigners.

This view proposes that crowding-out was avoided in the 1980's. There is the possibility that the problem has been pushed further into the future. The U.S. may have been spared by the fact that international investors came to its rescue. In essence, this view does not reject crowding-out, it sees it as something that could have happened but did not due to fortunate timing.

It is true that capital markets are highly integrated around the world. It is also well known that foreigners lent large amounts of capital to the United States in the 1980's. This leads to the next issue. Is there the possibility that crowding-out is happening on a larger, international scale? To look at this issue, evidence on international crowding-out is presented.

Evidence on International Crowding-Out

In the international area there are again many studies and theories that show relationships between U.S. deficits and interest rates around the world. Norton's (1992) thinking is that world capital markets are highly integrated, therefore when one country gets out of hand with its fiscal policy, rates in that country do not go up much compared to other countries, instead world wide rates go up. In fact, the U.S. deficit could be contributing as much as one percent of world interest rates. This is indeed a significant contribution. Kuttner (1992) thinks rates did tend to go up in the 1980's, because the U.S. had to raise rates in order to attract capital from overseas.
Greenhouse (1992) notes that other nations think that the U.S. deficit is too large and think something needs to be done for the deficit is threatening to push up interest rates around the world. Some take this position a step further. "Economists say America's demand for foreign capital pushes up interest rates worldwide. . . ." Many people who participate in world financial markets fear the worst about U.S. deficits. Many think interest rates have risen or will rise in the future because of large U.S. government budget deficits.

Only one study showed evidence of international crowding-out. Bundt and Solocha (1990) report that in the 1980's international crowding-out between the U.S. and Canada seems to have occurred. More precisely, they found that, "... increases in the real U.S. debt stock were correlated significantly with increases in Canadian short-term interest rates." The results reflect the fact that there is a great deal of interaction between the U.S. and Canada due to their close geographic relation. According to the research, there may be a relationship between U.S. deficits and international interest rates. This would lead to the conclusion that crowding-out can happen on an international scale. Indeed there are people who think investors are already being crowded-out, or the day will come when investors will be crowded-out. However, just as there are two sides to domestic crowding-out, there are also two sides to international crowding-out.
Germany will have little or no affect on world interest rates:
In total, these new demands on the capital markets will come to $625 billion to $825 billion over the next five years, or about $125 to $170 billion annually. That’s nothing to sneeze at, but it’s far less than the $3 trillion that private companies and governments in the industrialized countries invest each year.

Furthermore, long-term interest rates are as low as they have been in years. Therefore, businesses and homeowners need not worry about being crowded-out even when the economy turns up. When looking at these numbers and reviewing what has happened in the past, it seems as though international crowding-out has not occurred, and probably will not occur for some time if ever.

Lastly, the body of evidence presented against domestic crowding-out can safely be expanded to include the international market. Surely those who believe that crowding-out is not occurring within the U.S. would also argue that it is not occurring internationally. Certainly many articles and studies refute both domestic and international crowding-out.

All this information leads one to wonder what is really happening. It would appear that a question such as crowding-out could be easily explained by some mathematical relationships or economic theories, but this is not the case. A few general conclusions can be drawn from the research, but certainly no definitive answers can be found. One factor that must be considered is the time frame starting with the Reagan years and
continuing to the present. As Norton (1992) puts it, this is when the combination of tax cuts, military build-ups and recession sent the deficit into hundred billion dollar territory. Up until this time, the U.S. had done only little experimenting with deficits. This is one of the reasons why the crowding-out effect is very difficult to analyze. Up until the last decade, fiscal policy had been greatly different. Therefore, the time to study the effect has been somewhat limited. Prior to the 1980's, crowding-out was an economic theory and many economists warned that increasing the deficit further would have catastrophic results. Fortunately, the U.S. has not experienced any of these catastrophic results.

Next, the possibility of a foreign rescue comes into play. It is easy to see that world financial markets are global and highly integrated. There is much evidence to this everyday. Therefore, there is a good possibility that the U.S. avoided a crowding-out in the 1980's because excess capital from other parts of the world filled domestic demand. It seems that U.S. capital supplies alone could not have covered the demand by borrowers in this country during the 1980's. However, it is impossible to say that the U.S. would have collapsed had the infusion of foreign capital not been there. The foreign variable coupled with the relatively short time frame make conclusions difficult to come by.

Domestic crowding-out is certainly a questionable area, but what about international? International crowding-out can not be
completely ruled out because in some cases worldwide interest rates rose in the 1980's. Just how much rates rose, how many people were crowded-out, and how much of the rate increase was caused by the U.S. deficit is uncertain at best.

There are truly many theories on the deficit and its link to crowding-out both domestically and internationally. Unfortunately, the question concerning crowding-out has no easy answer. Very few certainties can be drawn from the research done. Maybe no one has looked at all the right variables, or maybe the problem is too big with too many variables to be efficiently studied. Finally, maybe the wrong thing is being looked for. Whatever the case, it is important to keep on looking for links between deficits and interest rates and crowding-out. If it is found that deficits do cause economic problems such as crowding-out, fiscal policy will need to be altered. Hopefully someday the correct conclusions will be drawn before they are accidently stumbled upon.

Other Budget Deficit Effects

Some believe that federal budget deficits have other adverse effects in addition to crowding-out. In the last section of this paper a few of these effects are looked at. Again it is hard to find many definitive answers, but it is important to look at these different aspects of the deficit to see if it is an appropriate way to run a country.

The first situation to look at is the influence deficits have on industry within this country. Two industries that are
affected by deficits are the auto industry and the computer industry. Leaders in both of these industries think that large U.S. deficit are, "... beginning to sink America's ability to compete" (Iacocca 1990). The large deficit means higher capital cost that must be carried while businesses are trying to compete. Margolis (1990) finds Sun Microsystems Inc. chief executive in agreement, believing that the soaring deficit makes the cost of capital in the U.S. very high. Iacocca (1990) claims the real cost of capital in the U.S. is about 7 percent, in Japan it is about 3 percent. Some examples help the author show how competition is affected. If Chrysler and Toyota both undertook similar new engine development programs and spread the cost over five years, the project would cost Chrysler $500 million, and Toyota $408 million. Furthermore, if Chrysler were undertaking its $15 billion project in Japan, it could produce two additional models complete with new power plants for the same $15 billion it spends in the U.S. These examples clearly show that industry leaders think capital costs are higher in the U.S. They also believe that this puts their competitiveness in jeopardy. Furthermore, they believe that these higher capital costs are directly linked to our government's budget deficits.

A final irony Margolis (1990) finds in this situation is that creditor nations are busy buying such large amounts of U.S. government bonds that they lack the money to buy our products.

Obviously industry leaders are upset by the fact that they think they are paying higher interest rates than their
competitors. It is also obvious that they blame current U.S. fiscal policy for part of the problem. Again it is hard to prove that the deficit is causing interest rates to rise. But, it is important to get the input of American business people on this matter. It is sad to think that government overspending may be crippling if not ruining some major industries within the United States. Again, this link has not been proven to be 100 percent correct, but it raises interesting questions and shows one reason why more studies are needed in this area.

Next, some general economic and business effects are examined to get a feel for how they fit into the big picture. The areas examined will be recession, productivity, and living standards. All these factors are somewhat related, and the problems they may be causing are very important.

Currently, the U.S. finds itself in a recession. McMillion (1992) believes the economy is back to the same spot it was in the early 1980's. The problem is that the national debt is $3.1 trillion larger than it was in 1981. All these years of running budget deficit after budget deficit seem to have left us in a large fiscal mess. According to Mufson (1992), the U.S. government would normally step in and stimulate the economy, but to keep the deficit from getting worse the government has been unable to jump start the economy. Judis (1992) states that growth has been slow throughout the 1980's. "The average annual increase in GNP has declined from 3.3 percent in the 1970's to 2.85 percent in the 1980's. . . ." It appears that as budget
deficits were being run up in the 1980's, the economy was being run down. Now we are left in a situation where the economy has come to a halt and cumulative deficits are extremely large. Unfortunately, the government can not step in and help to alleviate the situation.

Norton (1991) thinks another thing that is occurring is a slowing of productivity in the U.S. Furthermore, Thorton (1990) argues that, "...deficits...'crowd out' private investment." This affects output because the tools of production are not purchased because they are too costly. Therefore, the economy suffers. Mufson and Yang (1990) believe the economy is generating little to no growth, and policy makers are finding it impossible to come up with the means to stimulate the economy.

It is thought that the big problem is that the U.S. has gone from being a nation of savers to a nation of borrowers. "The United States has gone from being the largest creditor nation to the largest debtor." Black (1991) estimates that without the dramatic turnaround from savers to borrowers, the country could have added 15 percent more plant, equipment, and machinery which would have increased GNP by 5 percent. Furthermore, the New York Fed estimates that, "the economy will lose 10 percent of GNP over the next nine years unless the savings rate picks up." Not only do the past and present seem bad, but the future does also.

Again these facts are presented without rebuttal, but many people believe they are happening. If they are, the U.S. is hurting itself economically by running budget deficits year after
year. The last general business and economic effect studied is the lowering of living standards in the U.S. Passell (1992) argues that failure to cut spending or raise taxes in this decade almost guarantees lower living standards in the next. Judis (1992) expects this decline in living standards to take the form of diminishing government services, slower economic growth, and declining real income. Greenhouse (1992) finds supporting evidence from the Organization for Economic Cooperation and Development (O.E.C.D.). The O.E.C.D. found that the major factor behind the slow growth in living standards in the United States is the large budget deficit.

Norton (1992) uses projections of the future to show how the situation may effect taxpayers of tomorrow. A new method of calculating deficit effects called generational accounting shows the unfair deal unfolding for future generations. Some numerical examples help to bring the problem into focus. For instance, a male age thirty-five will pay $195,000 more in taxes than he will receive in benefits. For a thirty year old, the difference is even higher at $201,000. Furthermore, many generations born today will face taxes that could claim up to 60 percent of their income. It appears that we are handing a financial mess to future generations. All because society had to have everything today even though it is not willing to pay for those things today. If and when future generations object to sacrificing their living standards for past excesses, it is certain that generational conflict and slashed benefits for the elderly will
ensue. If these estimates are correct, the country is headed for some rough times both financially and politically.

The reason these three effects were chosen is due to their relatedness. Certainly the economy, productivity, and living standards go hand in hand. By no means are the above effects an all inclusive list of the many possible deficit effects. Nor are they accepted as true. Many people believe that budget deficits have no links with recession, productivity, or living standards. However, these things are very important to look at because they emphasize the fact that the government does not operate in a vacuum. Government fiscal decisions have many affects on the economy aside from their intended ones. This points to the need for more study in these areas before the country is hit by unexpected, unintended deficit consequences.

The last thing to examine is the affect our deficit has on other nations. Many nations are angered by U.S. fiscal policy and think that the U.S. is spreading its economic problems to other parts of the world. This sentiment is shown in a report by Greenhouse (1992) which claims that other nations are, "...becoming a bit fed up...", with the U.S. for its continued budget deficits. The general consensus is that vast amounts of U.S. borrowing are threatening to push up interest rates around the world. Other nations certainly have the right to be upset if the think that U.S. policy is hurting them. Why should other nations pay the price for our economic excess? Members of the O.E.C.D. also think that solutions to the deficit
problem are easily found; and all that is needed is the will to implement them. The O.E.C.D thinks that tax increases are the solution since the U.S. ranks second to lowest in taxes, but has the highest budget deficit. Obviously the U.S. does not treat fiscal policy like other nations do. The government likes to spend, but does not like to pay for this spending through new taxes. Dissatisfaction from others regarding U.S. fiscal policy is understandable in light of this situation.

Another international problem is that the current U.S. recession appears to be spreading to other nations. Franklin (1991) thinks because the U.S. is the world's largest importer, domestic recession and low currency values are hurting other nations that export to/import from the U.S. "The net result is that the U.S. will export a portion of its recession overseas." The worry here is that the U.S. recession is likely to be controlled by the large debt burden in this country.

Here another link has been made between U.S. deficits and recessions. However, this time the recession is likely to be felt all around the world. Certainly no one would expect the U.S. to consider other nations first when making fiscal policy. With world financial markets the way they are, the international repercussions of any decision must be considered.

On the international front, there will undoubtedly be those who disagree about taxation, fiscal policy, and recession. Many economists would argue that the world is simply experiencing an economic slowdown that is unrelated to fiscal policy in any one
country. It is important however, to get a feel for the mood of other nations. There are three reasons why it is important. One, if these things are actually happening then they must be remedied for the good of the U.S. and the good of the world. Two, if other nations dislike U.S. policy they will probably develop a reluctance to work with the U.S. in the future. Three, the U.S. may be jeopardizing its standing as one of the greatest nations in the world.

Clearly, federal budget deficits are an elusive problem. Crowding-out, the major focus of this paper, was looked at along with a handful of other related, potentially harmful, problems. The effects studied are not all inclusive, but they give some insight into this important, unsettled issue. Certainly many other factors can be compared to deficits to see if any correlation is present. As mentioned previously, deficits have not been proven to cause crowding-out domestically, or internationally. Whether deficits are causing slowed productivity, lower living standards, or creating recessions seems possible, but is open for some dispute. Many people believe that deficits are causing these problems, but no mathematical or scientific models were found that prove a definite link between United States budget deficits and these economic problems.

The job of finding any such links is important due to the implications it will have on U.S. fiscal policy. It is important for policy makers to remember that they are in uncharted waters
and decisions that seem to be sound may come back to haunt the country. Only time and further research can prove any certain effects of budget deficits. Hopefully any negative consequences will be discovered before they are stumbled upon accidently. Until conclusive studies are made, government officials should remember that they do not truly know where continued budget deficits will leave us tomorrow.

Personal Thoughts and Conclusions

In ending this paper, here are the personal thoughts and conclusions about government deficits as viewed by this paper's author.

Any government that thinks that it can run annual budget deficits and get away with it is ignoring reality. Although government finances are different from personal finances, there is nothing stopping the government from going bankrupt. Fortunately, the U.S. is not considered bankrupt at the present time, but its occurrence seems within the realm of possibility. Furthermore, the government is setting a bad example for the citizens of this country. Certainly this was an unintended consequence, but once the government began buying everything on credit, so did the people. The nation went from a relatively conservative saving nation to a have it all, borrowing nation. Fortunately personal finance is not the same as government finance. There is a greater degree of accountability with personal finance. Currently we are seeing many people falling victim to prior excess. The major point here is that the
government is expected to set the tone in a country. Unfortunately the tone in this country is borrow and have it all today. Therefore, the first thing that is needed is a change in government philosophy which should lead to a change in personal philosophy. This change should move away from deficit financing towards budget surpluses in this country.

This leads to views on the crowding-out effect itself. As mentioned previously, government and personal financing did a complete turn around from their historical past in the 1980's. Certainly the effects of this borrowing were not inconsequential. The U.S. probably avoided disaster in the 1980's because other countries were ready and willing to loan their money to us. This ultimately raised rates not only in this country but around the world. Fortunately, rates only rose slightly, therefore, this can not be considered a full fledged crowding-out. Unfortunately, what the future holds is unknown.

In terms of capital supplies around the world, it is hard to predict if there will be enough to go around. Only time will tell if a complete international crowding-out will occur.

The other economic effects that were referred to are probably also occurring to some degree. The big reason for this goes back to the interest rate issue. Even though businesses were not completely crowded-out in the 1980's, they still felt the pressure of higher real interest rates in this country. Businesses, unlike governments must weigh the costs and benefits of programs very carefully to see if they are financially
feasible. Many businesses probably passed on projects that would have been undertaken had rates been slightly lower. Ultimately this leads to lower productivity in the economy. This slowing of business investment probably contributed to the slowdown of the economy that is currently being faced.

It will be interesting to see if the new plan currently being worked on in Congress will actually lower the deficit. As mentioned before, deficit effects are hard to see. If the Administration thinks that deficits are not harming the country, they will not work to reduce them. If they are going to get serious about the problem, they must think long-term, not a quick fix. The largest government deficits have occurred over the past 10 to 12 years. Any feasible plan will gradually phase these problems out. Then the country can start running budget surpluses to tackle the ever increasing national debt that has been accumulated in the past.

Although concrete effects of continuous annual budget deficits can not be fully proven, they will ultimately lead to disaster. What type of disaster, and its seriousness are unknown. Hopefully the situation will be remedied before anything major happens. Until the situation is either fixed or fully falls apart, the country is forced to wait not knowing what is in store for tomorrow.
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