British Think Tank Predicts Financial Catastrophe for United States

Entitled "The Government Debt Iceberg," the latest report from The Institute of Economic Affairs (IEA) in London was meant primarily for British eyes, but there's enough in there to concern Americans worried about how the United States will make good on its promises. Researched and written by Jagadeesh Gokhale, a senior fellow at the Cato Institute, the report claims that the problem facing both the U.K. and the United States is the same: making promises without making provisions to fulfill them.

If a private business made a promise to a customer to be fulfilled over time, it would book that promise as a liability and make present plans to fulfill it. Not so the government. Gokhale says that governments use "backward-looking" financials — measuring only what has already been spent in the past — with little if any regard for, and certainly no strategy to pay for, promises made to be fulfilled in the future.

At present the U.S. government owes debtors, both private and public, foreign and domestic, more than $17 trillion, an amount about equal to the entire output of the American economy in one year. Put another way, it owes more than four times the total revenues taken in by that government in one year.

But, according to Gokhale, this greatly underestimates the real unfunded liabilities of the government, by a factor of seven. Taking into account future promises, the government's debt is closer to $120 trillion.

Gokhale put the problem into perspective:

> Western governments have developed unfunded social insurance programmes where retiree benefits are paid for from the taxes of the working-age population.
>
> That means that an ageing population leads to rising expenditures that cannot be covered without increasing taxes on the young.
>
> Politicians have known about population ageing for around 50 years but [have] ignored the problems it will create.

The solutions are going to be painful. He estimates that if the federal government were all of a sudden to come to its senses and begin to do real-world accounting for the promises politicians have made over the past decades, income taxes would have to double. Conversely, in order to balance the books, those promises would need to be cut in half.

Philip Booth, IEA's program director, wrote: "We have never been in a situation like this before. It's quite possible that we will not find our way through without serious social breakdown and/or mass emigration of the most mobile and productive people."

Gokhale offers unlikely solutions. Countries can try to inflate their way out of those promises, reducing the future value of them to recipients. But, he says, "This is unlikely. Future pay-as-you-go social insurance obligations are generally price index-linked … and health care involves the provision of a set of services [that cost more over time]."

Nor is it likely that the economy can grow its way out of the burden. Economies already weakened by the Great Recession and heavily laden with regulatory demands and mandates and rules just won't be robust enough to generate sufficient additional tax revenues to pay the elderly. The impasse is predictable and probably unsurmountable. Writes Gokhale:

> In the United States, for example, entitlement programme beneficiaries who paid payroll taxes while working feel a strong moral and legal entitlement to retirement, survivor, health and other benefits….
>
> They possess growing political clout to maintain those benefits as promised.

With little chance for higher taxes to pass muster with current workers, and no chance for significant cuts in benefits likely to be acceptable to retirees, what about the iceberg that Gokhale uses as a title for his report? When will the ship of state hit it? What then?

All good questions, none of which Gokhale answers. He thinks the first step is to force the government accounting office to begin issuing realistic projections about the true state of affairs about those unfunded liabilities.

An insight into answers to some of those questions was offered by the change of heart and mind that has occurred over the last 15 years by one economic commentator of the current scene: Dr. Gary North. Back in 2000, North wrote a review of *Gray Dawn*, written by Peter G. Peterson, then chairman of the Council on Foreign Relations. In his book Peterson explored the coming wave of Baby Boomers, which was likely to overwhelm the government with claims for benefits paid for during their working years. Peterson used the same analogy — an iceberg — that Gokhale used to describe what was coming nearly 15 years ago:

> The major economies of the world are on a collision course toward a huge, as-yet-unseen iceberg: global aging.
>
> Increased longevity is a blessing but it carries with it costs and questions few countries wish to deal with.
>
> This looming demographic challenge may become the transcendent issue of the twenty-first century.

In his review of *Gray Dawn*, North said:

> The Federal Reserve System will create the money, thereby creating mass inflation, or else Congress will move up the retirement age, year by year, stiffing the geezers.
>
> The government-guaranteed retirement myth will end….
>
> I'm age 58. That's me.

Today North has changed his tune. In noting the report from IEA, North said it was just one more report signifying nothing, that ignorance and diffidence by politicians and reticence on the part of taxpayers to do anything substantial about the problem will continue into the foreseeable future. North referred to his conversation with Peterson back in 2000:

> When Pete Peterson wrote *Gray Dawn* in 1999, he talked about this attitude. He was then the chairman of the Council on Foreign Relations. He could get in to see any major politician on earth. He said that every national leader he had spoken with over the previous decade was aware of the actuarial reality that faced his or her nation. Without exception, all of them refused to go public with this information.

With little incentive to change, nothing will. Bondholders are happy to hold U.S. treasury securities, despite receiving precious little to offset the risk of bankruptcy. Credit rating agencies are happy to continue giving those securities high ratings for their low risk of default. Taxpayers grumble about paying taxes and have little interest in seeing them rise in order to "balance the books." Geezers are adamant in their claims to "their" benefits, despite many of them knowing that their contributions in past years were long spent elsewhere by the government. Administration after administration continues to offer expanded welfare programs with little thought about how to pay for them. Inflation numbers remain muted. Life goes on.

As North put it, reflecting his change in attitude towards the problem over the last 15 years:

> The IEA is simply publishing an updated version of a report it could have published in 1980, but with different numbers. Nothing will change….
>
> The IEA in five years can issue another report with new — larger — numbers.

This is precisely the attitude that will assure that nothing will be done before the ship of state hits the iceberg. We must realize that, despite the fact that national finances are already in desperate shape, we are only in the beginning stages of the retirement trend of the Baby Boomers, and they will continue to retire en masse for nearly 20 more years. Instead, politicians need to be replaced with statesmen who do see the future calamity coming and begin to change course accordingly.

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