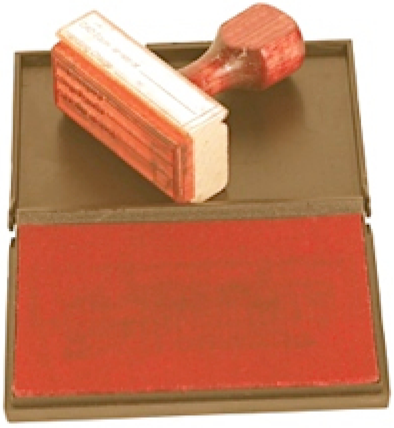
Federal Red Ink Forever



When the Congressional Budget Office's preliminary analysis of the Obama Administration's 2012 budget was announced last week, observers were shocked — shocked! — to learn that deficits over the next 10 years would be nearly $10 trillion, almost $2½ trillion more than the administration's estimate.

The CBO had to modify many of the administration's assumptions, and address at least one major error, in order to come up with its conclusion. First, the CBO assumed that the economy wouldn't rebound nearly as strongly as projected by the White House. White House budget Chief Jacob Lew wrote on his blog that the "economy will fully recover after this recession [just] as it has after previous ones. " Second, the CBO noted new revenues from some transportation programs had no source — it was pulled out of the air by the administration — and so the CBO ignored it. Thirdly, the CBO discovered that the administration had penciled in savings by further reducing payouts to doctors under Medicare without providing any details on just how that feat was going to be accomplished, and so the CBO adjusted for that "$300 billion" oversight.

But the big difference between the White House fairy tale and the CBO's analysis was interest on the national debt. If the economy doesn't "fully recover," then two things happen: revenues continue to stay flat or even decline further, and borrowing to make up the difference would increase. Says the CBO report:

> Outlays would be greater under the President's budget than in CBO's baseline in each of the next ten years, primarily because the [estimated] reduction in revenues would boost deficits and thus the costs of paying interest on the additional debt that would accumulate. In particular, net interest payments would nearly quadruple…over the 2012–2021 period…

And at some point lenders are going to want a little extra "risk premium" (read: higher interest rates) for loaning to a BBB credit risk (the United States) that the major rating agencies are still counting as AAA.

Rep. Paul Ryan (R-Wisc.) noted immediately the fatal flaw emanating from either the administration or the CBO: neither budget ever reaches “primary balance,” a nice way of saying income never equals spending: deficits forever.

The net of all of this, then, is that the national debt is likely to double from its current level of $14 trillion in just 10 years. Doing the math, then, it means that the United States would owe TWICE its gross domestic output in one year, or as the economists put it: 200 percent of GDP.

Just how likely is the economy to “recover fully” as Lew hoped? Bill Bonner is the author of *The New Empire of Debt: The Rise of an Epic Financial Crisis* and *Financial Reckoning Day: Surviving the Soft Depression of the 21st Century* and offers his views at The Daily Reckoning in an article published at LewRockwell.com, Bonner builds the case that not only is the economy not recovering, it’s in the eye of the hurricane with “winds picking up speed. It’s getting larger…stronger…It’s intensifying.”

He points out, for instance, that housing starts are running at a million less than they were before the Great Recession started. Employment is “back to levels it was at 10 years ago — with 7 million fewer jobs than in 2007!” Bonner asks: if the consumer is such an important part of the economy, how can he spend? Going back to 1973, adjusted for inflation, “the average wage is lower today — that’s almost 40 years of going nowhere. ” And then he notes that the second wave of ARM resets, recasts and defaults begins next month. Plus the cost of living is inexorably rising, putting additional pressure on the consumer.

Unless someone in Washington grows a backbone and starts getting serious about major cuts in spending, the treasury will continue to fund deficits and debt by lending. But if the time comes when lenders can’t be found, the lender of last resort is, as always, the Federal Reserve. At present, the Fed is already buying a significant part of the Treasury’s offerings, and is making noises about continuing to do so after the current program (QE2) has ended in June.

But what does that mean? It simply means what it has always meant in history: central banks only know how to do one thing, and that is to increase the money supply. That further reduces the purchasing power of each unit of currency. The final destination is always, as Voltaire put it: “Paper money eventually returns to its intrinsic value — zero.”