Written by Charles Scaliger on August 26, 2010

True Federal Debt $202 Trillion, Kotlikoff Says

Think you're scared enough about the economy, the ballooning deficit, and the prospect of ruinous tax rates and runaway inflation to pay for astronomical government debts? If you haven't read Boston University economist Laurence Kotlikoff's August 10 article for Bloomberg ("U.S. Is Bankrupt and We Don't Even Know It"), you probably aren't.

Dismissing official federal debt figures out of hand as misleading "fiscal labeling," Kotlikoff estimates that our true fiscal gap is a staggering $202 trillion — about 15 times the "official" debt level pronounced by government statisticians. The reason for this vast discrepancy is the scurrilous practice — used by the federal government to conceal real levels of indebtedness —– of declaring certain liabilities, like Social Security and Medicare payouts, as "off budget." It's as though these are not enormous sums of money that the federal government has committed to pay out over the next couple of decades as waves of Baby Boomers and Generation X-ers retire.

The federal government has behaved like an imprudent householder who, having taken out a mortgage, a car loan, and a student loan, proceeds to run up an enormous credit card debt — then declares the last "off budget" and ignores it. Just as laws, credit ratings, and debt collectors will eventually catch up with such behavior in the private sector, so too the pitiless laws of economics will eventually bring our federal government to heel.

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And the day of reckoning won't be pleasant. Kotlikoff minces no words in describing an outcome comparable to what Weimar Germany endured in the great hyperinflation of the 1920s:

> Herb Stein, chairman of the Council of Economic Advisers under U.S. President Richard Nixon, coined an oft-repeated phrase: "Something that can't go on, will stop." True enough. Uncle Sam's Ponzi scheme will stop. But it will stop too late.
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> And it will stop in a very nasty manner. The first possibility is massive benefit cuts visited on the baby boomers in retirement. The second is astronomical tax increases that leave the young with little incentive to work and save. And the third is the government simply printing vast quantities of money to cover its bills.

> Most likely we will see a combination of all three responses with dramatic increases in poverty, tax, interest rates and consumer prices. This is an awful, downhill road to follow, but it's the one we are on. And bond traders will kick us miles down our road once they wake up and realize the U.S. is in worse fiscal shape than Greece.

Simply put, the lies our government continues to tell itself and us about the debts run up over the past few decades will soon be laid bare. What Kotlikoff has labeled "Enron accounting" has enabled the federal government to perpetuate the deception whereby older generations are subsidized by younger generations. Few Americans are even aware that the so-called "Social Security trust fund" consists only of IOUs — the federal government spends Social Security "contributions" before they are even paid, just as it spends every last cent of money extracted from the collective taxpayers' hide. Government neither saves nor invests; it consumes.

One unpleasant point that Kotlikoff avoids is that there is a difference between tax rates and tax revenues. Simply put, Americans will be neither able nor willing to pay significantly higher taxes. Demands to pay higher income taxes will most likely be met with non-payment or outright revolt, which will leave the federal government only the option of printing its way out of debt. Once the rest of the world figures out that game, though, the feds will find no takers for their bonds, and the end of America as we know it will come about in a tsunami of hyperinflation.

Let us be stark about the "awful, downhill road" that America will soon follow (indeed, is already on), unless our leaders make dramatic cuts in government spending in a hurry. Attempts to raise taxes will be met with resistance. Printing money to make up the difference will follow, precipitating hyperinflation that will — as it did in Weimar Germany in the 20s and Argentina in the '70s and '80s, and as it is doing in Zimbabwe in the present day — wipe out most of America's savings. That in turn will spell the end of commerce as we know it, as banks will no longer have any reserves on which to base loans. Vast swaths of the professional classes, especially those on fixed salaries determined by contract, will be left destitute. Civil unrest will almost certainly follow, providing a pretext for a federal crackdown and perhaps dictatorship. This is precisely the chain of events experienced by pre-revolutionary France and Weimar (pre-Nazi) Germany.

As we have written previously, this problem is at root political rather than economic. Whether we solve it or not will be determined by our political will. And if we follow France, Germany, and other unhappy spendthrift nations down the dark path from bankruptcy into civil unrest and dictatorship, the clock of human progress will be set back for generations, perhaps centuries, to come.