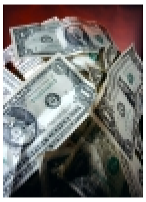
U.S. Debt Level Unsustainable, Report Says



"The debt level of the United States is unsustainable, something has to give," said the co-author of a new joint report released last week by the National Research Council and the National Academy of Public Administration. The committee that prepared the 268-page study, entitled Choosing the Nation's Fiscal Future, included three former heads of the Congressional Budget Office.

A WorldNetDaily article by Jerome Corsi, entitled "Forecast: Debt to Dwarf GDP," provided key quotes from the study as well as from Rudolph Penner, one of the former CBO heads. "The fundamental problem is that we have these three very large programs — Medicare, Medicaid and Social Security — that … are growing faster than tax revenues and faster than the economy," Penner told WorldNetDaily. This is creating an "unsustainable federal budget deficit [that continues to grow] ever onward and upward."

The current national debt is already equal to 50 percent of the country's gross domestic product, and will grow to 80 percent in less than 10 years unless something is done. The study says that "any efforts to rein in future deficits must entail either large increases in taxes to support these programs, or major restraints on their growth — or some combination of the two."

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If action is postponed "for even a few years, a large and increasing federal debt will inevitably limit the nation's future wealth [and] also increase the nation's liabilities to investors abroad, who currently hold about one-half of the federal government's debt." Not only will an increasing national debt raise the interest payments due to these debt holders, it "may contribute to a loss of international and domestic investor confidence in the nation's economy, which would, in turn, lead to even higher interest rates, lower domestic investment, and a falling dollar."

By starting now on an aggressive deficit-reduction plan, the pain of higher taxes and reduced benefits will be much less than if such a plan is delayed, the report says. Four alternatives were offered, each based not only on what Penner admits are "extremely optimistic" tax revenue assumptions, but also on political resolve to face reality. Penner expressed concern that such "political resolve to increase taxes [is] much less firm that the urge to increase entitlement programs." Another highly questionable assumption was that those foreign investors and governments would continue to provide "all the [money] we need at a constant interest rate."

However, any such plans should be delayed until after the mid-term elections, "as soon as the economic recovery strengthens," a National Research Council news release describes the report saying. In fact, the debt may be allowed to increase to 60 percent of GDP, but "any higher ratio would create an unacceptable risk of higher interest rates and financial crisis."

Testimony by Mark Zandi of Moody's Economy.com before the Financial Crisis Inquiry Commission on January 13 confirmed the report's conclusions. He said, "The nation's fiscal situation has … been severely damaged [and] the nation must now struggle with a federal debt-to-GDP ratio that cannot be sustained without serious harm to the economy's long-term growth prospects. The government will have no choice but to implement painful spending cuts and tax increases." Zandi also noted that "the financial crisis marks a significant inflection point for the U.S. economy."

According to Zandi:

> The very poor fiscal situation reflects the expected final taxpayer cost of the financial crisis and Great Recession: more than $2 trillion, or 14% of GDP. For historical context, the savings and loan crisis in the early 1990s cost taxpayers some $350 billion in today's dollars: $275 billion in direct costs and $75 billion due to the associated recession. That equaled [less than] 6% of GDP at the time….
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> Without significant changes to tax and government spending policy, the budget outlook deteriorates rapidly even after the costs associated with the financial crisis abate. This deterioration is largely due to the rising cost of entitlement programs….
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> Substantive changes to tax and spending policy have become much more urgent in the wake of the financial crisis. Unless policymakers credibly address these issues soon, a fiscal crisis is likely to result in lower stock prices, higher interest rates, a measurably weaker dollar, and seriously negative long-term implications for the U.S. economy.

Zandi concluded his remarks: "The fiscal outlook was daunting even before the crisis, and now feel overwhelming."

The most obvious place to begin would be with Social Security, according to former Commissioner of the Social Security Administration, Kenneth Apfel. He says, "Virtually all experts agree that reform will require either tax increases, reductions in … benefits, or a combination of both." Any form of privatization was not considered, "in part because [the revenues diverted to private plans] would be needed … to finance transition costs."

One reason Congress has ignored the growing crisis is the continuing willingness of foreign governments to continue to purchase U.S. Government debt which is used to finance current spending.

John Palmer, co-chairman of the Committee on the Fiscal Future of the United States, draws an analogy to "when a family takes out a mortgage it can easily afford [in order] to purchase a home. However, spending more to pay [increasing] interest on [existing] debt means that less is available for other needs, and [continuing to borrow] when there will not be sufficient income in the future to repay [the] debt is a serious problem."

Elsewhere on this site an article examined the impact defaults would have with Alt-A and Option ARM mortgage on the recovery. The analogy Palmer uses is apt. The analogy of the American consumer buying a house with a mortgage that he discovers later that he can't afford is indeed "serious." When considering, however, when it's the entire economy that discovers that it cannot continue to live beyond its means, that the impact begins to be felt.

What if the lender wants to increase the interest rate on the mortgage to offset the perceived increased credit risk? That isn't a problem with a fixed-rate mortgage, but the federal government has to refinance one-third of its outstanding debt every year, not to mention trying to find financing for the trillion-dollar deficits being created every year. What if the lender won't refinance? What if the lender wants his money back? What if the lender is China, who (in the kindest possible terms) probably doesn't have the best interests of the United States at heart? What then?

Palmer suggests that "America's debt will not be fully repaid (or [will] be repaid in greatly inflated dollars)."

He asks the rhetorical question: "Can the country grow its way out of the problem? Not likely. One reason is that labor force growth … will continue to slow as the baby-boom generation passes into retirement and is replaced … by the succeeding smaller sized cohorts." He continues:

> The Committee believes that reasonable options to prevent a crisis are still available, if action is taken soon. The steps we take should distribute the required sacrifices fairly, and give people affected by benefit changes ample notice, so they can adjust their own financial plans accordingly. No solution will be painless, but by acting sooner, we can avoid more painful steps later on.

President Obama announced plans to create a bi-partisan commission to "make recommendations to Congress on ways to reduce the federal budget deficit." The *New York Times* admitted that such a commission "would buy time for the White House and Congress, putting off decisions until after this year's midterm elections while the commission deliberates."

David Walker, head of the Peter G. Peterson Foundation, said:

> The announcement of an agreement to create a presidentially appointed fiscal commission that will report to the Congress and be assured a vote on its recommendations is a major step toward putting our nation's financial house in order while protecting our social safety net programs.

Gary North, on the other hand, calls this "kicking the can." He expressed his view of the matter by saying, "There is no turning back from the path the government has chosen for us. There is no deliverance politically. There is no way to overcome Congress's decision to spend without taxing, borrow without any hope of re-paying, keep interest rates low without inflating, and be re-elected next time."

With the recent opposition to increased government spending expressed by voters in Massachusetts, New Jersey and Virginia, and the increased influence of Tea Partiers in politics, it is too early to call it "game over." Thomas Jefferson expressed the point perfectly in 1820, when he wrote:

> I know no safe depositary of the ultimate powers of the society but the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them, but to inform their discretion by education. This is the true corrective of abuses of constitutional power.

Amen.