Revenues Grow but Spending Grows Faster — and Deficit Explodes

The nonpartisan Congressional Budget Office (CBO) has never bought the line that Trump's tax cuts would pay for themselves. Instead, it has projected that tax revenues over the next 10 years will fall $1.5 trillion short of government spending over that period.

The report from the U.S. Department of the Treasury on Tuesday confirmed the CBO's conclusion: For May, increases in tax revenues flowing from individual taxpayers were more than offset by decreases in corporate tax revenues, resulting in a budget deficit for the month of nearly $150 billion, two-thirds higher than May a year ago. For the fiscal year (starting last October) through May, tax revenues of $217 billion were overwhelmed by government spending of $363 billion, creating a fiscal-year-to-date deficit of $146 billion. On an annualized basis, total deficits for the fiscal year, which ends in September, will be awfully close to the CBO's initial projection of $804 billion.

And that's just the beginning. Skeptics such as Ed Yardeni (head of Yardeni Research and author of *Predicting the Markets*) are certain these numbers understate the problem.

First, he blames the shortfall on increases in military spending, Social Security, and Medicare. He notes that as the 76-million-strong cohort of Baby Boomers reaches retirement age, not only do they leave the workforce and reduce greatly their contribution to the great river of tax revenues flowing into the U.S. Treasury, they become "takers" from that river instead.

And that hastens the inevitable liquidation of the scant reserves those programs have built up over the years, moving their bankruptcy (absent Congressional intervention) ahead by up to five years. Yardeni is careful to point out that, as that liquidation takes place, the programs' "nonmarketable" securities that replaced FICA contributions and turned them into debt obligations will have to be redeemed by the Treasury Department using taxpayers' present dollars. To no one's surprise, the government has considered those FICA deposits as revenues to be spent and not assets to be held and preserved for the programs' participants. As Yardeni pointed out, the day of reckoning is now here, putting further pressure on the Treasury. As Yardeni explained: "The fund [Social Security's Old-Age and Survivors Insurance Trust Fund] is a scam! It has been invested entirely in so-called "intragovernmental holdings" of nonmarketable Treasury securities. In other words, the Treasury borrowed and spent all the surplus. There is nothing in the fund but IOUs from the Treasury to itself!"

Yardeni considers at least two other factors hastening the decline in those reserves, which would drive the deficits even higher than projected: more and more boomers taking early retirement as they become aware of Social Security's fragile financial condition (getting out while the getting is still good), and U.S. government bond buyers demanding a risk premium for loaning money to a government that is already more than $20 trillion in debt.

Yardeni is persuaded, however, that those bond buyers will be enticed into continuing to purchase billions more of U.S. government debt over time without demanding a risk premium partly because the government is paying higher interest rates on its bonds than other governments (i.e., Germany and Japan), And partly because they don't fret over inflation coming back any time soon. Said Yardeni: "They seem to believe that the Fed is ahead of inflation, so there is no reason to demand a big inflation premium."

As a result, Yardeni is sanguine about the future: "The bottom line is that the U.S. budget deficit doesn't matter … for now."

It's the lull before the storm. The math is inexorable: Tax revenues will, despite increases due to tax reform, never catch up to government spending. At some point, interest rate hikes currently being implemented by the Federal Reserve and the increasing pressure on the Treasury to sell more and more billions of dollars in bonds to cover the shortfalls will awaken bond buyers to the reality: The U.S. Government is going broke on the installment plan, and at some point there will be the inevitable day of reckoning.

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