Part One

OUR DEBT: AMERICAN FINANCIAL RISK HAS NEVER BEEN HIGHER

Chapter 1

The $65 Trillion Wind Blowing from Our Future

Perhaps the most alarming financial document written in American history was put on the Web for the public to see on December 14, 2005. Addressed to the president and members of the House of Representatives and Senate, the brief letter written by the comptroller general of the United States informed our leaders that every full-time worker in the country owes $375,000. This amount, which represents each worker's share of total federal government obligations, was 127 percent higher than what was owed just five years earlier, the letter explained.[1] However, it did not account for the gargantuan continuing expenses derived from Hurricane Katrina or the ongoing conflicts in Afghanistan and Iraq—wars whose ultimate costs some academics have estimated could run into the trillions.[2]

It was during this time—the federal-liabilities-doubling-in-five-years time—that the Bush administration began reporting a lower deficit (the government's yearly revenues less expenditures, not accumulating debt on the books) thanks mainly to soaring tax revenues derived from a strong economy. Ironically, it was also in these deficit declining/debt soaring times that then Treasury Secretary John Snow was forced to borrow from the federal employees' retirement fund for a few weeks as he waited for Congress to raise the government's statutory debt limit, which it dutifully did.[3] It was the fourth time the debt cap had been raised since President Bush had taken office.[4]

Is the deficit actually falling as federal debt gallops forward at the fastest pace ever ($1.5 billion per day)?* It depends on how you do the numbers. The federal debt is $9 trillion, or about six times that amount if you include the present value of all future promises our government has made (as Walker, the government's chief accountant, did for the calculation above). The White House reported a $296 billion deficit for its 2006 fiscal year, or 2.2 percent of our GDP. But using generally accepted accounting principles (the ones required of American corporations to prevent them from deceiving the public) would make the deficit almost 10 times larger—$2.4 *trillion*, or 18 percent of GDP.[5]

Even if we accept that the deficit is improving as our total national debt continues to climb, most economists believe the deficit is only taking a breather before the marathon, or as Federal Reserve Chairman Ben Bernanke suggested, it might be the "calm before the storm."[6] Beginning on January 1, 2008, an explosion of government spending was ignited by 78 million Americans. These are the men and women of the baby boom generation, born between 1946 and 1964, who are becoming pensioners and the medical beneficiaries of the proportionately declining younger generations that remain working.[7] It is to them, our future retirees, that America owes the most, a perhaps unpayable amount.

While the federal debt has just passed the mammoth $9 trillion mark, this is peanuts compared with what is owed, the payments that will need to be made to the Social Security, Medicare, and Medicaid recipients in the years that lie ahead. Though estimates vary, the total national debt,

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*See for yourself by Googling "U.S. national debt clock."

including these obligations, has been calculated to be as large as $80 trillion dollars.[8] A recent, more conservative estimate is that total government liabilities, funded and unfunded, are now $65 trillion. To put this amount into perspective, it is larger than the entire capital stock of the United States, all the land, buildings, roads, homes, automobiles, factories, bank accounts, stock certificates, and consumer durables that we possess.[9] Lawrence Kotlikoff, an economist at Boston University and researcher for the National Bureau of Economic Research, believes our debt is so large that in a study prepared for the St. Louis Federal Reserve, he openly asked the stunning question, "Is the United States bankrupt?"[10]

As government disbursements begin to skyrocket in the years to come, our leaders will in time be forced to reduce the benefits of America's old and/or raise taxes, an inevitability that even Bernanke has warned of.[11] How high would taxes have to rise? In 2002, a team of top economists, statisticians, actuaries, and fiscal analysts from the Treasury Department, the Office of Management and Budget, and the Federal Reserve estimated that taxes would have to rise a steep 69 percent to achieve "generational balance"—that is, to balance the government's future expenditures with its tax receipts.[12] By the way, this inconvenient fact was omitted from the president's 2004 budget for fear it would undermine a third proposed tax cut.[13]

Since entitlement programs like Social Security involve transferring wealth from the young to the old, it remains to be seen how willing future generations will be to pay for extravagant promises made in the past. Will the young accept an increasing tax burden when they realize that earlier generations paid proportionately much less in payroll taxes during their lives? You should expect to hear the term "generational fairness" bouncing around the media increasingly in the years to come, as some economists have pointed out.[14]

Some believe this "entitlement panic" has been blown out of proportion and that the United States is far from bankruptcy. Why? Because the government can simply break its promises to the tens of millions of Americans on the verge of retirement. Entitlement benefits like Social Security "are not a contractual government obligation in the sense that a T-bond is" and there is "no such legal right to Social Security", a *Wall Street Journal* editorial pointed out in response to the dire warnings of Kotlikoff, Comptroller General David Walker, and other economists.[15]

The dark implication is that government bond holders (like foreign investors, who today own more than half of the Treasury securities in circulation) have no need to worry. But American citizens face the possibility of being cheated by our leaders in what would become perhaps the biggest financial scam in world history: men and women of the most powerful nation that ever existed being denied promised tens of trillions of dollars. Such an outcome is unlikely, if anything because it would mean mass political suicide in Washington. There is no political wrath like that of an angry senior voter. But this just brings us back to the paying the bill problem, which will necessarily be resolved through sharply higher taxes, reduced benefits, or both.

The intensifying debate over entitlements, which should be alarming to the great many Americans who will rely on federal pension and medical support to live out their final years, makes clear that the time for tough decisions is at hand. In strong words for a man of his position, in 2007 Fed Chief Bernanke warned of a "fiscal crisis" unless the entitlement problem is addressed very soon, though it should have been dealt with "ten years ago."[16] A buoyant economy has allowed Congress and the president to continue increasing the federal debt, and very few of our leaders show concern that the $220 billion we are paying each year in interest alone is larger than expenditures on Medicaid or the combined total for all federal income-support programs.[17] However, in the next few years, as the baby boomer tsunami gains strength, the government will finally need to ask the public for deep financial sacrifices. But we have problems of our own.