

Part One

ECONOMIC FORCES

Parts One and Two of this book lay the foundation that will be used for making investment recommendations in Part Four. The budget deficit, the trade deficit, and the underlying problems of our health care, military costs, and interest costs, all combine to build the serious imbalances that will drive our future.

All of these items are so interrelated that it is almost difficult to put one before the other, but I start (in Chapter 1) with what I believe is the most fundamental—namely the federal government budget deficit. It is the budget deficits that will affect the dollar the most. Chapter 2, on the trade deficit, explains how interrelated foreign investment is to our government debt. Chapter 3 describes health care, Social Security, and the military, which are the biggest items that are causing the problems of the budget deficit. Because they are so insurmountable, you see how extremely problematic is the hand that has been dealt our leaders, and you will be able to conclude where the argument about inflation versus deflation has to go.

This is pretty heavy reading, but it will be worth your effort, because it will position your outlook for decades to come.

Chapter 1

The Budget Deficit Drives the Growth of All Debt

The goal of this book is to provide you with the tools to invest wisely and protect yourself against the mismanagement of our monetary systems by our government. Our money is produced by our government, so understanding how government deficits are the root of money creation puts you a step ahead in understanding where the value of our money is likely to go. This chapter explains how our government spends money, collects the taxes, and more important, makes up the difference by creating new money when big deficits arise.

To put this in perspective, I begin by looking at the largest aggregate of the world quantity of money as identified by the International Monetary Fund (IMF), called Total Reserves plus Gold at Market, and I compare that against industrial production in Figure 1.1. It shows how

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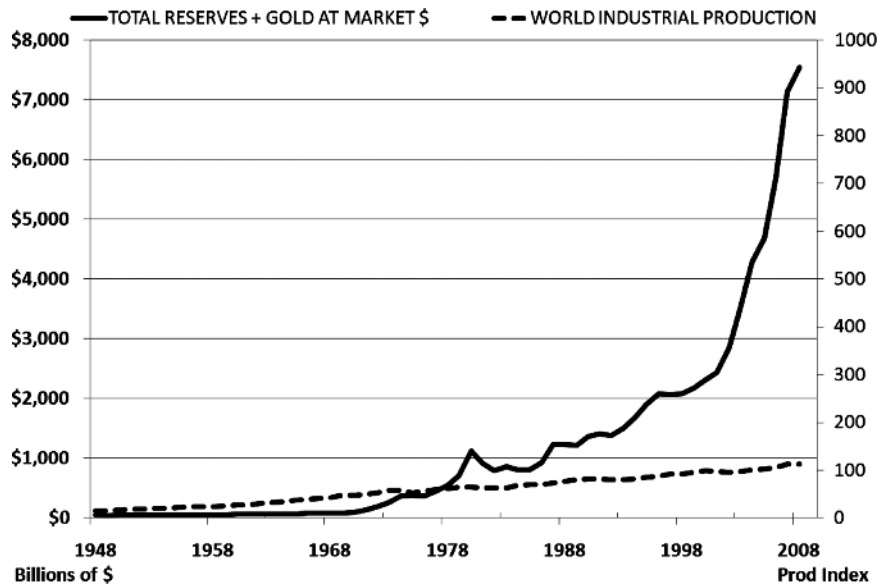


Figure 1.1 Money Has Grown Much More Than Industrial Production

the creation of paper money by all the central banks in the world has grown much more rapidly than industrial production. What that means in the long run is that the paper money will decrease in its purchasing power as the governments produce more and more paper.

Figure 1.2 shows the result of dividing the quantity of money by the amount of industrial production. If money were growing at the same rate as production, the ratio would be a straight line across the graph. It's no surprise that governments have been printing much more money than we have been producing goods, but it is informative to notice that the increase in quantity of paper money in the world dramatically increased after the United States went off the gold standard and stopped trading gold for dollars after 1971.

There was a time when money was based on a measure of gold or silver, but that is not so today. Today, money is debt. For confirmation of that, consider that the dollars held in your wallet are called Federal Reserve Notes and are officially a liability on the Fed's balance sheet.

Those Federal Reserve Notes were issued against the assets of the Fed, which until recently has mostly comprised federal government

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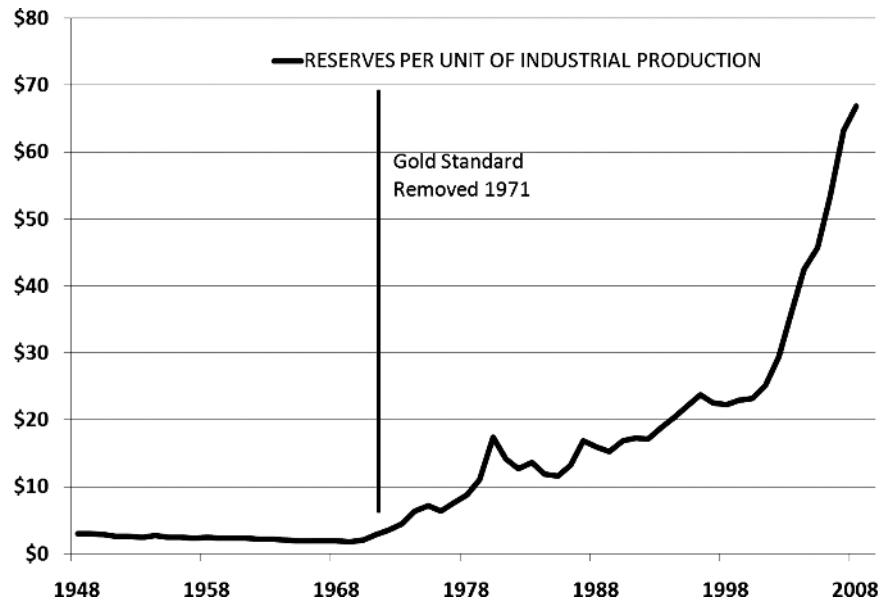


Figure 1.2 Money (World Reserves) Divided by Production Is 20 Times 1970 Level

debt—namely Treasuries and an historical artifact of a pittance of gold. Of late, much of those Treasuries have been replaced by toxic paper purchased as part of the broader bailout.

In this chapter, my purpose is to pick apart the components of U.S. government debt in such a way that by the time you're finished reading, you'll be in the top 1 percent of Americans in understanding the depth of the crisis we are now facing. I start with the debt issued by the central government because this is the central driver for creating new money. Government debt is called Treasuries, or more specifically T-bills, Treasury Notes, and Treasury Bonds, depending on the length of the term, and it is basically the result of government borrowing when it spends more than it collects in taxes.

The increase in government debt allows the increase in household and business spending, which leads to the growth in personal and international debt. It is the continual growth of our debt that has gotten us to the place of overleverage, which will now unwind with many difficulties.

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It is correct to think of government debt as the mother of all debt because it starts the whole bubble process by first creating the money and liquidity that allows the private sector to spend and get into more debt. Ultimately, it is the combined debt of the government that weighs on the intrinsic value of the currency it is denominated in.

If you find this concept a bit confusing, don't worry: These days, most people, including economists, do not have a clear idea what money really is. The lack of any clear understanding of what a dollar is (or therefore what it's worth) stacks the deck in favor of those in control of the currency. Simply, breaking away from a gold standard (or any tangible link for that matter) set the table for the world's biggest confidence game—a game that is growing bolder with each passing day.

The Budget Reflects the State of the Nation

Every year, the president and Congress go through an elaborate budget process to decide how much the government will spend and tax. The Congressional Budget Office (CBO) analyzes the president's proposal and gives its own estimate of its financial impact. Figure 1.3 shows the CBO's long-term estimates for the ratio of government debt to the size of the economy. The government's own projections show a clear trend for huge government budget deficits and ever-increasing levels of outstanding debt.

This projection into the future reflects the “alternative fiscal scenario” representing what is likely to occur if today's fiscal policies continue. This projection is based on a reasonable set of assumptions and does not include any of the many big proposals now being floated, including universal medical care and “cap-and-trade” (i.e., the U.S. government's proposal to control pollution by requiring CO₂ polluters to put a limit on their emissions—to “cap” them—in exchange for rights that they can trade in the open market).

Figure 1.4 takes a closer look at the actual deficit and how fast it has been growing, and this chart should raise alarms all by itself. As of November 2009, the difference between tax receipts and government outlays for the last 12 months was \$1.5 trillion. That is approaching four times the largest previous budget deficit.

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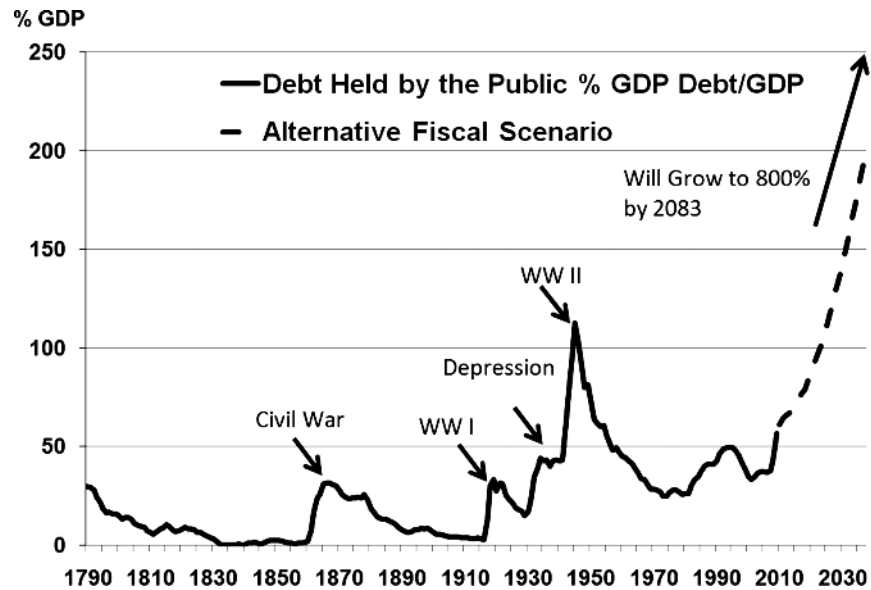


Figure 1.3 The U.S. Government Debt Will Explode over the Next Two Decades to 800% of GDP

SOURCE: Congressional Budget Office: The Long-Term Budget Outlook, June 2009.

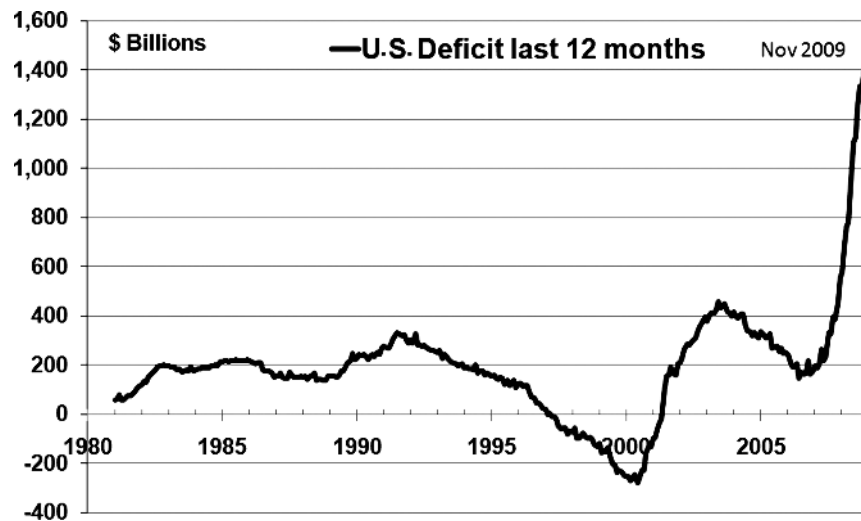


Figure 1.4 The Actual U.S. Deficit Is at a Record \$1.5 Trillion

SOURCE: U.S. Treasury.

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The deficit is the difference between spending outlays and tax receipts. The expansion of spending is the bigger cause of the deficit.

Federal Budget Spending

A breakdown of federal government spending, shown in Figure 1.5, reveals the two biggest sectors as national defense and human resources. Human resources includes Social Security and Medicare, both of which are growing dramatically. Defense has also grown with the invasions of Iraq and Afghanistan.

Taxes and the Federal Budget

Individual income taxes are the biggest source of federal government revenues, with another big contribution coming from Medicare and

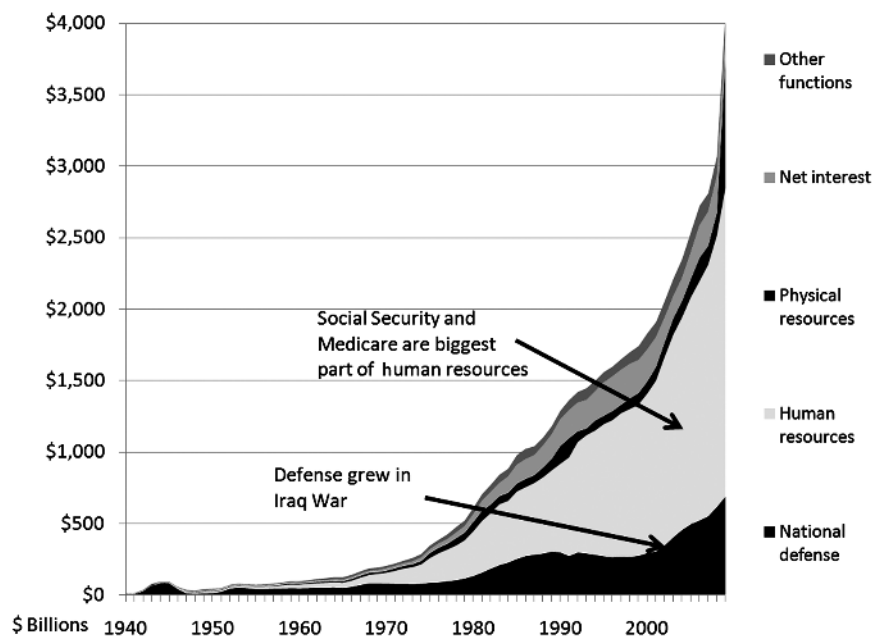


Figure 1.5 Federal Budget Spending Reaches Toward \$4 Trillion in 2009
SOURCE: Midsession Review OMB, August 2009.

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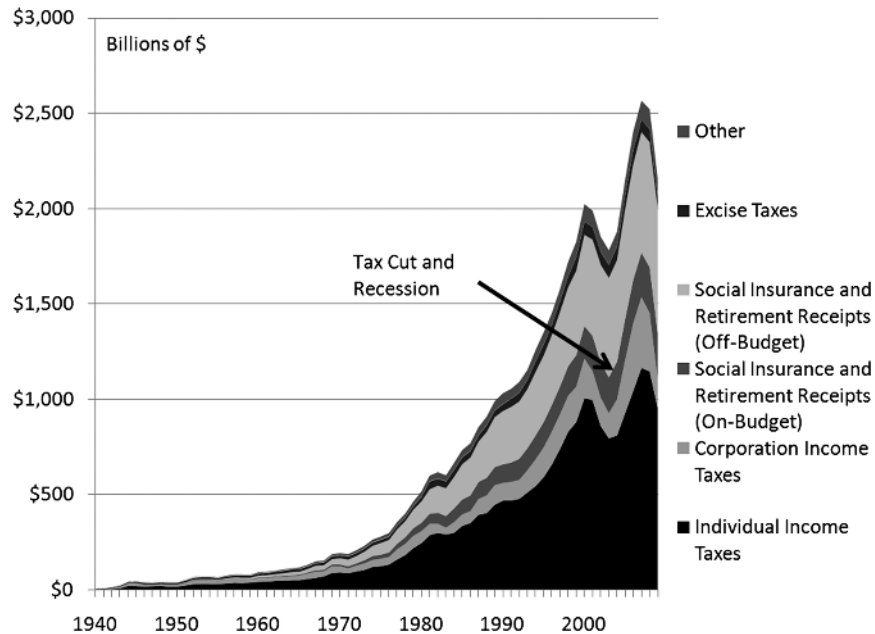


Figure 1.6 Tax Receipts Reached Only \$2.1 Trillion

SOURCE: Midsession Review OMB, August 2009.

Social Security-related taxes. Importantly, total tax revenues of \$2.2 trillion fall well short of the government's almost \$4 trillion annual budget, as shown in Figure 1.6.

For the federal government to spend more than it taxes, it has to borrow the difference. The mechanics are that the Treasury sells interest-bearing T-bills, notes, and bonds. The buyers of those Treasury instruments are in effect lending the government the money needed for current spending priorities, in exchange for a yield to be paid over time.

Federal Budget Borrowing

Figure 1.7 describes who is lending money to the U.S. government so that it can continue its large-spending programs, which are bigger than the taxes. If we understand who are the sources of the money, we can better understand whether the government can continue these huge

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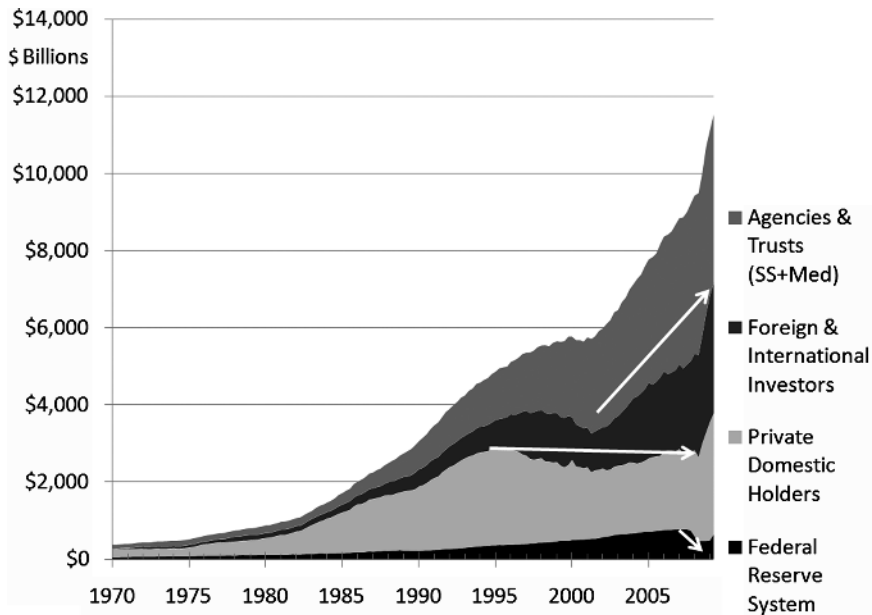


Figure 1.7 Buyers of U.S. Government Debt: Agencies and Trusts, Foreigners, Private Domestic, Fed

deficits if some of these parties can't step up to the plate, as they have in the past.

Let's take a closer look at each group shown in Figure 1.7.

- **Private Domestic Buyers:** The American public are major purchasers of Treasuries. During World War II, it was considered patriotic to buy government bonds to support the war effort. Today, these purchases are driven more by risk aversion and the desire to earn a "safe" yield.
- **Foreign and International Investors:** In the 1990s, a new dynamic emerged, as foreign and international investors became a major new purchasing force for U.S. government debt. As a result, increases in government spending were no longer reliant on U.S. households making the decision to set aside savings in order to buy Treasuries. As you can see in Figure 1.5 on federal government spending, when the government was offered cheap money in seeming endless quantities—money that originated from a

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consumption—made U.S. public and recycled through the foreign suppliers back to the Treasury—it began spending with both hands.

- **The Federal Reserve System:** The Fed is another regular buyer of U.S. government debt. Although this is traditionally small in comparison to the other sources of funding, the Fed's Treasury purchases are disproportionately important because those purchases expand the nation's money supply. It is notable that the Fed was a seller of Treasuries in 2008, a result of essentially swapping its "good" Treasuries for hundreds of billions of dollars worth of suspect mortgage-backed and other asset-backed paper from troubled financial institutions.
- **Agencies and Trusts:** Finally, Figure 1.7 shows how agencies and trusts are a large component of government debt, although this debt is materially different in that it reflects debt owed to the government itself. This category arose based on the government's contention that a reserve should be accumulated to cover the Social Security and Medicare obligations assumed for the large group of retiring baby boomers.

Agencies and Trusts Explained

To meet this demographic challenge, the necessary accounting entities were established and regulations put into place to collect the funds to build these reserves. These reserves are considered obligations of the government, owed to the government, to be tapped as necessary to provide the considerable—and eventually overwhelming—entitlements due under Social Security and Medicare.

The problem is that the funds supposedly being set aside for retirees are not there! Sure, the trust funds are there, but the money is already spent on a wide variety of programs, from defense to paying interest on the government's many debts. I repeat: *There is no money in them*. At this point, the accounting entities hold nothing more than nonmarketable securities that are correctly viewed as Treasury bills that can't be sold to anybody. The money collected for Social Security and other programs is put in the trust funds where the surplus after paying retirees' current benefits is used to buy the government debt. That is the portion of Figure 1.7 identified as Agencies and Trusts. The Social Security Trust

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surplus decreases the amount of the deficit and the amount borrowed from the public.

Ahead of the onslaught of the retirement payouts, these trusts have built up funds in excess of their immediate spending requirements. That will change as the large wave of baby boomers reach retirement and begin to draw down these accounts in earnest—at which point the government will find itself faced with yet another huge demand on funds it doesn't have.

The Total Public Debt of the government is \$12.5 trillion. Not including these Trust Funds leaves the amount of Federal Debt Held by the Public at about \$7.5 trillion. When the government runs a deficit of \$1.5 trillion, that is added to the Debt Held by the public. If the Trust Funds grow, that is added to the Total Public debt.

How Will the Deficits Be Funded?

It's clearly important to understand how the future deficits will be funded. Having just examined the primary buyers of the Treasury instruments, I can now attempt to project which of these buyers are able and likely to step up their purchases in order to provide the fuel for the government's planned ramp-up in deficit spending.

The President's Office of Management and Budget (OMB) has provided an estimate of the size of federal government debt out to 2013 (see Figure 1.8). Let's take a look at each of the four components of this chart:

- **U.S. Private Domestic Holders:** In my analysis, I assume that U.S. private domestic holders can probably increase their holdings moderately now that households are consuming less and saving more, and financial institutions have money to invest in Treasury paper.
- **Foreign and International Investors:** Important foreign holders, notably the Chinese, Japanese, Russians, and Indians (among others), have openly announced their decision to cut back on further purchases and their existing holdings of U.S. government debt. Further, the source of funds previously allocated to their purchases—trade surpluses—have fallen sharply with the recession. As a consequence,

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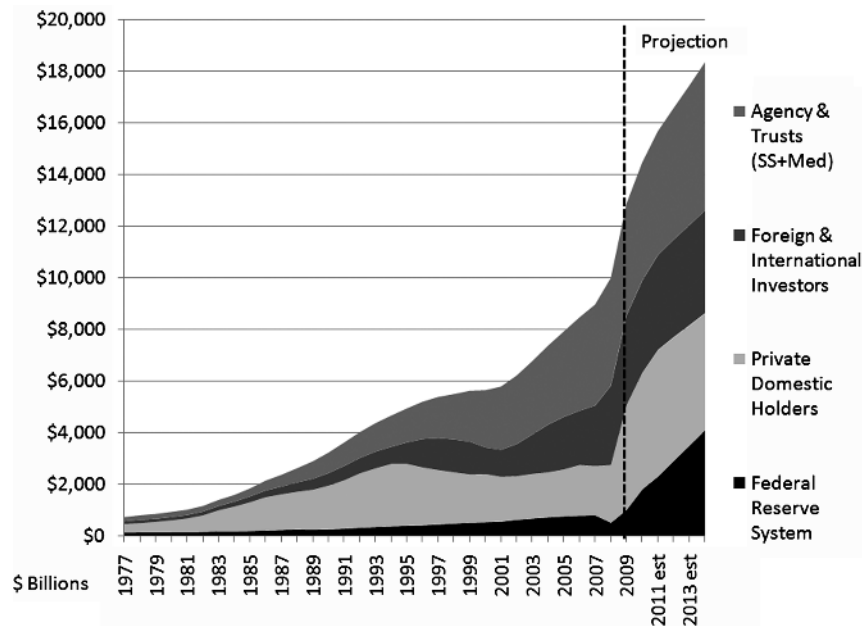


Figure 1.8 How the Total Federal Government Debt Will Grow with the Help of the Fed

SOURCE: Office of Management Budget and author's estimate of Fed portion.

going forward, foreign buying is unlikely to increase, and it will likely shrink.

- **Agency and Trusts:** These are really not a part of the equation at this point, but they reflect programs on “auto-pilot” and are quickly headed to the point where they will negatively impact the deficits, rather than helping to alleviate them.
- **The Federal Reserve:** Adding this all together (and I am being conservative in my assumptions), there are simply not enough buyers to cover the accelerating federal deficits. That leaves the lender of last resort—the Federal Reserve—as the only remaining candidate to satisfy the government’s massive funding needs. There is no viable alternative. The likely effect of that massive new money creation is reflected in projection to the right of the dashed line in Figure 1.8.

The federal government is not the only borrower in our credit markets. Typically, households and businesses (which make up the private

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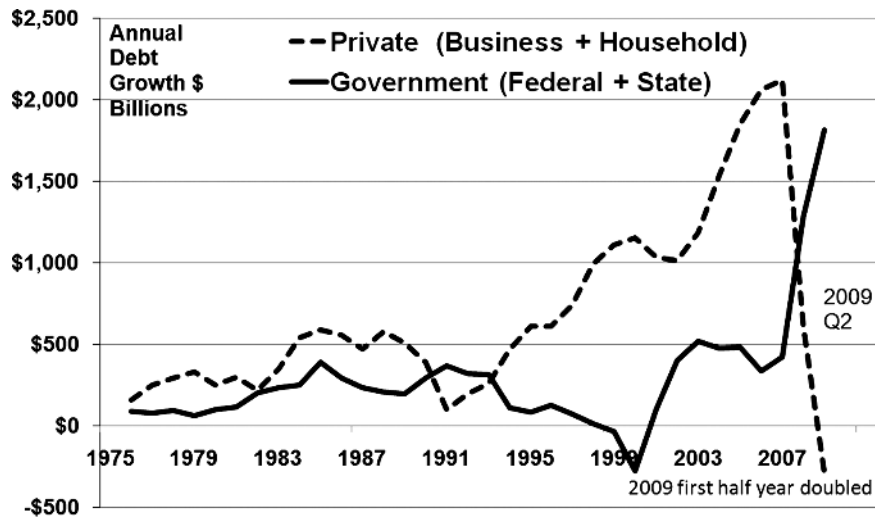


Figure 1.9 Government Borrowing Takes Over from Private Borrowing
SOURCE: Fed Reserve Z.1.

sector) borrow more than the government. But in this serious recession, borrowing by the private sector has collapsed. The largest part of private borrowing was for mortgages for housing, and we all know the many reasons for the collapse of mortgage lending. Businesses have also cut their credit demands. In a sense, this is fortunate for the federal government: As the private sector stopped borrowing from the credit markets, the federal government is able to borrow more than ever before and still able to do so at modest rates because the other demands for credit dropped so dramatically. Part of the reason that the federal deficit has been able to expand is that the private sector borrowing has collapsed in the credit crisis, as shown in Figure 1.9.

History Puts the Credit Crisis in Perspective

Using a log scale, the huge changes at the higher levels of spending and taxing are less pronounced and seem more possible, as shown in Figure 1.10. The spikes for the World Wars spending were huge. Those wars had immediate causes and a specific ending. The financial drain did not linger.

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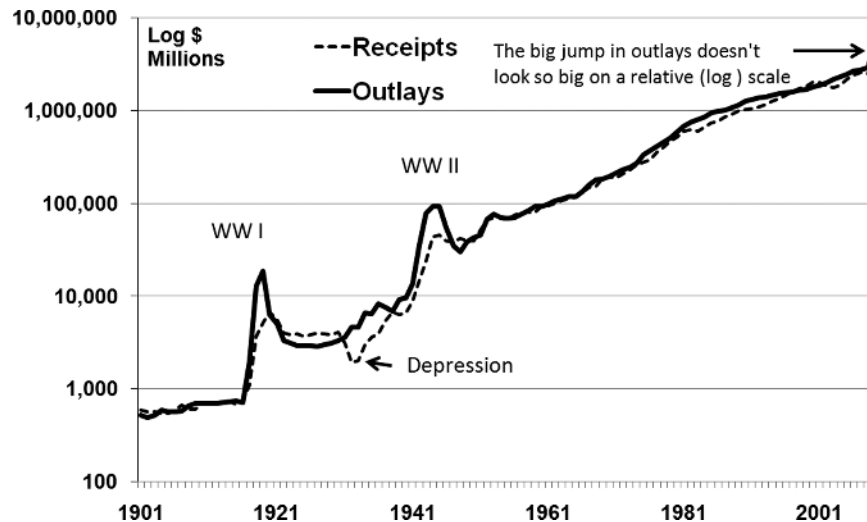


Figure 1.10 How Federal Government Spending and Taxing Increased during the Last Century

In this big picture, it is not so obvious that the receipts (taxes) dropped to half during the Depression, from around \$4 billion to \$2 billion. We are experiencing a tax receipt drop of 15 percent in 2009, but the government is not projecting anything like what happened during the Depression.

Dividing the measures by GDP gives a relative base to see just how big a \$2 trillion budget deficit is in relation to the size of the economy (see Figure 1.11).

The accumulated government deficit as a ratio to GDP jumped during the World Wars and is climbing again very rapidly. Currently, the outstanding cumulative total deficit is a mind-numbing \$12.5 trillion.

Historical Projections Have Underestimated Deficits

As unpleasant as it is to look just over the horizon at the unsupportable deficits, if history is any guide, then the level of unpleasantness is probably

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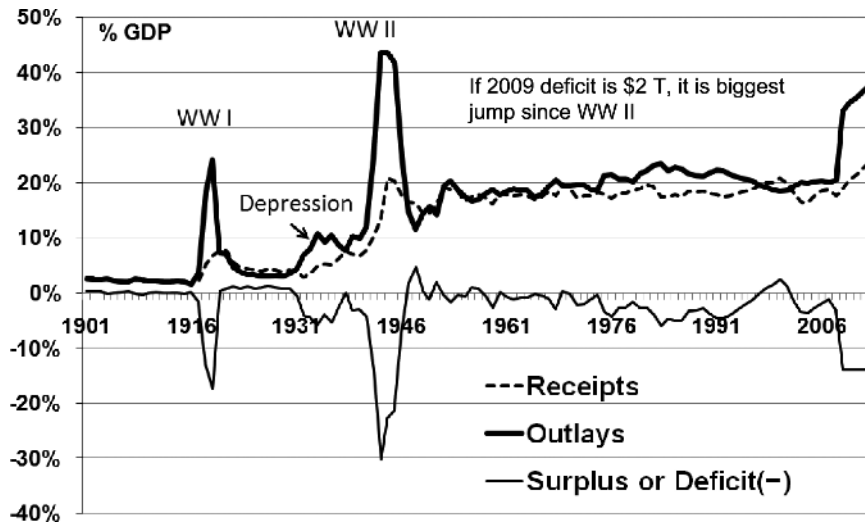


Figure 1.11 Federal Outlays and the Deficit Jumped in World Wars—Just Like They’re Doing Now

significantly understated. Supporting that point, see Figure 1.12, which shows historical deficit projections.

Figure 1.12 shows the historical projections for U.S. surpluses/deficits, year by year, starting in 2001. For example, the highest line in Figure 1.12 shows the estimate calculated in 2001 for future-year surpluses. As you can see, the forecast expected only increasing surpluses from 2001 through 2011. Stating the obvious, that projection was wildly off the mark—as were the longer-term projections developed in every subsequent year, through 2008. And in 2009, the deficit of \$1.4 trillion is a scale of deficit not remotely contemplated as recently as the 2008 projection.

With this dismal historical record, I’m extremely skeptical about the 2010 forecasts that have deficits rebounding significantly in 2011 and beyond, if for no other reason than that, absent some unforeseeable event, it’s irrational to assume that the government’s budgetary imbalances will improve as dramatically as indicated by those improving deficits. Instead, it is far more likely that the economy will remain under stress for some years to come, at the same time that new programs are implemented that *increase*, not decrease, government spending.

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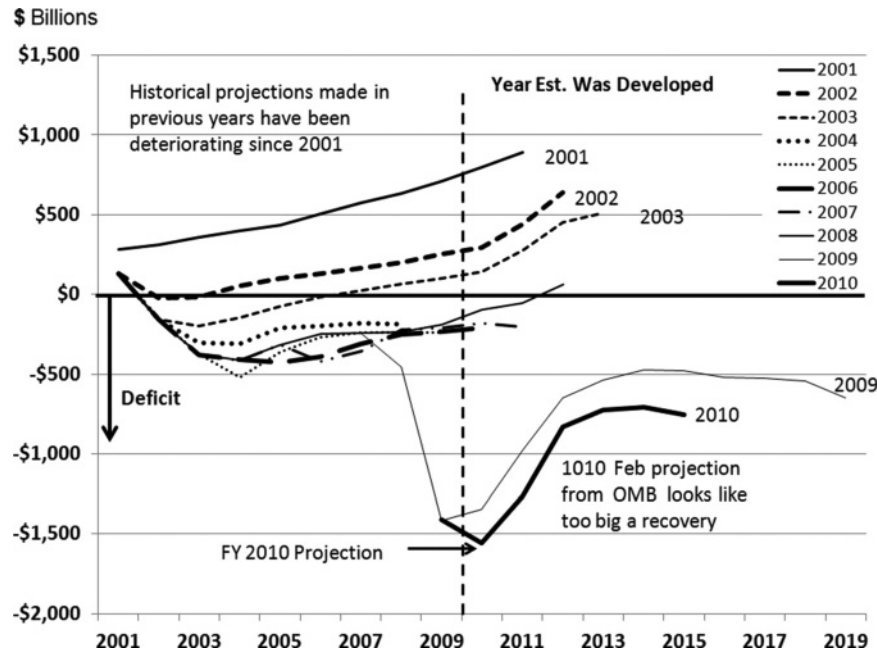


Figure 1.12 U.S. Deficit Projections Became Worse Each Year
SOURCE: CBO, OMB.

One possible savings could be a reduction in direct stimulus spending. But looking closely at the \$787 billion stimulus program passed in 2009, you can see that most of it will actually be spent in 2010 rather than in 2009. The health care programs being debated are estimated to cost a trillion dollars over the coming decade. Renewable energy, education, and new bailout programs are likely. And if interest rates jump, as I very much expect they will, the government's already massive interest costs will also jump.

My conclusion is that the actual deficits will be considerably worse than projected.

The Components of Government Spending

At the beginning of this chapter, I presented a chart prepared by the Congressional Budget Office (CBO) showing the long-term projections for federal spending, out to the year 2030 (refer back to Figure 1.3).

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Of course, any projection that far out is certain to miss the mark and therefore can't be expected to reflect how things will ultimately work out. Even so, the methodology used by the purportedly nonpartisan staff is generally considered sound, so their projections can serve as a useful starting point to understanding the components of federal spending and the intransigent nature of that spending.

Figure 1.13, which shows federal spending as a percentage of gross domestic product (GDP), is important because it shows that health care spending grows at levels that absorb too much of our overall effort as a nation.

Figure 1.13 also shows how the second-biggest component—interest on the debt—is affected by the accumulating deficit that is necessary to support the medical projections.

It's important to note that the lines on Figure 1.13 should *not* be growing over time, because they show the percentage of spending as a

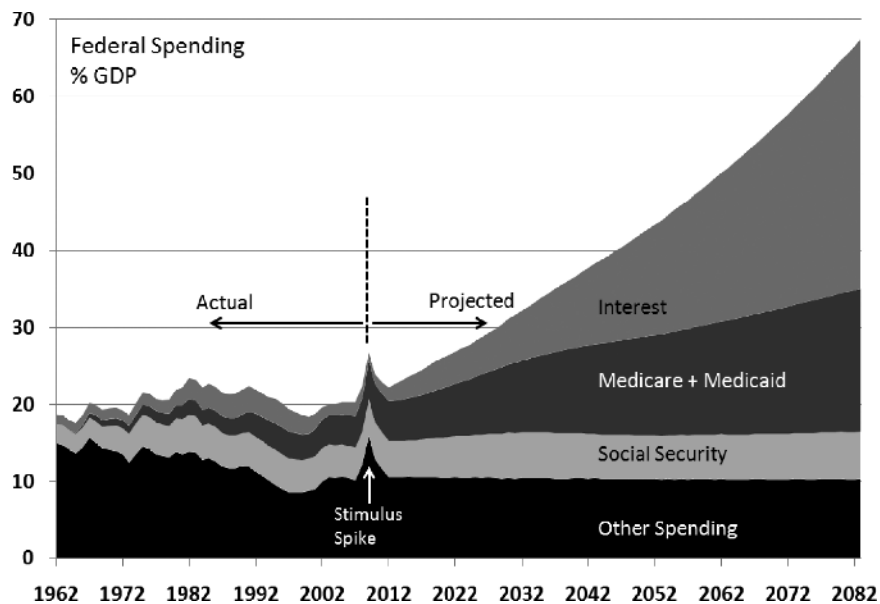


Figure 1.13 Health Care Spending and Interest on Debt Are Increasing to Levels that Our Government Can't Support

SOURCE: Congressional Budget Office, The Long-Term Budget Outlook, June 2009 Alternative Fiscal Scenario.

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fraction of the output of the country. If things were stable, all these lines should be *flat*, not increasing.

As an aside, I expect the GDP to grow more slowly than the CBO anticipates, the result being that this ratio of expense to GDP will look even less favorable.

In the longer term, the interest rate is assumed to be around 5 percent. With government deficits so large and projected to get larger, that interest rate could easily grow to 10 percent, which would mean that the current projection is far too optimistic.

In time, as credit eventually unfreezes, a resurgence in private sector borrowing will only add to the pressure for higher rates. If confidence is lost in the dollar, interest rates will rise to compensate for loss in purchasing power of the currency.

The problem with higher interest rates is the compounding effect, where interest has to be paid on funds previously borrowed to pay the interest on prior borrowing. It creates a self-destructive spiral. In fact, the scenario we are now looking at is analogous to that which historically has resulted in runaway inflation of the sort experienced in many Latin American countries over the last 40 years.

The long-term chart shown in Figure 1.13 contains the central message: There is absolutely no way government spending can increase to the point where it constitutes 70 percent of GDP.

In other words, the current trajectory just can't happen. Something very important will break well before we get there. Figure 1.13 gives me confidence in saying that government will likely be limited in its expansion by a collapsing dollar, and that many government expenditures will be less than estimated because they will be based on depreciating dollars. Furthermore, the pathway of debt and deficit will be changed by the inflation that decreases the value of outstanding debt.

Government Is Taking over More and More of Our Economy

Although many Americans (including myself) are growing tired of America's never-ending bailouts, it is important to brace yourself because there are a lot more on the way. The following sections describe a few of the bailouts we will be seeing that will add to the government problems and that haven't gotten much media coverage.

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State Government Bailouts

State budget troubles are worsening. States have already begun drawing down reserves, and the remaining reserves are not sufficient to weather a significant economic downturn. Also, many states have no reserves and never fully recovered from the fiscal crisis in the early part of the 2000s.

The vast majority of states cannot run a deficit or borrow to cover their operating expenditures. As a result, states must close budget shortfalls by either drawing on reserves, cutting expenditures, or raising taxes. These budget cuts often are more severe in the second year of a state fiscal crisis, after reserves have been largely depleted. The federal government will eventually be forced to step in and offer states some form of assistance to prevent economic collapses and humanitarian disasters. This means another bailout.

Unemployment Bailout

State-funded trusts, which pay unemployment benefits, are running out of money. The federal government has increased these funding problems through its repeated extensions of unemployment benefits, with the total run of the benefits now being extended to 99 weeks in states with over 8 percent unemployment. Because it is likely there will be more layoffs, shortfalls in unemployment funding are going to come faster and be bigger than most anyone expects. In response to these shortfalls, Congress will loan the states whatever is necessary to keep unemployment benefits coming, even if they have to print every last dollar. After propping up financial institutions and indirectly paying their executives billions of dollars, they now have (politically speaking) no choice.

The Pension Benefit Guaranty Corporation (PBGC) Bailout

PBGC is an agency established by Congress to insure participants in defined-benefit pension plans against losing their pension in the case of their employer going under. Nearly 44 million Americans in more than 29,000 private-sector plans are protected by PBGC, and some 1.3 million workers are already covered by plans that have been taken over by the agency. Although the PBGC is financed from insurance

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premiums collected from companies and the assets it assumes from failed pension plans, it is widely presumed that the federal government would bail out PBGC if it became unable to meet its obligations for retirees.

There are several reasons to expect that PBGC might need such a bailout:

1. PBGC is underfunded by \$22 billion to September 2009.
2. PBGC underfunding by sponsors with distress criteria totaled \$168 billion in 2009, up from \$47 billion in 2008.
3. The economic downturn and financial market meltdown will likely cause PBGC to take over many private pension plans, and most of these will be severely underfunded.
4. The agency's board decided to move a large share of the portfolio out of safe assets (such as Treasury bonds) and into riskier assets (such as stocks).

So depending on how underfunded the pension plans it takes over next are, and how badly its investment portfolio does, it is possible the PBGC will require a federal bailout.

Housing Bailouts

Because a recovery from our downward spiral is unlikely until the housing markets stabilize, there is a good possibility that we will see another, bigger federal housing bailout as Congress continues to try to jump-start the economy. Most commentators misunderstand the true moral hazard of bailouts. Although bailouts might have an adverse effect on the future actions of individuals and businesses by encouraging risk taking, the real problem is their effects on future actions of the government. Specifically, each bailout makes it harder to say "no" to the next bailout. This pressure to fund future bailouts is made far worse if those receiving bailout money are truly undeserving. After all, if the government is going to give \$45 billion to Citigroup (one of the banks responsible for our current mess) and insure \$306 billion of its riskiest assets, then how can it say "no" to bailing out the state of California (for example) or South Carolina?

This "me, too" phenomenon will get much worse after the treasury market collapses, and the Fed starts monetizing the treasuries that were

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sold to fund the current bailouts. If the Fed printed money to bail out the banks, why shouldn't it print *more* money to fund unemployment benefits? Politically speaking, you can't bail out the irresponsible and then let the responsible sink, which means Congress isn't going to be saying "no" to a lot of the bailout requests. Unfortunately, these bailouts will become increasingly meaningless because, when you bail out everyone, you bail out no one, as you destroy your currency.

The experiment now being conducted couldn't have been done when dollars were redeemable for gold, because there would be a collar on the expansion of debt.

The current spending to bail out the financial problems is much bigger than what was done in the Depression, and the consequences look to be a terrible drain on the rest of the economy that has to foot the bill. A relatively small group of failing banks is receiving immense sums.

The dollar can't weather this big an assault, and the foreigners that own too much U.S. government debt (that now pays essentially zero interest) are not going to like how things evolve from here. This looks like a disaster in the making, and I don't say that lightly. Monetary meltdowns have occurred too many times, in too many countries, to discount that possibility here in the United States.

How Government Debt Compares to Inflation in Other Countries

A primary reason to spend time understanding the government's massive debt, is that it can lead us to a better understanding of how big the inflation might result from the Fed's large-scale monetization of that debt.

I took data from a study of previous financial crises by Laeven and Valencia and selected those that became currency crises. Figure 1.14 compares the outstanding debt of those countries to their inflation at the inception of their crisis.

The variability is huge, but the current Debt-to-GDP of the United States puts our country right in the middle of this group of countries: around 50 percent and growing. (I'm using debt held by the public rather than total public debt to be consistent with the rest of the study. The difference is described previously in this chapter.) The United States has

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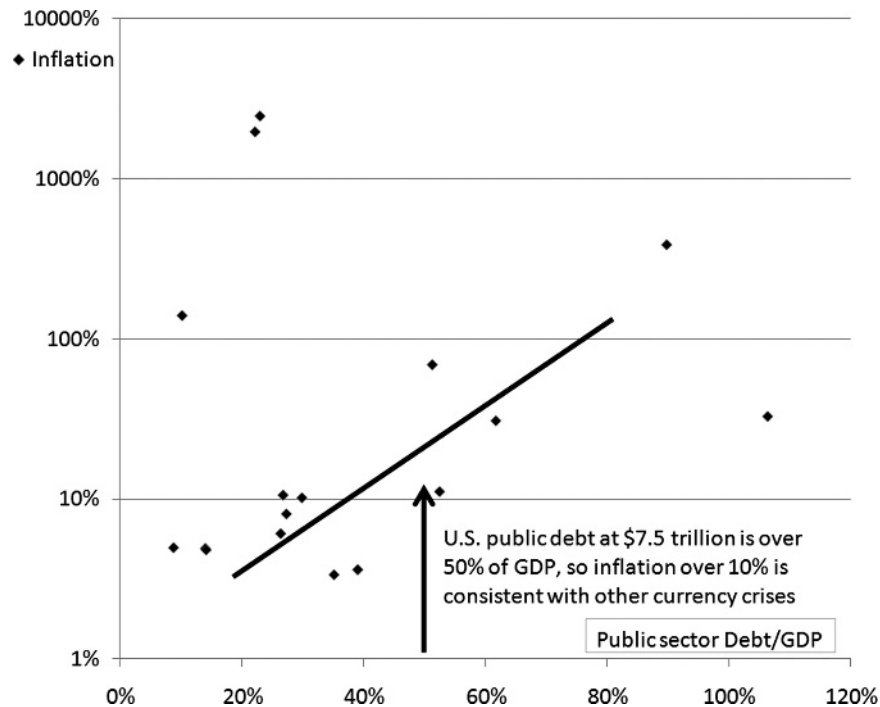


Figure 1.14 The Federal Debt/GDP Level Suggests Inflation Could Be Much Higher

SOURCE: Laeven and Valencia (2008) IMF Study.

many strengths not enjoyed by many of the crisis countries, most notably in the worldwide acceptance of the dollar as a basis for other currencies. But that particular advantage could become a double-edged sword if the U.S. dollar were to collapse and lose its international standing. Even so, the dots of the potential inflation that might follow the kind of deficit we have incurred suggest that a much higher rate, perhaps above 10 percent, would not be unusual at some distant future.

Conclusion

The purpose of this chapter has been to confirm the huge and growing federal government budget deficits, deficits that appear set to persist and to worsen until the point where the system breaks.

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The rapid rise and projected long-term budget deficit cannot be met by traditional buyers, which increases the importance of the Federal Reserve as the lender of last resort. The government and the Fed protest that this monetization won't occur, but I can see no way to avoid it—at least not without a complete turnaround in the very nature of government in this country, with a redefining of both the scale and the scope of the institution. That is a best case I will be happy to see come to pass, but it remains unlikely at this writing, and so we must prepare for the worst case.

At this point, broader measures of money have stopped growing, and the economy is flat. There are fewer borrowers, as households and business don't want to take on new debt and lending standards have become more restrictive as wary banks remain risk averse. In this environment of credit contraction, the price of assets that rely on credit (housing and autos, for example) are declining. As the economy's sluggish performance persists, profits collapse, jobs disappear, and wages remain stagnant. Industrial commodities that were overhyped by speculators and index funds fell at the start of the collapse. Thus, for the short term, there is serious global economic slowdown as bad debts are wound down and this leads to deflation. But the deficits have planted seeds of future inflation that will be difficult to manage.

What is money? Money in these United States is an abstraction, but it is an abstraction based on debt. And with steep increases in debt now in the cards, the dilutive effect on the purchasing power of the underlying currency is a certainty.

The conclusion is that the federal government is spending far more than we can afford, and the best projection from the government itself says that this deficit will continue to extremes that will hurt our currency. Even without all the details presented here, it should be obvious that government officials and their close buddies the bankers all benefit when the government creates new money for themselves, and that the taxpayer and outsiders are left with the bill. The incentives are lined up: Who wants to vote for a congressman who raises taxes? For those in power, there is everything to be gained by spending more, and little incentive to return to balanced budgets. So the system is fundamentally flawed in such a way that it is unlikely to be repaired until another serious crisis forces some action.

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As the government has created more debt, it also creates more money for spending, and some of that spending has spilled over into buying foreign goods. Our trade deficit accumulates and becomes our country's debt to the world. The next chapter explains how big our international debt has become and how that foreign debt has been recycled back to support our government domestic debt. It is important to see how these are all related and driving toward the same conclusion: monetary difficulties ahead.

