Public Daily Brief

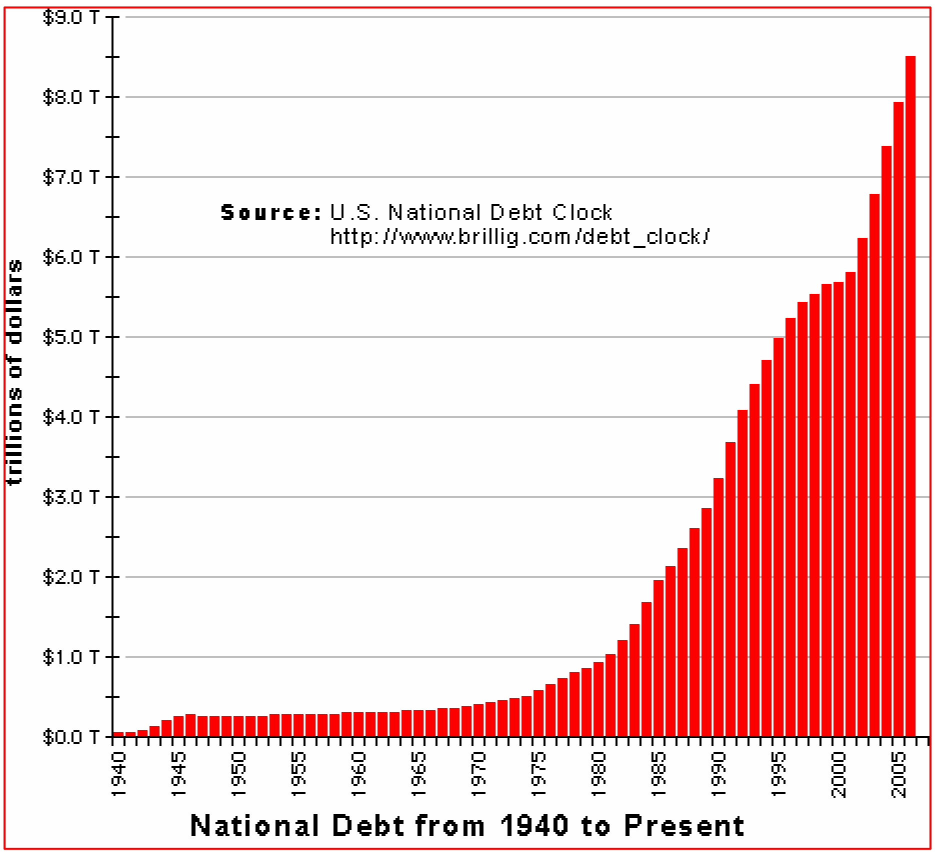
Cumulative Topical Report

POLICY: Debt

I place economy among the first and most important of republican virtues, and debt as the greatest of the dangers to be feared.

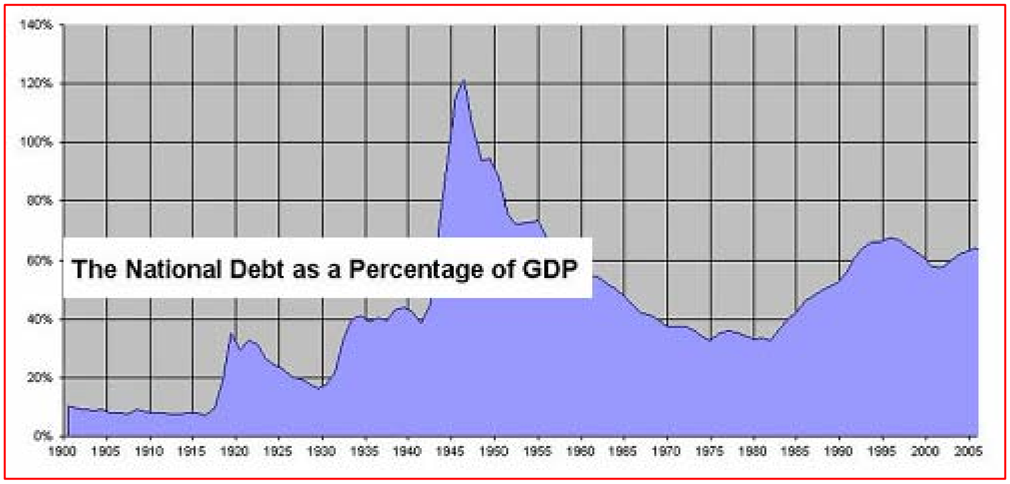
-Thomas Jefferson, 1816.

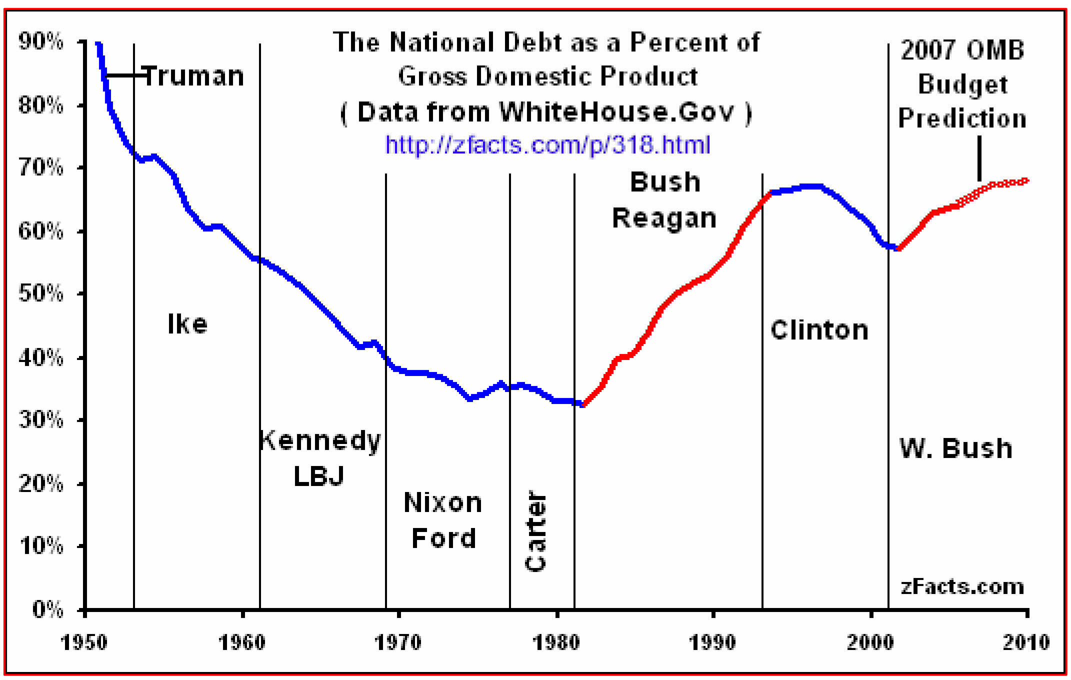
Debt is not uncommon, nor unfashionable, for the governments of developed nations but the **US** has the highest debt in absolute terms among developed nations, a debt growing more than twice as fast as the national economy. ***Borrowings*** – which is most commonly meant in reference to the ***national debt* --** are just one part of monetary quagmire-in-waiting. Given the plague of expert references to “national debt” in the media, it is a surprisingly vague term. *Borrowings*, monies needed to pay for past unfunded government expenditure, are famously at record levels in excess of $4 trillion. But debt in the form of presently unfunded commitments to federal and military pensions is also around $4 trillion, hence the familiar $8 trillion quoted as the national debt, about 65% of GDP of around $12.5 trillion. One reason this “national debt” is a compelling issue is that it has grown in absolute terms in a spectacular, almost exponential, way in the last twenty years.



Graphing *absolute dollars* conceals some nuances of *inflation-adjusted* figures but does not hide the fact that something different has been happening in the last twenty years compared to the twenty years before that. Even if US growth had been abundant in the last twenty years (which it has not) it would not account for the rate the debt has grown. Another way to consider the debt is as a proportion of GDP. These figures (1900 to 2005) show the shocks of the 1920s and 1930s and the immense costs of the *Second World War*, then a gradual decline in debt despite the ***Korean War***, the ***Space Race***, and the ***Cold War*** settling back to a “new normal” in around 1980. Displaying these figures along with the presidential terms from **Truman** to **Bush** (XLIII) shows that the most obvious event to occur when the present debt trajectory starts in 1980 is the inauguration of President **Reagan**, the small government, low-tax president.

Each of the two main polarities in US politics will read these figures in different ways. However, one observation that seems inescapable is steep increase in indebtedness occurs during the times of fervent tax cutting.





But the $8T national debt is only a portion of real and imminent government debt. Just as real as any debt in *T-bills* there is a shortfall of almost $13 trillion to fund forward ***social security*** liabilities and $30 trillion to fund forward ***Medicare*** liabilities. This money does not exist at present but is required in a trust fund or some equivalent form now if federal social support obligations are to be met. Thus, in every real sense, the “national debt” is not $4T or $8T but over $50T, four-times annual GDP and, if nothing is done, this increases by around $1T each year.

When notions of retirement, pensions, and social security for older people were cast into law in the US and many other Western nations in the 1930s and 1940s, life expectancy was about 60 men for and 66 for women. Any universal benefits ("pension") scheme was intended for the last two or three years of life. By 2000, life expectancy had increased by about 15 years. These social "safety net" schemes were also based on a demography of around 25 births per 1,000; a fresh supply of fully-employed young tax-payers that would constantly grow the tax base. Today, the US birth rate is 14 per 1,000 which, even allowing for improved infant mortality rates, will produce a smaller tax-base to support a generation of baby-boomers who refuse to die. Other nations are even worse off in this regard -- **Germany** (8 per 1,000), **Italy** (9), **Canada** (11), **Australia** (12), **China** (13).

An additional factor in this debt predicament is the now obvious fact that the world of ***the future*** will <u>not</u> be a gentle continuation of today. It is already clear – on balance of probabilities – that ***energy*** will be more expensive, that ***water*** will be more scarce and will factor into increases in almost all ***food*** costs, that a Pandora's box of expensive ***bio-remediation*** will no longer escape attention, and that the consequences of ***climate change***, although debatable in detail, are certain to have real additional costs. So human ***demography*** and reality of ***world resources*** will conspire to reduce ***productivity*** (and ***profitability***), ***disposable income*** (and ***tax revenue***) at a time when somebody will need to pay the government's debts. That situation may be desperate (but not hopeless) were the international situation to be a predictable continuum of today but there is little reason to believe that all turns in international affairs over the next 10 to 25 years will be to the economic advantage of the US.

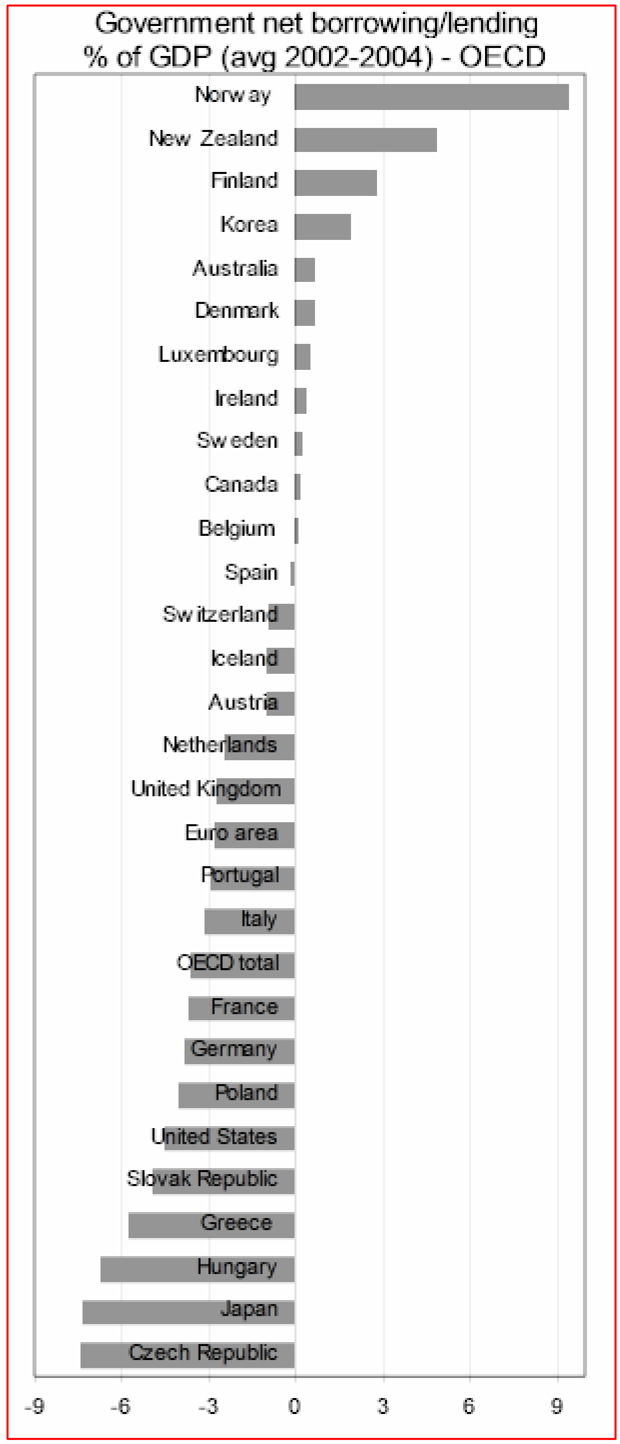
None of this discussion of the debt is theoretical. In 2008, the first wave of the 78 million "baby boomers" (born 1946 to 1964) reach 62 and qualify for early retirement ***Social Security*** options. This same first wave turns 65 in 2011 and will start to make demands on ***Medicare***. The quoted "$30T" shortfall in *Medicare* commitments is the calculated amount that should be in place <u>now</u> to meet the estimated $200T *Medicare* will need over the next 75 years (assuming existing benefits, tax rates and premiums).

These mythical* trust funds *are a financial oxymoron
— they can't be trusted and they aren't funded.
- Peter Peterson (Commerce Secretary under President Nixon)

Some economists are deeply worried about the US debt and the sudden readjustments it may precipitate in the US economy and the wider world economy. Other economists say that the US government can't go broke because it can ***print money***. Therefore government pension schemes, *Medicare* and other government liabilities can always be met. In fact, some say it is naïve to expect the government to behave like a corporation. Mere promises will not suffice for corporations which is why they are required by law to back a pension scheme with a certain amount of hard cash funds reserved for the purpose. This is because there is no guarantee a corporation will be around to honor it promises. But the United States – and similar ***sovereign*** entities – are deemed to be ***perpetual***. Failing presently unforeseen circumstances that lead to a *Second US Republic* that repudiates debts of the previous regime, the debts the federal government is inclined to honor can always be honored with a fist-full of freshly-printed dollars. At what fraction of a percentage point this printing leads to what level of inflation (debasement of the currency) is grist to the economist's mill. Some economists add that the US can always increase its *tax rates* closer to the despised European rates, and/or can cut *spending* elsewhere (*defense* is often a soft target), and/or can reduce (partially repudiate) the promised *level of benefits*, and/or can reduce the actual *cost* of services delivered (following a *universal health scheme* such as Australia's). In all events, tax-payers and/or tax-payers of future generations will be the ultimate underwriter of the US sovereign debt.

Federal borrowings	$4.3 T	34% of GDP
Federal & military pensions	$3.9 T	31% of GDP
Social Security liability	$12.7 T	102% of GDP
Medicare liability	$30.0 T	240% of GDP
Total	**$50.9 T**	**408% of GDP**

Although economics is devoid of ***values***, caught as it is between the realities of the ***ekonomia*** and the reification of abstracts such as the "invisible hand in the marketplace", it adopts as *a priori* human inclinations such as "***confidence***". An unsecured debt – one depending on a written promise alone - is only as good as the inclination and the ability of the debtor to pay. All that stops a run on *bonds* (a dis-inclination to roll them over) is confidence that the US government will be good to its word well into the future and will have the ability to service and repay its debts. The OECD observes that the US debt position would be unsustainable but for this confidence. Any weakening of confidence in the future of the US economy and a drop-off in the inclination to buy bonds calls for either a rise in the interest rate offered, or to ***monetize*** part of the debt (i.e. ***print money***). Either measure can lead into a vicious spiral of confidence, monetization and rising interest rates – barrow loads of money, and the price of bread rising hourly, or at least a subtle move in that direction. Economists warn that substituting non-interest-bearing debt (currency) for bonds does not eliminate the debt but it does shift the burden (as decreased buying power) from ***future generations*** to the ***present generation***.



In politics – the *Art of the Possible* – the future invariably takes second-place to the present. Future voters are just that; it is the dynamic between the cynical present voter and the cynical politician that determines the *now*. Telling the emperor he has no clothes is difficult enough; telling Americans they are not as rich, as productive, as assured a future as they have been told for a generation verges on the politically impossible. Today is the first day of the Future. Economists argue how liabilities can be deferred to this Future, or brought forward closer to now, but the realities are that recent US administrations have made every effort to defer a raft of tough actions not necessarily to some abstract "future generation" but to any administration but this one -- popular (and unfunded) spending, including tax-cuts, can gain political support now, and the future can look after itself. The ultimately fatal weakness of representative democracy is that representatives will strive not for the public good but for whatever will preserve their job as representatives.

In the end, it is the liberals who save the conservatives.

- John Kenneth Galbraith (1908-2006), Economist

Some think that the US debt crisis – albeit undeclared as a crisis – provides a timely occasion to review the very nature of Federal debt. Why does Treasury take pieces of paper (promissory notes called T-bills) to the Federal Reserve Bank where they are turned into other bits of paper which, one or two steps later, are turned into promissory notes called currency? The first bank with functions like those of the present Federal Reserve, the *First Bank of the United States*, was created in 1791 by **Alexander Hamilton** (ca. 1756-1804). **Thomas Jefferson** opposed the idea. The present Bank was created in 1913 by the *Federal Reserve Act* in late

1913 and Paul M. Warburg (of a prominent European banking family) and others were appointed to the first Board. When an administration is honest enough to declare the debt position unsustainable and gain the support of an educated electorate it may be timely to have a thoroughgoing review of the very basis of the federal finance system. Jefferson loathed public debt and would certainly have loathed the present debt position. Now may be an appropriate time to rethink public debt from first principles.

The OECD suggests that the US has a constellation of issues that would have already caused serious loss of lender confidence in any other nation. Continuing 7% deficits adding to a $53T national debt, and a net external debt over $2.5T are situations that will not respond to "benign neglect" – hope is not a plan. In fact, a "*disorderly adjustment involving substantial strains in US financial markets cannot be ruled out*". Some measures that would have a beneficial effect include policies to boost ***national saving***, to move more resolutely to bring down ***budget deficits***, remove obvious ***anti saving biases*** in the tax code such as the "egregious" *deductibility of mortgage interest payments*. The OECD also sheets home some of the blame for the debt crisis to the "underperforming" ***education*** system where average attainment is falling in contrast to other OECD countries. Subsidies to the agricultural sector are also blamed, as is under-investment in ***transport infrastructure***, particularly ***ports***.

Near-term	Mid-term	Long-term
Economists are the least qualified of any to explain the US financial position. Political arguments must generally be fairly simple but the Parties or independent non-profits could contribute greatly to ***elector education*** by clarifying the main issues and giving an insight into how and why governments chalk up debt in their name. An increasing portion of the population understands the advantages – and dangers, evils, and ruin – of *credit cards* and will be ready to hear about how their present and future is tied to government debt. Economists are incapable of the communic-ation necessary to achieve that clarity but many will be able. Politicians fear voters who know too much but that is how it should be.	Some developed countries have already been through some of the pain of educating their electorate about ***demographic changes*** and about how "now" and "the future" and tax and pensions and benefits and standards of living are all aspects of a single vision. The US has done little yet in this direction. The US tax-payer (or their children) is the ultimate underwriter of US debt – many voters are not aware of even that obvious fact. With education, voters can be trusted to realize that "***low-tax***" - "***high-tax***" are not policy descriptions (generally of an opponent) but labels that hide bigger issues about financial planning of the national household for now and the future.	The sub-text of commentators such as **OECD** refers to the logical possibility that the US debt position could bring grief. Two or three convergent events or trends could lead to a weakening of confidence in the US economy. ***Energy*** crisis, ***diplomatic*** crisis, ***war-like*** crisis are candidates, alone or together, to foul the US playing field. The **EU**, **China**, **India** will all increasingly close in on the US economy over the next 5 to 10 years. It will be a world where the US is not the only *fat kid in the canoe* anymore and the US will have to play nicer than it has over recent decades. The *American Dream* may no longer be there just for the taking. Worse still, it may just become a dream.

[2,304 words]

…/Sources

Selected Sources

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Also see …

OSS.NET Internet Link Tables (Annotated source-list for this and other topics).

http://www.oss.net/extra/document/?module_instance=3&action=show_category&id=113&language_selection=0

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Hazard Level		Change Codes
	↓	Deteriorated
	•	Steady
	↑	Improved
	⚡	Alert

week-ended		*See daily* **list of news items**
		Now conflated with **ECONOMY**
2007 Feb 26	•	[nothing significant to summarize but see links to stories in this topical area]
2007 Feb 19	•	Former **IMF** Chief Economist says of the **US** ***debt*** "*Americans had better pray that their creditors will be as happy to accept dollars as they are now.* "
2007 Feb 12	•	[nothing significant to summarize but see links to stories in this topical area]
2007 Feb 05	↓	President **Bush** is seeking $100B for wars in 2007 -- the funding requests for **Iraq** and **Afghanistan** will be submitted to Congress in the form of ***emergency budget "supplementals."***
2007 Jan 29	↓	The new chairman of the **Senate Intelligence Committee** says ***education***, ***health-care***, the ***environment*** and ***homeland security*** -- and ***intelligence*** on **DPRK** and **Iran** -- are all being starved by the costs of **Iraq**.
2007 Jan 22	•	[nothing significant to summarize but see links to stories in this topical area]
2007 Jan 15	•	The ***US Trade Deficit*** improved for the third straight month -- "*Despite the improvement, however, the US stands to finish 2006 with its largest imbalance on record, eclipsing the $716.7B figure for 2005.*"
2007 Jan 08	•	[nothing significant to summarize but see links to stories in this topical area]
2007 Jan 01	•	**Britain** finally discharged its ***War Debt*** from the ***second world wa***r – it has repaid a total of $7.5B, including interest.
2006 Dec 25	•	[nothing significant to summarize but see links to stories in this topical area]
2006 Dec 18	•	[nothing significant to summarize but see links to stories in this topical area]
2006 Dec 11	•	[nothing significant to summarize but see links to stories in this topical area]
2006 Dec 04	•	[nothing significant to report]
2006 Nov 27	•	[nothing significant to report]
2006 Nov 20	•	[nothing significant to report]
2006 Nov 13	•	[nothing significant to report]
2006 Nov 06	•	[nothing significant to report]
2006 Oct 30	•	[nothing significant to report]
2006 Oct 23	•	[nothing significant to report]
2006 Oct 16	↑	The ***federal deficit*** has dropped to $250B -- better than the $423B forecast -- has been driven by better-than-expected ***tax receipts***, especially from corporate profits." The **World Economic Forum** [of **Davos** fame] says ***war spending*** is undermining the U.S. economy -- "What is unsustainable is the present growth of the U.S. ***deficit*** as a share of GDP". The US ***trade deficit*** for June 2006 narrowed to $64.8B but it is still the fifth largest deficit on record.
2006 Oct 09	↑	A drop in the ***federal deficit*** to $250B has been driven by better-than-***expected tax receipts***, especially from corporate profits."

2006 Oct 02	•	[nothing significant to report]
2006 Sep 25	•	[nothing significant to report]
2006 Sep 18	•	[nothing significant to report]
2006 Sep 11	•	[nothing significant to report]
2006 Sep 04	•	[nothing significant to report]
2006 Aug 28	•	[nothing significant to report]
2006 Aug 21	•	[nothing significant to report]
2006 Aug 14	•	***Farm products*** and other exports help reduce the ***trade deficit*** for June 2006 to $64.8B but it is still the fifth largest deficit on record.
2006 Aug 07	↓	Some said the federal government's financial health got $3.5 trillion worse last year — it was revealed that US tax-payers are cheated by as much as $70 billion a year by ***tax evaders*** — auditors said that USAID used an accounting "shell game" to hide cost overruns in **Iraq**.
2006 Jul 31	•	Auditors say the US Agency for International Development (**USAID**) "used an accounting shell game to hide ballooning cost overruns" in **Iraq**.
2006 Jul 24	•	The **Army** says it needs to watch its pennies at home because of the ongoing extraordinary costs overseas.
2006 Jul 17	•	[nothing significant to report]
2006 Jul 10	•	A surprising jump in tax revenues is beating down the budget deficit which will come in below $300M, less than expected but large.
2006 Jul 03	•	The growing deficit is a disaster-in-waiting or sensible statecraft, depending on the school of economic thought.

Commencement of Service

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