The Ever-Worsening U.S. Government Debt Problem

> [This is an email I sent to friends on May 24, 2009 together with an article on the topic from the *San Francisco Chronicle* (appended below). –Scott H.]

Hi everybody,

Appended below is an article from today's *San Francisco Chronicle* about the ever worsening U.S. government debt problem. It's well worth reading.

But the article does not really bring out the deep predicament (or dialectical contradiction) in which the capitalist ruling class and their government find themselves. In brief it is this: Once a boom reaches its limits and consumer debt has about expanded as far as it can, the only way to keep the economy going from then on is through ever more massive Keynesian deficit financing. (The government can either buy more and more things itself, or else it can give the money to those who will spend it.) The trouble is, this cannot continue forever, let alone keep expanding at an ever faster pace as it must do to keep the economy from sinking into a deep depression.

If the government is just printing the money to cover the deficits, then before long there will be massive inflation. Alternatively, if the government is just borrowing the money, those lending it to them will get ever more nervous, start to demand higher interest rates (as they are now doing), and eventually refuse to lend at all once they see that they will probably never get their money back (or that they will only be repaid with a much debased currency because of major inflation).

On some level, and to a limited degree, the government knows it has this problem. That is why Obama has been *talking* about the need to restrain the growth of government debt at the same time he is expanding it at a record pace! They KNOW they need to have bigger deficits (to rescue the economy) and at the same time they KNOW they need to cut the deficits (to rescue the economy!). So they make a pretense at doing both of these totally opposite things.

Because those indoctrinated with bourgeois ideology (including Obama and his lieutenants) don't really understand the nature of the current crisis, they think this predicament is only *temporary*. I.e., they believe they can "prime the pump" and get the economy going well again, at which point they can reduce the new deficits and eventually even start to pay off some of the massive debt they are now piling up. This is a complete pipe dream! In reality, the moment they take their foot off the accelerator, the economy will start sinking again.

But because they themselves see the need to *both* expand the deficits and (at least eventually) to cut way back on those deficits, their actual course is certain to be one of fits and starts. When the economy is clearly sinking rapidly (as it is at present), they will hugely expand the deficits; but when this burst of new debt partially stabilizes the situation for a short period they will try cutting back on the deficits—which will lead to further economic weakness and a sinking economy again.

So it will be back and forth like this for some time to come, even while the *overall* trend will be toward the ever greater expansion of government debt and at an ever faster pace. Then eventually, there will be a renewed international financial collapse involving the collapse of the dollar, or in other words, sudden massive inflation. (Actually, even that will probably run in fits and starts, once it starts, but the first blast will probably be quite a shock.)

How long until the support for the dollar collapses and hyper-inflation begins? In the article below they guess that it might be as long as 10 years, or even a bit more. My guess is that the first advent of this new aspect of the crisis will come far sooner than that. It could actually happen at any time, but probably it won’t be for at least a couple years yet.

Many bourgeois commentators and politicians are now saying that the worst part of the present crisis is past, and that—while unemployment is still growing and the economy is still sinking—it is doing so at a more gradual pace. They think this means we are at the bottom or near it, and that things will soon be picking up. It is true that because of the current massive round of Keynesian deficit financing there will likely be a partial stabilization for a few months [it turned out to be more like a year], but if the deficit spending is cut back even just partially, the downturn will resume again and even pick up speed. This is almost surely what will happen over the next year or so.

But looking at the overall crisis with a longer view, and how things will play out over the next several years, we are by no means at or nearing the worst part of it. There is much, MUCH worse to come!

Scott

Government debt swells as choices get harder

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This year, the government is borrowing 50 cents of every dollar it spends. If that were just a blip caused by a historic financial crisis that necessitated a $787 billion fiscal stimulus and a $700 billion bank rescue in the space of about three months, there would be little cause for concern.

But it is not a blip. It is a relentless curve of red ink that will, within the decade, take U.S. debt levels to the record reached at the end of World War II, from 40 percent of the nation's output now to 80 percent, and then rapidly thereafter into the realm of banana republics.

"We are accumulating a massive debt. We owe about half of that debt to foreigners, including the Chinese and others whose foreign policy is not always well aligned with ours," said Isabel Sawhill, a former Clinton administration budget official who now co-directs the Center on Children and Families at the Brookings Institution. "So we are really losing control of our economic destiny and possibly losing control of our foreign policy as well."

Japan has lost its AAA credit rating, the United Kingdom may soon follow, and there is talk that the United States is headed fast down the same path.

The markets fired a warning shot last week when the Treasury Department announced a huge sale of new debt - $162 billion - as part of its financing of the government's $1.8 trillion deficit this year. That's as much as the entire government spent just eight years ago. Within hours, interest rates on U.S. Treasuries shot up.

In recent weeks, the prices of credit default swaps on U.S. government debt - a measure of the risk that the government could do the unthinkable and default - have risen to record levels.

Ambitious plans

The market reactions highlight a growing disconnect between the Obama administration's ambitious spending plans, including a $1.5 trillion overhaul of the nation's health care system, and the money available to do it.

As if to underline the point, the Social Security and Medicare trustees, who include three Obama Cabinet officials, issued their report saying the finances of the two bedrock social programs are dire.

"We are heading toward very high debt-to-GDP ratios very soon," said UC Berkeley economist Alan Auerbach. He said the rise in perceived risk of the federal government going bankrupt is sobering.

As it is, the United States does not even meet the standards for admission to the European Union, because its deficit and debt levels are too high, said Sen. Judd Gregg, the top Republican on the Senate Budget Committee. The federal government faces either enormous tax increases or inflation (regressive taxation in another form), to remedy the problem, he said.

"That means people, instead of having money to buy a home, have to send it to the government to pay the interest on the debt," Gregg, R-N.H., said in an interview. "There are no ways around this. This is not academic. It's not theoretical. It's real. The numbers are there."

The appetite for U.S. debt has remained robust, and Treasurys were viewed as a safe haven amid the financial turmoil last fall. Budget analysts have been warning about the sorry condition of the county's finances for years, and nothing happened. But the United Kingdom credit warning has turned many eyes suddenly to the United States.

"Nothing happens until it does," said Auerbach. "People were warning about the housing market and the bubble and nobody seemed to worry about that, and now a lot of us are sorry. The United States can go on for several more years doing absolutely nothing responsible to get the debt under control and things may be fine, but at some point, and it's impossible to predict when, people can lose confidence in the U.S. government's ability to deal with its problem, and things can unravel. Whether that happens in five years or 10 or even longer, it's impossible to say."

The idea that something very bad will happen is now a consensus view among budget experts.

Country at risk

"Our creditors are beginning to ask questions, and it's only a matter of time before something bad happens," said Saw-hill. "None of us can predict exactly when or exactly what, but we know that we're putting ourselves in very high-risk situation as a country."

Even House Majority Leader Steny Hoyer, the top lieutenant to Speaker Nancy Pelosi, said this month, "If a fiscal meltdown comes, there will be no one to bail out America."

So far, there is little indication that Washington is taking the issue seriously, other than talking about it.

President Obama said several days ago in announcing $17 billion in proposed budget savings that "we can no longer afford to leave the hard choices for the next budget, the next administration or the next generation."

But $17 billion is a grain of sand in the roughly $60 trillion in unfunded liabilities the federal government carries.

Obama calls his budget a "new era of responsibility," but it would add $9 trillion to an already unsustainable debt burden over the next decade.

Obama inherited a mess, including the financial crisis. The Bush administration put everything - wars, tax cuts, Medicare prescription drug benefits - on the national credit card instead of paying for them. While Obama talks about changing direction, he has not yet done so.

In fact, his plans not only do not fix the problem, they make it worse. The Congressional Budget Office said the Obama budget will cut taxes by $2.1 trillion, most of that by extending most of the Bush tax cuts, and increase spending $1.7 trillion over 10 years, resulting in a net increase in interest costs alone of $1 trillion.

Obama made some hard choices, but most of these have been shunned or are being watered down by Congress, from trimming tax write-offs for charity to raising revenue by limiting greenhouse gas emissions. Congress has already raised the price of the administration's latest supplemental spending bill, adding $6.2 billion for military hardware, including C-17 aircraft that Defense Secretary Robert Gates recommended terminating.

But the larger problem, as in California, is that the public also recoils from spending cuts and tax increases

"It goes back to my days as mayor," said Sen. Dianne Feinstein, a California Democrat and former mayor of San Francisco, who noted during an interview in her office Thursday that she is very worried about the situation. "I would go before a group. Do you want more police officers?"

"Yes," was the firm reply.

"Do you want more firefighters?" Yes, again, very firmly.

"Do you want to pay for them?" An emphatic no.

"That's the situation out there," Feinstein said.

She said she has been saying no to more requests than at any time in her 16 years in the Senate. Just that morning, she said, the chief justice of the California courts came in asking for money to finish a computerized system to consolidate records so that the criminal justice system would know if an individual had a record of illegal firearms possession, domestic violence, or the like - a program she strongly favors but the state can't afford. Yet she said no to trying to get federal aid.

Money isn't there

"The requests don't stop coming," Feinstein said. "We've had over 2,000 earmark requests from counties, from cities, up and down the state. Local governments are in trouble, they're looking for money, and everybody comes here, and says, 'Can't you do it?' And there just isn't the money."

The story is a microcosm of what will happen with increasing frequency as Medicare starts squeezing out more and more other spending as the Baby Boom retirement gets seriously under way.

Hoyer, D-Md., has suggested fixing the finances of Social Security before taking on health care reform to send a signal to markets that Washington is serious about its budget problems. Social Security is a much smaller problem than Medicare, and the proposed fixes are a combination of higher payroll taxes and lower benefits. Feinstein said she would favor means testing.

But Pelosi and Obama have said no to taking on Social Security and want to proceed instead with health care reform. They argue - correctly - that it is Medicare and health care costs generally that are driving U.S. finances over a cliff. The United States spends $2.5 trillion a year on health care, more than any other rich nation, and yet has poorer outcomes. About $700 billion is wasted each year. Health insurance premiums have been rising five times faster than wages for eight years and are bankrupting businesses too.

But there is also widespread skepticism about Obama's claim that spending more on health care now will somehow fix the budget. Savings from such things as computerized health records and preventive care will not begin to cover the cost of expanding care to the uninsured. Nor will higher taxes on the wealthy.

"The administration has been hard-pressed to even find ways to pay for the expansion of health coverage, much less a way to bring down the deficit at the same time," Sawhill said. "If you could slow the trajectory on health care spending it would help, but not much in the next decade. And I'm not sure we have a decade to fix this problem."

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