

Friday, March 4, 2005

The coming fiscal meltdown of America

Ok folks, so as promised, here's the first part of the definition of the problem - and a crack at a solution....

First, let's define the problem.

Many people know that our federal "debt", or that which the government counts as the obligations it has to various people, is as of this date \$7.7 trillion dollars.

That's a lot of money. Indeed, you can see how quickly it has grown since 1987 or thereabouts at the link <http://www.publicdebt.treas.gov/opd/opdpenny.htm>.

What is not commonly known, however, is that this figure is not the whole story. Oh no. Our government is far too tricky for that. Indeed, due to all manner of chicanery, including taking the extra money received from FICA (Social Security) and Medicare taxes beyond what is immediately paid out in benefits and issuing "IOUs" (not debt - and not counted in the federal debt!) has taken place over the last 20 or so years.

There are also promises to pay various things, such as the Medicare Drug Benefit, that are unfunded - that is, there is no money set aside for them.

Between all of this, the **real** public debt is actually closer to \$43 trillion dollars - or about six times the "official" figure! (Source: CBO)

That's roughly \$350,000 for every full-time worker.

Now think folks - how long does it take **you** to make \$350,000?

Forever, I suspect. Or damn close to it.

Why hasn't this little game blown up in our faces yet? *Because so far, we haven't had to cash any of the IOUs that we have written.*

This state of affairs will not persist!

Indeed, it will not persist long at all. The folks debating social security like to talk about the year 2042 as the year in which the trust fund is "exhausted." One small problem - **there is no trust fund. All there happens to be is a stack of non-negotiable IOUs which do not have status as "debt".**

So when does the hammer fall? Long before 2042. Like, in about **ten years!**

That is when the Social Security and Medicare systems will run cash-negative - that is, it will no longer taken in enough in taxes to pay current benefits. When that happens, the trustees will have their IOUs out in hand, asking for the Treasury - and Congress - to redeem them.

Neither Congress nor the Treasury has the money to do so, as they've spent every last nickel of it.

So then what?

Well, by law, benefits must be reduced to that which the administration can actually pay. *The IOUs will have*

to be written off, since they are uncollectable as debt, there is no means to enforce them, and there is no chance of actually raising those funds.

How much will they be reduced? The first year, by just a few percent. But each year the percentage will grow, until roughly 2052 when two-thirds of the benefits promised will not be able to be paid. That is, if the estimates are accurate (they're probably not - indeed, the shortfall will likely be worse than predicted.)

What else could Congress do? Well, they could try to raise taxes. The problem with this of course is that they've never kept their hands off the FICA money before, so what makes you think they would this time around? There's no way to force them to keep their promise. Further, we couldn't possibly raise taxes enough to matter - to fully fund Social Security, including paying off the IOUs, we'd have to have a **FICA** tax rate of **fifty percent or more**.

That would put most people's effective federal tax rate somewhere between sixty and **eighty-five** percent, including low-income people!

So is there no solution to this mess?

Sure there is. Take the money out of their hands. Privatize Social Security. Completely.

Unfortunately, this is going to screw the folks who paid into it until now, myself included. ***That is unavoidable at the present time.*** It does not matter what Congress or the President **says**, the simple fact of the matter is that there is not now and never will be the ability to repay those "special issue" IOUs. ***Never.***

By privatizing it, however, will will at least stop lying to our children and grandchildren, in that we will no longer promise them something we know we can't deliver.

We can also reasonably expect that for those people with at least **twenty** years to retirement, they'll be about as well off under a private system as they would have been with Social Security. For those with more than twenty years, they should do better - a lot better.

For those with **less** than twenty years to retirement, they're going to have to suck it up to some extent. Private retirement accounts have been around a lot longer than ten years. Hopefully people have been contributing to them. If not, while we may be able to offer **some** assistance, we simply cannot provide what was promised.

The money is simply not there, and both political parties are equally to blame for this, as are YOU (and I), the voters, who keep returning them to office to "bring home the bacon!"

Second, we must reform how Washington gets and spends its money. It is essential that the debt be paid down. It is further essential that we align the goals of government and the private sector economically, so that government revenues are tied to the success of the private sector.

There is only one way to do this - massive, fundamental tax reform.

Such reform comes in the following steps, **all of which must occur** - none are acceptable without all of the others:

1. The 16th Amendment, allowing a tax on incomes, must be repealed, and the language of the repeal must bar the government from seeking review of its intent or changing it (e.g. the Supreme Court must be stripped of jurisdiction to "creatively interpret" this.) Until this can happen (and it will take a while) legislation must be passed that is tied to the remainder of the below reforms, and which legislatively bars the use of the 16th Amendment.
2. As a consequence, all employment and income taxes will be eliminated. This includes the FICA and

Medicare taxes, FUTA (federal unemployment tax), and of course the income tax, both on corporations and individuals.

3. In place of these taxes, we must enact a **consumption** tax in the form of a national sales tax. The expected rate necessary to replace the above taxes is 26%. Along with this tax, there must be a "prebate" paid to each and every legal household (that is, excepting illegal immigrants) in the form of the tax that would be paid on a poverty-level income for that household size. This makes the poverty-level household tax-free, a household living at twice the poverty level operate on a tax rate one-half of the gross rate, etc. The full proposal to do this is found at <http://www.fairtax.org> - it is a good proposal, and one we need to get behind.
4. Along with the repeal of the 16th Amendment, we must pass a balanced budget amendment which specifies that (a) the government must report and account for money using GAAP (just as must all businesses), (b) that any debt issued to cover short-term deficits must have a term of no more than 10 years, (c) that debt may not be "rolled over" except in time of formal, declared war, and (d) that the existing public debt must be paid down within 30 years on a GAAP-acceptable amortization schedule.

This sort of change is revolutionary.

If we do not do it now, we may not get the chance to do it on our terms. If our government is unable to market its debt in the international marketplace, and it may well be unable to do so in the near future, the result will be a default on **all** government programs. The government currently consumes some 1/3rd of the US GDP - such a default would trash the United States economy overnight - far worse than any terrorist act could hope to.

If it happens, we will have only ourselves to blame.

Get informed folks, then act.

Before others do it for us.

Posted by Karl Denninger at 16:21

I've tried more than once to find a way to post comments on Market Ticker, but obviously I'm too dumb (I find it v. difficult to find my way around multiple comment fora)! And I can't sign your petition because I'm not a US citizen (though that may change, one day). Please don't lose patience with your readership, even if most people seem apathetic. You don't always know immediately what effect your words are having - ask any parent. It may be that you are not casting your pearls before swine, but casting bread on the waters to prepare the fishing. Best wishes - "Sackerson" Anonymous on Oct 29 2007, 16:12

Even though I've only read your market ticker for couple of weeks, I signed the petition. If you have loyal readers, they should sign too. I hope you reconsider. Thanks for your efforts. It is appreciated. Anonymous on Oct 29 2007, 22:39