Can America pay its public debt

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The American Debt Burden

Can America Repay its Public Debt?

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At the end of May 2012, The US public debt exceeded $15.3 trillion. Since the debt is increasing by approximately $4.1 billion a day, it is expected to reach $16 trillion by the end of 2012, or some 105 percent of the US Gross Domestic Product or GDP; and to reach $20 trillion by 2015. In light of these facts, can The US government pay its debt in the near future? Can it even service its debt without going deeper in debt? The answers are No: the United States has passed the point where it could service its debt without going deeper in debt, let alone repay it.

Can the United States do something to ameliorate the debt problem in the short run? Yes, it can. But to be able to do so, the US President and Congress have to acknowledge first that the traditional fiscal and monetary tools of economic and financial management are no longer workable. If the American government continues to follow the largely outdated policies and give priority to political infighting and special interests, the problem will only get worse. Senator Tom Coburn, commenting on the political infighting in Washington and the severity of the debt problem, wrote, "of my Republican friends I would ask: what good is a Republican Party without a republic? And of my Democratic friends: what good is your commitment to the poor without an economy to sustain your commitments? (Tom Coburn, While Washington Slept, *the Washington Post*, April 5, 2011, A21)

For the United States to gradually reduce its debt as a percentage of its GDP, the annual increase in the size of its GDP has to exceed its budget deficit. If the budget deficit, including interest payments, exceeds the GDP growth, the debt will grow in size as well as a percentage of GDP. On the other hand, for United States to repay its debt over the long run, it has to have an annual budget surplus that exceeds the debt interest payments. According to the Congressional Budget Office (CBO), the last time the US government had a surplus was in 2001.

From 2001 to 2009, spending increased by 6.5% of GDP (from 18.2% to 24.7%) while revenues declined by 4.7% of GDP (from 19.5% to 14.8%), causing deficits to increase substantially.

According to the US Department of the Treasury, revenues in 2009 were $2.104 trillion, expenditures $3.52 trillion and the deficit $1.42 trillion; in 2010, revenues were $2.162 trillion, expenditures $3.45 trillion, and the deficit $1.3 trillion. As for 2012, the budget is projected at $3.8 trillion, and the deficit at $1.3 trillion. Since the average growth rate for 2011 was 1.7%, and 2012 does not look much better, the GDP is expected to increase by $255 billion in 2012, compared to a deficits of $1.3 trillion. This means that the increase in GDP represents a fraction of the budget deficits, causing the debt to increase in size as well as a percentage of GDP.

Although interest rates on US Treasury bills have come down substantially during the last two years, the decline does not reflect a better performing US economy; rather, it reflects a worsening outlook for the world economy, particularly the EU economy. Assuming an average interest rate of 2.5% annually and an average economic growth rate of 2.2%, annually, with no recessions or drastic change in policy, the US public debt would reach $28 to $30 trillion by the end of 2022. Consequently, the annual interest payments would reach $750 billion, and the debt to GDP ratio would rise to 150 percent. Therefore, under current spending and tax policies, the United States is neither able to service its debt without going deeper in debt, nor reduce its size as a percentage of GDP, let alone repay it. Some people might think that a 2.2% annual growth rate is too low; unfortunately, they are mistaken. The times of high economic growth rates are over; the world is passing through an era of diminishing expectations, and its capacity to produce most essential goods exceeds it capacity to consume such things.

Can the United States live with a continuously rising debt to GDP ratio like Japan? (Japan's debt is estimated at 230% of its GDP.) I do not believe it can. The American socioeconomic conditions and cultural values are different from those in Japan, and therefore what works for Japan is unlikely to work for the United States. Nations usually borrow to close temporary budget deficits, or to invest in projects designed to increase the production capacity of their economies, which causes tax revenues to rise and eventually close the deficit gap. The United

States has been borrowing to finance wars and wasteful conspicuous consumption. The Japanese high savings rates have enabled the state to borrow from its citizens and recycle their money on their behalf. In contrast, the US government, due to low savings rates, owes about half of its public debt to foreigners.

Despite these differences, using domestic savings to finance budget deficits seems to have caused the Japanese economy to stagnate and loose its dynamism. But since Japan's population is largely stagnant and its standards of living are high, Japan does not have to create millions of new jobs every year. In contrast, the United States has to create about 1.5 million new jobs annually due to population growth, and spend billions of dollars to help the needy due to high unemployment rates and huge and widening income and wealth gaps separating the rich from the poor. Dependence on foreign sources of capital to finance budget deficits, therefore, does not allow the United States to have a growing debt ratio to GDP without damaging its economic and political credibility. Experts estimate that when debt reaches 90% of GDP, it causes potential economic growth to decline by 1%. America has already passed this threshold.

What are the options to dealing with the debt problem? the United States has few options: to default, which is considered no option; to double the current tax rates, which congress would never do; to go deeper in debt with no guarantees that lenders will continue to extend new loans to a state that lacks the will to manage its budget and live within its means; or resort to printing money and risk inflation and weakening the dollar. Therefore, the only way to deal with this problem is to find a creative way to repay the entire debt now. (See our paper, "Liberating nations from the debt burden.")

Economists have suggested several ratios of debt to GDP that are supposedly sustainable. No debt to GDP ratio is sustainable or unsustainable without qualifications. Sustainability is a function of three major factors: the annual economic growth rate, the size of the budget deficit, and interest rates. Each state can borrow until markets say, No more. At such a point, however, markets would have lost confidence in the economy and the state's ability to manage its financial affairs. And markets are on the verge of losing confidence in the US economic, financial and political management as indicated by S&P action taken on August 6, 2011 to down grade US bonds. Since almost all Western states have borrowed too much to service their debt without going deeper in debt, no economy is “too big to fail;” few economies, however, seem “too tall to fall.” Nevertheless, unless they take drastic measures, all highly indebted states will eventually fall under the increasing weight of the debt they carry on their backs.

If the United States were to repay its debt now, the budget deficit would be reduced by some 30% immediately. Such an action would restore consumer and business confidence, calm the financial markets, and give the government an opportunity to grow its economy, while restructuring spending and tax policies. And if the United States were to climb back within 10 years to where its finance were in 2001, when revenues were 19.5% of GDP, and the budget 18.2% of GDP, it will be in a position to contain its debt, and to gradually reduce its size.

Adding some $4.1 billion daily to the public debt is causing the US financial situation to deteriorate rapidly, and the threat the debt poses to the American economy and the welfare of the American people to get more serious day by day; poverty and despair are on the rise. The per capita debt is about $49,000 and is increasing by $12 a day, $360 a month and $4,300 a year, with no end in sight. If the United States continues to finance spending by borrowing and printing money, it would not take the financial markets long before loosing confidence in the US economy and the dollar. If this were to happen, the international pool of easy money would dry quickly, and interest rates would rise substantially, forcing the US government to rely solely on borrowing from the American people, printing money faster and raising taxes, which is a good recipe for a prolonged state of stagflation, if not depression.

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