Congress Fakes Fiscal Responsibility as Uncle Sam Heads toward Bankruptcy

By Doug Bandow
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The new budget bill has passed, hiking spending and taxes. Capitol Hill is back to the bipartisan business of mulcting taxpayers.

Unfortunately, Washington can't afford to wait for fiscal reform. The Congressional Budget Office's most optimistic estimate, the so-called "baseline," is that Uncle Sam will add $6.3 trillion more in red ink over the next decade. Annual deficits are expected to begin moving up again in 2016.

More realistic is CBO's "alternative" scenario, given how politicians usually behave. In this case Uncle Sam would run up $8.8 trillion more in red ink.

These estimates presume good economic times ahead and a minimum of new bail-outs. Unfortunately, that seems over-optimistic. Even the Postal Service continues to lose money.

Moreover, the entitlement tsunami—Social Security, Medicare, Medicaid, and now health insurance subsidies—will not have fully developed by 2023. As a result, warned CBO, without substantial policy changes "debt will rise sharply relative to GDP after." Put everything together and economist Laurence Kotlikoff figures that unfunded federal liabilities currently exceed $220 trillion.

There's more. Because federal debt crowds out private investment, CBO estimates that every additional dollar of government debt reduces national saving by 57 cents. As a result, the GDP likely will drop between four and seven percent, or perhaps even more, by 2038.

As I observe in my new column in *American Spectator* online:

In short, borrowing more causes us to owe more and pay more in interest. At the same time, we will be saving, producing, and earning less. It's a prescription for economic and budget disaster.

Unwilling to cut spending, Uncle Sam instead would have to raise taxes or borrow ever more. Under the alternative scenario the official (exclusive of Social Security-Treasury transfers) debt to GDP ratio would run around 190 percent by 2038, greater than Greece at its worst. In a paper for the U.S. Monetary Policy Forum earlier this year, economists David Greenlaw, James D. Hamilton, Peter Hooper, and Frederick S. Mishkin posited one scenario under which "The debt/GDP ratio would rise much more rapidly, hitting 304 % of GDP by 2037."

Moreover, explained CBO, "Growing federal debt would increase the probability of a fiscal crisis, when … the government would thereby lose its ability to borrow at affordable rates." Based on international experience, David Greenlaw and his colleagues warned "that countries with debt above 80 percent of GDP and persistent current-account deficits are vulnerable to a rapid fiscal deterioration as a result of these tipping-point dynamics." In that case federal liabilities likely would explode, as they did in the 2008 financial crisis.

The feedback loop would continue to worsen. Noted Greenlaw, et al., "If U.S. government finances are not put on a sustainable path, … then the public might expect the Federal Reserve to be forced to monetize this debt. What would then unhinge inflation expectations would be the fear of fiscal dominance, which could then drive up inflation quickly."

Amazingly, observed David Greenlaw, et al., "As recently as the 1990s, the United State government was running budget surpluses and there was serious discussion of what would happen if the federal government was able to retire its debt." That world is long gone, probably forever.

Still, Washington is celebrating Good News! For the first time in five years, the annual federal deficit has dropped below $1 trillion.

Alas, the cheery interlude will be brief. Soon the red ink again will be growing, and the more government spends and taxes, the worse will be the economic impact. No wonder CBO warned of "the unsustainable nature of the federal government's current tax and spending policies."

Washington only faces "difficult choices," in CBO's words. America's political leaders should be choosing among them instead of passing another dishonest feel-good budget agreement.