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UP AND DOWN WALL STREET | TUESDAY, NOVEMBER 2, 2010

Why Americans Are Angry

By **RANDALL W. FORSYTH**

Voters know something is wrong if the U.S. faces a worse fiscal gap than Greece.

AS AMERICANS HEAD TO THE POLLS, pundits routinely describe them as angry. And well they might be with near-10% unemployment, 17% underemployment, stagnant earnings and declining wealth.

That also describes other parts of the world, notably Western Europe, where mobs have taken to the streets in France and Greece to protest the austerity measures necessitated by the fiscal crises there.

What's different is that much of the anger in America is aimed at the exploding government debt, not austerity measures to contain it. TARP and the financial bailouts clearly spurred the inchoate Tea Party movement and gained momentum with opposition to health-care reform. Notwithstanding some wing nuts in their midst, most Tea Party-types likely feel in their gut America's debt is its biggest problem and expanding it isn't the solution.

Two articles by leading economists demonstrate why "stimulus" has become a dirty word in politics—because debt levels have become so massive that the public, rightly, fears that a fiscal day of reckoning looms ahead.

Indeed, a newsletter with that very title, Day of Reckoning, brought to my attention an article by Laurence J. Kotlikoff, an economics professor at Boston University. In "A Hidden Fiscal Crisis" in the September issue of Finance & Development published by the International Monetary Fund, Kotlikoff expands on his important academic work on the U.S. "fiscal gap."

That's different from the national debt. The fiscal gap measures the difference between the present value of the government's receipts and its outlays. The latter reflects mainly the huge future liabilities in the so-called entitlements for Americans, mainly Social Security and medical benefits such as Medicare.

That's not news, but the size of the problem defies comprehension. To close the fiscal gap would require a permanent fiscal adjustment equal to 14% of gross domestic product annually, according to an IMF study cited by Kotlikoff. Projections from the Congressional Budget Office are only slightly less dire—a 12% fiscal adjustment, assuming 3% interest rates. If one assumes a 6% interest rate, the needed fiscal adjustment figure is lowered to 8% of GDP.

To make that 8% adjustment would require more than a doubling in federal income-tax revenues, which totaled 7.4% of GDP in 2009, Kotlikoff continues. The CBO already assumes in its long-run projections that

the income-tax take will increase by 50% and growth in Medicare and Medicaid benefit levels will fall by about one-third in the short run and two-third in the long term. "Both CBO scenarios are implausible," he writes.

"Were the CBO to forecast without its strong assumptions, the U.S. fiscal gap in relationship to GDP would be substantially larger than that of Greece—and of most, if not all, the advanced economies that are members of the Organization for Economic Cooperation and Development."

Despite all this, the U.S. is able to borrow at extraordinarily low interest rates. But, says Kotlikoff, that could come to a halt "once the world catches on to the true extent of U.S. fiscal insolvency." Then the government would face the prospect of printing money to cover its debts, resulting in high inflation, financial instability—and further stressing the finances of the government because of its pledges, explicit or implicit, to bail out banks, money market funds and all manner of financial instruments.

All that debt ought to be hugely stimulative to the economy, at least to those brought up on the standard Keynesian framework drummed into two generations of economics students. Clearly, however, the record budget deficits aren't stimulating anything other than the ire of a large swath of the electorate.

According to Keynes, government borrowing in a slump would "prime the pump" of the economy, marshalling the excess savings that the private sector refuses to spend or invest. But, according to Richard Alford, writing in the *Institutional Risk Analyst*, the effectiveness of fiscal policy is, at best, uncertain.

In the classical model, which is based on the work of Harvard economist Robert Barro and nineteenth century economist David Ricardo, basically says borrowing for the future doesn't stimulate because the public realizes it eventually will have to repay the bonds in the future, with interest. So, they adjust their savings accordingly. To the extent that fiscal stimulus works, Alford explains, is because the public sees "a credible commitment to fiscal austerity in the future."

Another view—the "fiscal illusion hypothesis"—further helps illuminate both why the deficits stimulate so little but provoke so much anger. The hypothesis, which Alford writes dates back to the 1890s and more recently has been associated with William Niskanen of the Cato Institute, suggests the public systematically miscalculate the future cost and benefits of government programs, and typically underestimate the former relative to the latter. In other words, we really believe in the free lunch.

That is, until the crisis arrives. Once the public confronts the overwhelming evidence that they were too optimistic or even delusional, they ratchet up their rarely adjusted expectations about the future size, cost and riskiness of the government's debt. The result: political opposition to the debt increases along with calls for future austerity, Alford concludes.

These economists' writings help put into perspective what's bugging Americans as they vote Tuesday. As the *Wall Street Journal* noted Monday, this will be the third straight Congressional election where the dominant theme is to "throw the bums out." The Republicans lost the Congress in 2006 and the White House in 2008 while the Democrats are likely to lose the House with the Senate uncertain.

But while voters are acting on legitimate concerns about the dangers of debt, where is the talk of the need

for shared sacrifice to deal with it? Instead, we remain gripped by the worries about the present and the future, which depresses rather than stimulates the economy.

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