Commentaries

NOW RAISING INTELLECTUAL CAPITAL

« **Previous Post**
Next Post »

13:03 August 28th, 2009

Debt on autopilot

Post a comment (2)
Posted by: Christopher Swann
Tags: Commentaries, debt, health care, Obama, social security

At first glance this week's budget projections paint President Obama as a spendthrift. The White House itself offered a grim glimpse of a future in which U.S. debt more than doubles to $17.5 trillion in a decade — an increase of nearly $10 trillion.

Merely servicing the U.S. debt will cost more than America currently spends on either defense or social security.

But the yawning deficit can't be blamed on Obama — or for that matter, on Bush or on the financial crisis. Instead the government's finances are locked on autopilot, with entitlement programs driving the country towards a fiscal crisis.

Spending on three giant programs — Social Security, Medicare and Medicaid — will account for three quarters of the extra borrowing over the coming decade. By 2019, it will more than double to $2.5 trillion — more than the U.S. government expects in total tax revenues for next year.

Washington needs to address the deficit soon. To avoid pointless political wrangling, it is first important to make clear what is not causing the fiscal meltdown — including the economic stimulus.

Even if you add in interest payments from the $789 billion recovery bill, the stimulus accounts for only a tenth of the rise in debt up to 2019, according to calculations by Chris Edwards at the Cato Institute.

Three years of weak tax receipts, courtesy of the recession, will cost the country about $1.3 trillion if interest costs are included. This represents just 15 percent of the borrowing binge.

And there is little the government can do with the other spending it has under its control. Indeed Obama is assuming that he will have little money to play with.

The White House forecasts have discretionary spending falling slightly in real terms from $1.26 trillion to $1.12 trillion. This includes a hefty real cut in defense from $687 billion to $559 billion in 2019. Spending on all other departments, including energy, education, labor and agriculture, is also set on a downward trajectory.

Failure to act could have a number of severe consequences. The first would be that debt servicing will swallow up an ever greater share of tax revenue. By the time current teenagers are working, around 36 cents for every dollar of income tax they pay will go to interest payments, according to White House figures. This compares with about 19 cents now.

Then there is the threat of a buyers strike on U.S. bonds. Berkeley economist David Romer argues that investors can quickly pivot from being eager to lend to governments at low rates of interest to being unwilling to buy Treasuries at any price. This may never happen, but the dangers increase along with the deficits.

Time is running out. Powerful as the United States is, the country continues to accumulate debt at this rate at its peril. The focus must be squarely on the real problems — medical spending and social security.

On healthcare this means ensuring that the costs to Americans are no longer hidden by employer-provided schemes. A more transparent system would put the brakes on rising costs more effectively than any other measure.

On Social Security the United States should gradually start to ratchet up the retirement age until it reaches 70. Social security was not designed to cope with an average retirement that now lasts more than 20 years.

The first step to preventing a looming fiscal disaster is to have a non-partisan discussion about the source of the problem.

The financial crisis has brought forward crunch time. Political procrastination on entitlement reform is now even more dangerous.

Post a comment (2) |
Share
| Trackback

Comments RSS

2 COMMENTS SO FAR

the following quote from the article is worthy of comment:

August "The first step to preventing a looming fiscal disaster is to have a

- **These posts are written by Reuters columnists. Any views expressed are their own.**
- Search Commentaries SEARCH

Author Profile

Christopher Swann
Columnist
I am a columnist at Thomson Reuters focusing on economics. Prior to this I worked at Bloomberg and the Financial Times. | **View Profile**

Recent Posts

Aug 28
Time to get tough with AIG
Aug 28
Debt on autopilot **Comments (2)**
Aug 28
Investment banker admits: we overcharge **Comments (1)**
Aug 28
Banks must see the debate has changed
Aug 28
The FDIC plays hide the ball too **Comments (2)**

Archives

- August 2009
- July 2009
- June 2009
- May 2009

Commentaries Feeds

RSS Subscribe to all posts via RSS (What is RSS?)

Tags

AIG bailout banking bank of america banks bonds Bonuses britain California China citigroup CMBS commercial real estate Congress debt Derivatives Earnings economy European Commission European Union FDIC Federal Reserve financial crisis General Motors Germany Goldman Sachs High-Frequency Trading Lehman links Merrill Lynch Microsoft Obama Opel Ponzi private equity regulation SEC Sergey Aleynikov stocks TARP Toxic assets treasurys UBS united states Wall Street