

## Decision time for profligate America

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EDITOR'S LETTER

ALLISTER HEATH

IT pains me deeply to have to write this but America could already be in terminal decline. Like in many other Western countries, a short-termist and self-interested political elite has convinced a deluded electorate that lowish levels of tax can go hand-in-hand with exploding amounts of public spending, forever. They can't. America faces three choices: either long-term bankruptcy; or the adoption of a European style social democracy with much higher taxes funding a bloated welfare state, as many Democrats would like; or the unwinding of many spending programmes and the return to a small government model, as proposed by the Republicans' Paul Ryan.

Given that the US budget deficit will be close to 10 per cent of GDP this year, and that the IMF thinks the US will eventually need a fiscal consolidation worth 11.3 per cent of GDP to stabilise the national debt, Standard & Poor's was right to slap a negative outlook on America's AAA credit rating yesterday.

America's fiscal challenge is even greater than that facing the UK or most other rich nations, as documented by Michael Tanner of the Cato Institute in his paper, *Bankrupt: Entitlements and the Federal Budget*. Over the past 40 years, federal spending (excluding states and local governments) has averaged about 21 per cent of GDP, while revenues have been roughly 16.6 per cent of GDP, leaving a smallish structural deficit (the highest ever tax take was 20.6 per cent of GDP in 2001). That deficit wasn't ideal – but it wasn't a catastrophe either because the economy grew by roughly that same amount, which meant that the debt to GDP ratio was relatively controlled. However, the tax take now is just 14.9 per cent or so – while spending has soared, mostly permanently. The problem is this is not merely cyclical: a recovery would increase receipts and cut spending, but not by enough – and if there is no change to current policies, Tanner calculates, by 2050 federal government spending will exceed 42 per cent of GDP. Adding in state and local spending, the state in its entirety would consume nearly 60 per cent of everything produced in the US. Assuming it hadn't gone bust by then, America would have been

transformed into a socialist country, a point made by Dambisa Moyo in her best-selling *How the West was Lost*.

The main reason why spending is out of control are “entitlement” programmes, especially social security (state pensions) and Medicare (health care for pensioners), which provide the middle classes with vast benefits – and as such have been deemed untouchable (and were increased hugely by Bush, whose spending policies would have made even Gordon Brown blush). Yet by 2050, those two programmes plus Medicaid will consume 18.4 per cent of GDP as the population ages and the cost of medical care rockets.

The left’s answer is higher taxes. But in a report from the Mercatus Center at George Mason University, Veronique de Rugy and Jason J. Fichtner calculate that the bottom 50 per cent of earners pay a mere 2.7 per cent of federal income tax revenues. The top one per cent already pay 38 per cent and the top 10 per cent pay 69.9 per cent. A bit more tax could be wrung out of the system – but only a national value added tax would raise real money.

If that were to happen, however, the battle would have been won by those seeking to turn America into a European style social democracy, in itself a recipe for gentle decline. It’s decision time for America.

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