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Presidential candidates unwilling to address US fiscal crisis

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On Wednesday, the US Treasury's dry monthly update stated that government revenues fell short of expenses last month by $US130 billion ($169bn) — about four times Canberra's annual deficit in a single month. These sorts of updates are routine. That the US is marching headlong into a fiscal crisis is the US presidential campaign's elephant in the room.

President Ronald Reagan, more than 30 years ago, quipped that the US deficit was big enough to take care of itself. Donald Trump and Hillary Clinton obviously think so, too.

The US debt to gross domestic product ratio peaked at just under 40 per cent when Reagan left office in 1989. Barack Obama will leave his successor a debt burden almost double that — just under $US14 trillion this year — and one expected to balloon to more than 140 per cent within 30 years as the gap between revenues and expenses yawns.

Yet not a peep about the US's deteriorating fiscal position appeared in the landmark economic speeches delivered by the two presidential aspirants this week.

To be sure, Trump mentioned the deficit seven times, but not the one Australians are inured to hearing about. For him it was the supposedly job-sapping "$US800bn trade deficit" — more than half with China — that needs to be tamed. "China engages in illegal export subsidies, prohibited currency manipulation and rampant theft of intellectual property," he fumed in Michigan.

Clinton mentioned debt only once, and then only to highlight the "explosion" in it that Trump's tax plans would fuel. She has a point. His plan to cut the top marginal tax rate to 33 per cent, slash the corporate rate to 15 per cent and abolish estate tax cuts while promising to maintain spending on popular social security and health programs would plunge the government far deeper into a fiscal crisis — assuming, of course, any of it got through congress.

"Trump's tax policies would be a disaster for this country, both in terms of the increase in debt and in terms of fairness," says Douglas Elmendorf, head of the Congressional Budget Office for six years until last year, suggesting that the idea Trump's tax plan would spur enough new activity to compensate was farcical.

The Committee for a Responsible Federal Budget estimated in June that Trump's mix of tax and spending policies would cost the budget almost $US11 trillion over the next decade, and Clinton's — a less dramatic grab bag of tax hikes that don't quite cover some populist spending promises — $US650bn.

Born out of congress's frustration with Richard Nixon's economic advisers in the 1970s, the nonpartisan CBO keeps tabs on the US's financial accounts. "The prospect of such large debt poses substantial risks for the nation and presents policymakers with significant challenges," it said last month, pointing to 30 years of rising deficits under present tax and spending laws.

Neither presidential candidate is paying much attention. "Public attention to the budget is most acute when the annual budget deficit is large, and right now it has fallen over the last several years," says Elmendorf. The US government deficit has indeed swung back from the almost 10 per cent of GDP it reached in the depths of the financial crisis, when Obama unfurled the world's biggest fiscal stimulus. But at a forecast 2.9 per cent of GDP this year, it is still 25 per cent larger than Australia's, proportionately, and projected to grow more rapidly.

"Both Clinton and Trump appear to have no sense of the magnitude of our country's fiscal insolvency," says Laurence Kotlikoff, a Boston University economics professor who also is running for president. The 65-year-old tax expert hopes to be "written in" — a quirk of the US constitution that permits voters to write the names of candidates they prefer on the ballot paper.

"Clinton and Trump have been talking about official federal debt, but they've totally ignored all the off-the-books liabilities that make our true red ink 10 times larger," he tells Inquirer, putting the "fiscal gap" — the future revenues and outgoings of the government in today's dollars — at $US199 trillion. "We would need an immediate and permanent 53 per cent increase in all federal tax rates under the current system to close the gap," he says.

His 157-page policy platform, Kotlikoff2016.com, provides a catalogue of US policy dysfunction, alongside sensible, if unrealistic, solutions.

As in Australia, health spending is generating the biggest hole in US public finances. The US budget is starting to look more European, with shrivelling defence spending alongside growing spending on entitlement programs. Defence costs will fall from 3.2 per cent of GDP this year to 2.6 per cent within years, while health costs will rise from 5.5 per cent to 6.6 per cent.

Trump has promised to repeal Obama's controversial and increasingly ineffective system to subsidise private health insurance for low-income working-age people — known as ObamaCare. About 12 million Americans bought subsidised private health insurance this year but 44 million remain uninsured.

"If you're a middle-income person the penalty is actually less than the premium; young and healthy people don't want to buy it," says Michael Tanner, a health expert at the Cato Institute.

While ObamaCare is failing, promising to repeal it is a distraction. It is a fiscal rounding error of about $40bn compared with the leviathans of Medicaid and especially Medicare, which weigh in about $900bn combined. Medicare, the program that subsidises healthcare for the over-65s, is responsible for more than three-quarters of this rise in public health costs, the CBO estimates, a - reminder of the generational conflict underlying budget repair.

Private health spending impinges on the US fiscal position too, via probably the biggest tax expenditure in the world: the exemption of private health insurance payments made by - employers, worth more than $US210bn this year.

"After World War II there were wage controls and labour shortages, so employers couldn't compete for the workers by raising wages so they began offering health insurance, too," Tanner says. "In the 1950s, the IRS decided the insurance wouldn't be taxed as wage income so private health insurance has become the biggest tax expenditure, one that largely goes to well-off people."

For his part, Elmendorf advocates tax increases and spending cuts to restore fiscal probity, suggesting charging older Americans higher premiums for using publicly funded Medicare.

He advocates more spending on infrastructure to lift growth and improve the economy's productivity capacity, especially in light of rock-bottom borrowing rates. "Brinkmanship around debt ceiling and government shutdowns is a thing of the past; the Republican strategy failed completely," he says. He thinks Kotlikoff's "fiscal gap" measures pessimistically put too much - emphasis on assumptions about the future.

Now dean of the Kennedy School of Government at Harvard University, Elmendorf says waste in the US government sector is likelier in the "entitlement programs" than in the bureaucracy.

"There is a lot of unhappiness in this country about the size of government but it's uninformed in the sense government is growing because of higher benefit payments," he says, noting the US federal payroll has shrunk significantly as a share of the workforce in his lifetime. Pay levels in Washington, DC, are relatively frugal; its bureaucrats earn barely a third of Australia's $800,000-a-year-plus mandarins, for instance.

The US government has managed only five budget surpluses in the past 50 years, all under two Democratic presidents, Lyndon B. Johnson and (mainly) Bill Clinton. It needs to improve on that record across the next 50 years to have any hope of avoiding a financial crisis.

Whoever wins in November will have to embrace tough, politically unpopular choices to put the US budget on the right path. Taxes will need to rise or spending will have to be cut. The bouts of growth and inflation that used to help governments avoid a fiscal quagmire have dried up. The economic outlook is an apparently bleak one, featuring population ageing, slowing international trade and falling productivity and industrial dynamism.

The US is groaning under huge debts and eking out the longest and slowest recovery since World War II, even with official interest rates near zero. Indeed, without low interest rates the outlook would be even worse. And these are artificial to some extent, given the Federal Reserve has bought up more than $US3 trillion in government bonds to put downward pressure on long-term interest rates.

Neither presidential candidate has a plan for extricating the world's most powerful government from the fiscal quagmire. This should be cause for concern outside the US as much as it is within.