



GET THIS RIGHT... PLEASE

Aug. 2 is such an important date for the global economy that I am using editorial licence to delay my promised “idea number two” for generating unique economic activity in rural Atlantic Canada (it’ll be back next issue, guaranteed.)

This date is when the United States government will have run out of its ability to manage its financial obligations without further borrowing. The U.S. has self-imposed debt ceilings which, once reached, require the administration to seek congressional approval for them to be raised. The theory behind such limits is that it imposes discipline on the administration and requires the president of the day, whose responsibility it is to produce a budget acceptable to Congress, to acknowledge the role of Congress in pre-approving deficit spending in excess of the current limit. That limit now stands at \$14.294 trillion (yes, you’re reading that right — \$14,294 billion).

The issue, or at least what is widely accepted as the real issue, is not the current budget deficit, which in and of itself is massive. It is the prospect of future budget deficits and their prospective size. This is due to so-called entitlement spending — obligations resident in Social Security, Medicare (for low income folks) and Medicaid (support for the elderly). Depending on whose forecast you believe, the present day value of the unfunded liability amounts to substantially more than \$60 trillion.

To put the problem in greater perspective: current entitlement spending, including interest costs, roughly equals all government revenues from all sources. So, to maintain entitlement spending at today’s levels (given the reality of demographics we know it will climb sharply) under an agenda of a balanced budget, all defence spending, all government programs, including the cost of government itself would have to be reduced to zero.

A rational person would conclude that the only logical response is to cut entitlement spending and raise revenues. Unfortunately, the debate in Washington has become bitterly partisan, with the Democrats wanting to demonstrate their



The U.S. will have run out of its ability to manage its financial obligations without further borrowing.

concern for protecting the “little guy,” whereas the Republicans are taking the position of no new taxes (on the theory that new taxes will stifle growth and growth is a panacea) and no increase in the debt ceiling absent meaningful cuts in spending.

The good news is that there is a solution. It is resident in the kind of thinking demonstrated by the Simpson Bowles Commission, which recommended a combination of cuts in entitlements and revenue-raising measures. The United States is not Greece: the economy is capable of adjusting (e.g. America has no value-added tax and this nonsense of making the interest on residential mortgage debt tax deductible has not proven to increase home ownership rates). And the current balance sheet of the U.S. is capable of absorbing a gradual transition to a more balanced and sustainable fiscal position.

So it is very disheartening to listen to the rhetoric in Washington and accept the generally perceived view that only a crisis and brinkmanship will bring about an accommodation.

Why is this important? Because global growth is slowing, because sovereign debt concerns are a real encumbrance on the economic outlook for a host of jurisdictions, because the U.S. is still, by far, the world’s largest economy and because the U.S. dollar is the world’s only true reserve currency and the world needs a reserve currency that commands the respect and confidence of the world.

So, watch the Aug. 2 date and the machinations around the production of a resolution. If a good long-term plan requiring compromise on both sides of the political fence and requiring the dismantling of the walls surrounding the privileges of all the special interest groups is not found, then the world economy will pay a big price. Interest rates will climb, investor confidence will be eroded and the public’s view for the leadership credentials and obligations of elected officials in Washington will be materially undermined.

That America is in decline will be without doubt. Let’s hope our friends to the south can get their act together. | ABM

Illustration: Iain Keith Murray

The views expressed in this column are those of the author and not necessarily those of Atlantic Business Magazine. Feedback: dchafe@atlanticbusinessmagazine.com