



THE UNITED STATES IS INSOLVENT

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The End of Money

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Prepare to be shocked.

The US is insolvent. There is simply no way for our national bills to be paid under current levels of taxation and promised benefits. Our federal deficits alone now total more than 400% of GDP.

That is the conclusion of a recent Treasury/OMB report entitled [Financial Report of the United States Government](#) that was quietly slipped out on a Friday (12/15/06), deep in the holiday season, with little fanfare. Sometimes I wonder why the Treasury Department doesn't just pay somebody to come in at 4:30 am Christmas morning to release the report. Additionally, I've yet to read a single account of this report in any of the major news media outlets but that is another matter.

But, hey, I understand. A report is this bad requires all the muffling it can get.

In his [accompanying statement](#) to the report, David Walker, Comptroller of the US, warmed up his audience by stating that the GAO had found so many significant material deficiencies in the government's accounting systems that the GAO was "unable to express an opinion" on the financial statements. Ha ha! He really knows how to play an audience!

In accounting parlance, that's the same as telling your spouse "Our checkbook is such an out of control mess I can't tell if we're broke or rich!" The next time you have an unexplained rash of checking withdrawals from that fishing trip with your buddies, just tell her that you are "unable to express an opinion" and see how that flies. Let us know how it goes!

Then Walker went on to deliver the *really* bad news:

Despite improvement in both the fiscal year 2006 reported net operating cost and the cash-based budget deficit, the U.S. government's total reported liabilities, net social insurance commitments, and other fiscal exposures continue to grow and now total approximately **\$50 trillion**, representing approximately **four times** the Nation's total output (GDP) in fiscal year 2006, up from about **\$20 trillion**, or **two times** GDP in fiscal year 2000.

As this long-term fiscal imbalance continues to grow, the retirement of the "baby boom" generation is closer to becoming a reality with the first wave of boomers eligible for early retirement under Social Security in 2008.

Given these and other factors, it seems clear that the nation's current fiscal path is **unsustainable** and that tough choices by the President and the Congress are necessary in order to address the nation's large and growing long-term fiscal imbalance.

Wow! I know David Walker's [been vocal lately](#) about his concern over our economic future but it seems almost impossible to ignore the implications of his statements above. From \$20 trillion in fiscal exposures in

2000 to over \$50 trillion in only six years? What shall we do for an encore...shoot for \$100 trillion?

And how about the fact that boomers begin retiring in 2008...that always seemed to be waaaay out in the future. However, beginning January 1st we can start referring to 2008 as 'next year' instead of 'some point in the future too distant to get concerned about now'. Our economic problems need to be classified as growing, imminent, and unsustainable.

And let me clarify something. The \$53 trillion shortfall is expressed as a 'net present value'. That means that in order to make the shortfall disappear we'd have to have that amount of cash in the bank – *today* - earning interest (the GAO uses 5.7% & 5.8% as the assumed long-term rate of return). I'll say it again - \$53 trillion, in the bank, today. Heck, I don't even know how much a trillion is let alone fifty-three of 'em.

And next year we'd have to put even more into this mythical interest bearing account simply because we didn't collect any interest on money we didn't put in the bank account this year. For the record, 5.7% on \$53 trillion is a bit more than \$3 trillion dollars so you can see how the math is working against us here. This means the deficit will swell by at least another \$3 trillion plus whatever other shortfalls the government can rack up in the meantime. So call it another \$4 trillion as an early guess for next year.

Given how studiously our nation is avoiding this topic both in the major media outlets and during our last election cycle, I sometimes feel as if I live in a small mountain town that has decided to ignore an avalanche that has already let loose above in favor of holding the annual kindergarten ski sale.

The Treasury department soft-pedaled the whole unsustainable gigantic deficit thingy in last year's report but they have taken a quite different approach this year. [From page 10 of the report:](#)

The net social insurance responsibilities scheduled benefits in excess of estimated revenues) indicate that those programs are on an **unsustainable fiscal path** and difficult choices will be necessary in order to address their large and growing long-term fiscal imbalance.

Delay is costly and choices will be more **difficult** as the retirement of the 'baby boom' gets closer to becoming a reality with the first wave of boomers eligible for retirement under Social Security in 2008

I don't know how that could be any clearer. The US Treasury department has issued a public report warning that we are on an *unsustainable path* and that we face *difficult choices* that will only become *more costly* the longer we delay.

Perhaps the reason US bonds and the dollar have held up so well is that we are far from alone in our predicament. In a recent article detailing why the UK Pound Sterling may fall, we read [this horrifying evidence:](#)

Officially, [UK] public sector net debt stands at £486.7bn. That's equal to US\$953.9bn and represents a little under 38% of annual GDP. Add the state's "off balance sheet" debt, however – including its pension promises to state-paid employees – and the total shoots nearly three times higher. Research by the Centre for Policy Studies in London says it would put UK government deficits at a staggering 103% of GDP.

If we perform the same calculations for the US, however, we find that the official debt stands at \$8.507 trillion or 65% of (nominal) GDP but when we add in our "off balance sheet" items the national debt stands at \$53 trillion or **403% of GDP**.

Now *that's* horrifying. Staggering. Whatever you wish to call it. More than four hundred percent of GDP(!). And that's just at the federal level. We could easily make this story a bit more ominous by including state, municipal and corporate shortfalls. But let's not do that.

Here's what the federal shortfall means in the simplest terms.

1. **There is no way to 'grow out of this problem'**. What really jumps out is that the US financial position has deteriorated by over \$22 trillion in only 4 years and \$4.5 trillion in the last 12 months (see table below, [from page 10 of the report](#)). The problem did not 'get better' as a result of the excellent economic growth over the past 3 years but rather got worse and is apparently accelerating to the downside.

Any economic weakness will only exacerbate the problem. You should be aware that the budgetary assumptions of the US government are for greater than 5% nominal GDP growth through at least 2011. In other words, because no economic weakness is included in the deficit projections below, \$53 trillion could be on the low side. Further, none of the long-term costs associated with the Iraq and Afghanistan wars are factored in any of the numbers presented (thought to be upwards of \$2 trillion more).

Table 4. Comparing Current Net Liabilities to Future Social Insurance Responsibilities					
billions of dollars	2002	2003	2004	2005	2006
Liabilities Net of Assets (balance sheet)	\$ (6,820)	\$ (7,094)	\$ (7,710)	\$ (8,467)	\$ (8,916)
	The balance sheet presents a 'snapshot' of an entity's current financial position (net of assets and liabilities as of the end of the current fiscal year.				
Social Insurance Responsibilities, Net (closed group - - off-balance sheet)	\$ (24,219)	\$ (26,858)	\$ (37,279)	\$ (40,038)	\$ (44,147)
	The Statement of Social Insurance presents the present value of estimated future revenues and expenditures under current law.				
Combined Net Liabilities (current) and Social Insurance Responsibilities (future)	\$ (31,039)	\$ (33,952)	\$ (44,989)	\$ (48,505)	\$ (53,063)

- The future will be defined by lowered standards of living.** As [Lawrence Kotlikoff pointed out](#) in his paper titled "Is the US Bankrupt?" posted to the St. Louis Federal Reserve website, the insolvency of the US will minimally require some combination of lowered entitlement payouts and higher taxes. Both of those represent less money in the taxpayer's pockets and, last time I checked, less money meant a lower standard of living.
- Every government facing this position has opted to "print its way out of trouble".** That's an historical fact and our country shows no indications, unfortunately, of possessing the unique brand of political courage required to take a different route. In the simplest terms this means you & I will face a future of uncomfortably high inflation, possibly hyperinflation if the US dollar loses its reserve currency status somewhere along the way.

Of course, it is impossible to print our way out of this particular pickle because printing money is inflationary and therefore a 'hidden tax' on everyone. Consider, what's the difference between having half of your money directly taken (taxed) by the government and having half of its value disappear due to inflation? Nothing. Except that the former is political suicide while the second is conveniently never discussed by the US financial mainstream press (for some reason) and therefore goes undetected by a majority of people as the thoroughly predictable outcome of deficit spending. All printing can realistically accomplish is the preservation of some DC jobs and the decimation of the middle and lower classes.

In summary, I am wondering how long we can pretend this problem does not exist. How long can we continue to buy stocks and flip houses, forget to save, pile up debt, import Chinese made goods, and export debt? Are these useful activities to perform while there's an economic avalanche bearing down upon us?

Unfortunately, I am not smart enough to know the answer. I only know that hoping a significant and mounting problem will go away is not a winning strategy.

I know that we, as a nation, owe it to ourselves to have the hard conversation about our financial future sooner rather than later. And I suspect that conversation will have to begin right here, between you and me because I cannot detect even the faintest glimmer that our current crop of leaders can distinguish between urgent and expedient.

What we need is a good, old-fashioned grassroots campaign.

In the meantime, I simply do not know of any way to fully protect oneself against the economic ravages resulting from poorly managed monetary and fiscal institutions. For what it's worth, I am heavily invested in gold and silver and will remain that way until the aforementioned institutions choose to confront "what is" rather than "what's expedient". This could be a very long-term investment.

Are you shocked?

All the best.

Chris

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