Speeches ignore impending U.S. debt disaster

No mention of fiscal gap estimated as high as $72 trillion

By Carolyn Lochhead, *Chronicle* Washington Bureau
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Washington — The first of the 77 million-strong Baby Boom generation will begin to retire in just four years. The economic consequences of this fact — as scary as they are foreseeable — are all but ignored by President Bush and Democratic challenger John Kerry, who discuss just about everything but the biggest fiscal challenge of modern times.

Yet whoever wins the 2004 race will become the first U.S. president to confront what sober-minded experts across the political spectrum describe as an impending "fiscal catastrophe" lying right around the corner.

Astronomical federal debt, coming due as the Baby Boom generation collects Medicare, Medicaid and Social Security, is enormous enough to swamp the promises both candidates are making to voters, whether for tax cuts, health care, 40,000 more troops or anything else.

"Chilling" is the word U.S. Comptroller General David Walker uses to describe the budget outlook.

"The long-term budget projections are just horrifying," added Leonard Burman, co-director of tax policy for the Urban Institute. "I've got four children and it really disturbs me. I just think it's irresponsible what we're doing to them."

What these numbers portend are crippling tax increases on workers, slashed benefits for retirees, gutted budgets for homeland security, highways, research and everything else, and an economic decline or a financial collapse that devastates the middle class, as happened recently in debt-strapped Argentina. Eventually, analysts insist, someone — today's children or tomorrow's elderly or both — will pay this debt.

Traditional budget measures used by politicians and the press give what Walker and many others call a highly misleading view of the U.S. debt. These focus on publicly held debt already incurred, now at $4.5 trillion, or 10-year budget forecasts like the one released last week by the Congressional Budget Office showing a record $422 billion deficit this year and a $2.3 trillion 10- year deficit.

'Fiscal gap' in the trillions

But these figures, worrisome enough, are deceptive because they ignore future liabilities such as Social Security and Medicare payments to the Baby Boomers. An array of government and private analysts put the actual U.S. "fiscal gap," which means all future receipts minus all future obligations, at $40 trillion (Government Accountability Office) to $72 trillion (Social Security Board of Trustees).

These are not sums, but present-value figures, heavily discounted to show in today's dollars what it would cost to pay off the debt immediately. The International Monetary Fund estimates the gap at $47 trillion, the Brookings Institution at $60 trillion.

"To give you idea how big the problem is," said Laurence Kotlikoff, economics chairman at Boston University, who has written extensively on the subject, to close a $51 trillion fiscal gap, "you'd have to have an immediate and permanent 78 percent hike in the federal income tax."

These obligations are not imaginary. And unlike the 1980s and 1990s, economic growth cannot bail out the government because the Baby Boom retirement is at hand. Those born in 1946 will reach age 62 in 2008, allowing them to take early retirement and receive Social Security benefits.

"It's a number that's so large that people find it implausible, and so they don't think about it," said Alan Auerbach, a UC Berkeley economist who studies the issue and consults for the Kerry campaign. "But it's based simply on the projections we have for Social Security and Medicare. People aren't making these numbers up."

A pathbreaking study by Jagadeesh Gokhale of the Federal Reserve Bank of Cleveland and Kent Smetters, a former deputy assistant secretary at the Treasury — commissioned by former Treasury Secretary Paul O'Neill — estimated a $44 trillion fiscal gap. It laid out a few painful options on how to meet the liabilities:

— More than double the payroll tax, immediately and forever, from 15.3 percent of wages to nearly 32 percent;

— Raise income taxes by two-thirds, immediately and forever;

— Cut Social Security and Medicare benefits by 45 percent, immediately and forever;

— Or eliminate forever all discretionary spending, which includes the military, homeland security, highways, courts, national parks and most of what the federal government does outside of the transfer of payments to the elderly.

Such corrective actions grow more severe each year. Waiting just until 2008, the end of the next presidency, would mean raising the payroll tax to 33. 5 percent instead of 32 percent, the study found.

Gokhale said that fresh numbers from the Medicare trustees show the fiscal gap has since grown to $72 trillion, $10 trillion of that for Social Security and an astonishing $62 trillion for Medicare, the government health care program for the elderly.

"The long-term picture is pretty bad," Gokhale said.

Election's absent issue

These numbers are seldom discussed, least of all in the 2004 presidential race. Ironically, as the Baby Boom retirement has neared — and the remedies grow more painful — political discussion has faded. Gone is Ross Perot's anti-deficit crusade. Gone is Newt Gingrich's call for Medicare restraint. Gone is Al Gore's "lockbox" for the Social Security surplus.

Instead, Kerry and Bush promise only to halve the current deficit in four years — "both (of them) relying on pretty imaginative accounting to get there" said Burman — while promising more spending and more tax cuts.

Yet today's deficit is a tiny fraction of the government's actual liabilities, which are so daunting they promise to make Bush's tax cuts a distant memory and Kerry's health care plan a fantasy.

While Bush and Kerry propose to address parts of the problem, "the numbers don't add up on either side," Walker said.

Medicare makes up the bulk of these liabilities, driven mainly by the expanding elderly population and rapidly rising health costs. Social Security, more often discussed as a looming problem, actually accounts for far less in future debt.

While Congress squabbles over whether the administration hid the new prescription drug benefit's 10-year cost — pegged by the White House at $534 billion versus CBO's $395 billion — the actual liability incurred by the new drug benefit is estimated at $8 trillion to $12 trillion.

Kerry and Democrats call the drug benefit inadequate. They would do little to restrain Medicare costs other than allowing the importation of price- controlled drugs from Canada.

Bush and Republicans added the drug benefit along with costly subsidies to providers. Even optimists do not expect their modest market reforms to cut costs.

Promises, promises

Kerry has promised not to cut Social Security. "I will not cut benefits," he said recently. "I will not raise the retirement age."

Democrats generally cite "trust fund" numbers that show Social Security - - and Medicare to a lesser extent — remaining solvent for decades, even though government officials repeatedly call the numbers an accounting fiction. CBO director Douglas Holzt-Eakin last week said the funds contain nothing but "electronic chits" that measure government obligations to itself.

Bush proposes adding private accounts to Social Security for younger workers, which could reduce future government obligations, but would do so by diverting a portion of the payroll tax, adding $1 trillion to the short-term deficit. That might have been feasible when Bush took office in 2000 facing a projected $5.6 trillion surplus, but the surplus is gone. Similar plans in Congress that instead rely more on benefit cuts have gone nowhere.

"The country's absolutely broke, and both Bush and Kerry are being irresponsible in not addressing this problem," Kotlikoff said. "This administration and previous administrations have set us up for a major financial crisis on the order of what Argentina experienced a couple of years ago."

If this sounds far-fetched, former Bush Treasury Undersecretary Peter Fisher and former Clinton Treasury Secretary Robert Rubin both alluded to such a scenario at a June budget forum in Washington.

"Having been involved in markets for a long, long time," Rubin said, "I can tell you these things can change unexpectedly and without warning," referring to potential financial market reactions to the U.S. fiscal position.

Fisher warned of a "pivot point" when "the collective wisdom of bond traders thinks that the deficit horizon has turned," adding, "Both Bob and I are nervous."

The world has seen fiscal imbalances of this sort before, in Asia and Russia in the late 1990s and more recently in South America. Such financial panics can be triggered by any number of events — a flight from Treasury bonds by the foreigners who buy much of the U.S. debt, for example — if investors' views of the market, which are focused on the short term, suddenly change.

"If you look at financial crises, they occur seemingly overnight," said Kotlikoff. "More and more pieces of straw drop on the camel's back, and all of a sudden, the camel collapses. ... Nobody knew exactly what day Argentina was going to go south or exactly what day Russia was going to default. The timing is up for grabs."

But early signs of a problem are now appearing, analysts said, starting with the mounting deficits under Bush caused not just by the recession and terrorist attacks, but also by enormous spending increases and tax cuts. The brief window of surpluses that appeared during the late 1990s economic boom offered a chance to address long-range liabilities, but those surpluses now are gone.

"Maybe the public doesn't want to hear it," Kotlikoff said. "Maybe politicians think ... the American public can't understand the truth or hear the truth or bear the truth. I think this is garbage. I think that people care about their kids and grandchildren and need to know the dangers facing them — and us."

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