Sun Journal

Debt is runaway train

By J Dwight , Populist Economics

Published: Nov 22, 2009 1:25 am

"The current path of indebtedness shows a permanent venture into economically unfavorable territory," says John Silvia, chief economist for Wells Fargo Securities. "It feels like we are on a runaway train where the engineer, conductor, brakeman, and some of the passengers are drunk on power and speed."

He's not alone among economists questioning the wisdom of high deficit spending, coupled with high and rising debt and policies that worsen these problems.

The United States now faces the highest deficit in its history — $1.4 trillion. This is 13 times the number of people who have ever lived, or $4,500 for every person living in the U.S. (Silvia pointed these numbers in a Nov. 5 commentary titled "Did the Nation Overdose on Debt?" published on wachovia.com.)

The amount of debt as a percentage of Gross Domestic Product is the most since just after World War II. Wartime debt is normally a temporary problem and has not historically damaged a country's ability to grow. But the trajectory of trillion dollar deficits for years to come, total debt approaching $13 trillion and accelerating and looming policies like cap and trade and health care reform pose a real concern for citizens.

As well as worry investors all over the world.

Yes, short-term deficits due to the collapse in the mortgage and housing markets, and the subsequent layoffs and unemployment, have contributed to the current debt and deficit problems. But we're looking now at long-term problems. When other countries have lived with heavy debt loads, problems only worsen and accelerate the longer the country remains in deep indebtedness.

In fact, recent studies released by the Congressional Budget Office show that without policy changes, the annual deficit will reach about 10 percent of gross domestic product within fifteen years. This is unsustainable.

The primary driver of federal spending for entitlement programs — Medicare and Social Security — are also poised to accelerate. Such programs are the major component of larger deficits. Even without the repercussions of cap and trade or health care reform, this growth alone may derail our national train.

Here are the problems: spending is growing faster than revenues, and foreign investors finance the growth in debt.

News stories have emerged recently saying that America's vaunted AAA rating and reserve currency status are in jeopardy. Losing these will affect every state and local rating, increasing borrowing costs for everyone. If most of our debt were financed by savings of people in the United States, this would be less of a concern, but 50 percent is being carried by people in foreign countries, most notably China, Japan and the middle east.

The current administration's and Congress' proposed policies create doubt in our ability to repay our existing debt. Our financiers should be worried.

Half of U.S. debt is owned, and being bought, by investors who should have fewer and fewer reasons to believe that the U.S. is going to be as reliable a debtor as the past. These concerns weigh on the dollar and buoy the price of gold.

The Federal Reserve's low interest rate policy may help stock prices increase. Their relative attractiveness, especially for dividend-paying stocks compared to zero interest on money markets, is driving their prices higher, not the prospect of a better economy or a more confident consumer. It's a measure of greatest avenue for profit, not overall consumer confidence.

In one way, the American already people get this. They have increased their savings and been paying down debt. The savings rate of the United States has been increasing sharply since the financial crisis began, after decades of decline. This may help in the long-term.

But, there is a major change in investor habits going on. Fewer and fewer believe that America is the best place in the world to invest. More and more people are shifting to overseas and commodity-based investments. This will counteract any benefit from better savings habits.

The country's runaway deficit and debt train must be stopped. Less spending and growth in the private sector that increases growth in tax revenues is the only way to do this. At some point, something has have to change. The current trends are disastrous.

Maybe the engineer, conductor and some of the passengers on this train will begin to sober up.

Or, maybe the people running the railroad will have to be replaced.

J. Dwight is a SEC registered investment adviser and an advisory board member of the Maine Heritage Policy Center. He lives in Wilton. E-mail jdwight@gwi.net.