S&P Points to Plain Problem

The general perception of the dollar as the world's backstop currency and of U.S. government debt as being as good as gold survived President Nixon's closing of the "gold window" in 1971 and the decade of economic malaise — which included significant inflation — that followed. This is surprising in hindsight because Nixon's action certainly fulfilled the criteria for a partial default, being motivated by the inability of the United States to service debts incurred in the Vietnam War.

In the rise of the euro, the U.S. dollar appeared for a time to have gained a competitor for an international currency — until the recent debt crisis in the EU. The ascendancy of economies like Brazil, China, and India, meanwhile, has created new international purchasers of U.S. government debt. With the European crisis spinning out of control, U.S. treasuries, yielding a very modest 2.34 percent for a 10-year maturity, are still very much in fashion. What, then, is all the fuss about?

As Standard & Poor's explained it:

> We lowered our long-term rating on the U.S. because we believe that the prolonged controversy over raising the statutory debt ceiling and the related fiscal policy debate indicate that further near-term progress containing the growth in public spending, especially on entitlements, or on reaching an agreement on raising revenues is less likely than we previously assumed and will remain a contentious and fitful process. We also believe that the fiscal consolidation plan that Congress and the Administration agreed to this week falls short of the amount that we believe is necessary to stabilize the general government debt burden by the middle of the decade….

Our opinion is that elected officials remain wary of tackling the structural issues required to effectively address the rising U.S. public debt burden in a manner consistent with a "AAA" rating and with "AAA" rated sovereign peers…. In our view, the difficulty in framing a consensus on fiscal policy weakens the government's ability to manage public finances and diverts attention from the debate over how to achieve more balanced and dynamic economic growth in an era of fiscal stringency and private-sector deleveraging. A new political consensus might (or might not) emerge after the 2012 elections, but we believe that by then, the government debt burden will likely be higher, the needed medium-term fiscal adjustment potentially greater, and the inflection point on the U.S. population's demographics and other age-related spending drivers closer at hand.

In other words, Standard & Poor's is unimpressed with the skimpy cuts agreed to by Congress, and expects that, in the face of political paralysis, the U.S. government debt will continue to rise sharply, making the likelihood of some sort of debt dilution — devaluing the dollars in which the debt is denominated, in other words — very likely.

Standard & Poor's action has received a lot of publicity, but it's far from the only sign U.S. creditors are coming to realize that their holdings of U.S. debt may not be as surefire as once imagined. Both China and India have made no secret of their intent to reduce their exposure to the U.S. dollar. Many other major investors, such as the celebrated Jim Rogers, have confidently predicted that the U.S. government, shorn of other options, will eventually try to print its way out of debt. And allegedly respected organs of opinion in the United States have even warmed to the idea. On August 9, for example, the *New York Times* ran an editorial excoriating the Federal Reserve for failing to take more robust action to combat the economic crisis. The *Times* recommended a number of countermeasures the Fed should use to bring the crisis and the national debt under control:

> [The Federal Reserve] could reduce the interest it pays on the banks' huge reserves or even tax the reserves to try to encourage more lending. It could also resume buying Treasuries or other securities to provide additional monetary stimulus. A more aggressive strategy would be letting inflation rise above the Fed's comfort level of 2 percent or so to, say, 4 percent. *That could help the economy by easing the repayment of debt.* [Emphasis added.]

Pronouncements like these, especially coming from the likes of the *New York Times,* are unsettling to investors. If the *Times* sees nothing morally wrong with the Fed's opening the money spigots wider in a conscious attempt to dilute U.S. debt, there can be little doubt that others in rarefied opinion-molding and policymaking circles are of a like mind.

Coin Clipping

Debasing currency is one of the oldest and most dishonest tricks used by monarchs and politicians to relieve themselves of the burden of heavy debts without inflicting ruinous taxes on their subjects and citizens. (Of course, the citizens must still pay in the end.) Roman emperors, lacking paper money and printing presses, engaged in "coin clipping," trimming some of the metal off the edges of coins for resale elsewhere, all the while leaving the face value of the coinage unchanged. Merchants and bankers soon discovered the ruse, of course, resulting in the steady depreciation of the value of Roman coins, a process analogous to modern inflation.

Coin clipping has been resorted to many times since the time of the Romans, both by public and private con artists, prompting mints to mill the edges of gold and silver coinage to make clipping easily detectable.

With the rise of modern banking and paper money in the 1600s, governments quickly discovered the power of the printing press. Then as now, governments ran up huge debts to fund wars and other extravagances unpopular with the taxpaying public — and learned how to pay for them by printing the necessary funds. The gargantuan public works projects, wars, and palace luxuries of France's Louis XIV were a particularly flagrant example of this practice. The autocratic "Sun King" ran French finances into the ground during his long reign, and generations of Frenchmen afterwards were stuck with the tab. The outcome was, first, a series of booms and busts during the first half of the 18th century, occasioned by the printing press (among them the infamous "Mississippi bubble"), and then, when France finally went bankrupt, revolution and tyranny.

Twentieth-century Argentina followed a similar path. From the world's eighth-richest nation at the beginning of the century, Argentina embraced the welfare statism of Juan Peron and his wife Evita. By the 1970s, the Argentine peso was virtually worthless, and Argentina had incurred debts that could never be repaid. Amid civil war, the military established a dictatorship, and soon finished off the Argentine economy in a ruinous war with Great Britain over the Falkland Islands. Hyperinflation and economic collapse followed, for which a turn to popular government proved only a temporary relief. By the beginning of the 21st century, Argentina was forced to default on a portion of her debt, resulting in overnight poverty for millions of Argentines and a dizzying rise in violent crime that continues to this day.

The United States has incurred heavy debts periodically throughout her history — usually in wartime, until the mid-20th century. But the pattern in early America was for wartime debts to be paid off. Following the War of 1812, the United States ran budget surpluses for 18 out of 20 years, and paid off more than 99 percent of her debt. During the 47 years following the Civil War, the United States had 36 budget surpluses and paid her debt down by 55 percent. After World War I, the nation had 11 straight budget surpluses and reduced the debt by 35 percent.

With FDR's New Deal, however, the United States began amassing large debts during peacetime to defray the costs for the massive new welfare state erected from the 1930s onwards. The debt ballooned during World War II to well over 100 percent of the GDP, but soon after the war's end, the size of the federal government was scaled back dramatically. The result was a postwar boom that allowed the GDP to gain a lot of ground on the debt.

Throughout the boom years of the '80s and the '90s, the debt continued to burgeon — but so did the GDP, allowing politicians the luxury of continuing to spend more and more sums on myriad programs, from their pet pork-barrel projects to military intervention across the globe. No matter how big government grew, it appeared that it would never be able to suffocate America's booming private sector.

Then, as must always occur sooner or later, the boom — fueled as it was by easy credit courtesy of the Federal Reserve — was over. The dot-com bust and 9/11 put an end to a generation-long bull market, but the federal government continued to borrow and spend as though the boom had never ended. The result, of course, is a mushrooming national debt that now threatens to administer the coup de grâce to our enfeebled economy.

A Belly Full of Borrowing

Yet official Washington, with a few exceptions, refuses to acknowledge that anything has changed. The Obama administration, in the midst of the worst economy since the Great Depression, fought tooth and nail to enact an enormous new healthcare overhaul that has already imposed hundreds of billions of dollars in new expenses, and embarked upon a third war in the Muslim world. And millions of Americans continue to clamor to keep the various benefits, handouts, and subsidies they believe themselves entitled to, blind to the long-term (and now, short-term) costs they are imposing. In a word, the state of the economy has changed drastically for the worse, but Washington is borrowing and spending more than ever before.

The numbers tell a grim story. The "official" national debt, which consists of all debt owed to outside parties plus intergovernmental debt owed, stands at more than $14.58 trillion dollars in the wake of the debt ceiling increase — an almost inconceivable sum, just over 100 percent of our 2010 GDP. Ten years

ago, the debt was not much more than a third of that — $5.7 trillion. Most of that growth is due to an explosion in the size and cost of government, far out of proportion to the actual growth of the population. It is a consequence of three overseas wars — one of which has been ongoing for almost a decade — two massive overhauls of healthcare under Bush and Obama, the creation of a vast new domestic security apparatus, and the overburden from dozens of hugely expensive government programs, from housing subsidies to Medicare, that have been in place for decades, among many other things.

And the real state of national finances is much worse than the official debt figures indicate, because of the dishonest practice of declaring large swaths of so-called "mandatory spending" off-budget. The total value of unfunded obligations to Social Security, Medicare, and Medicaid is about $45.8 trillion, while the amounts guaranteed via new programs designed to prop up ailing banks and financials, like the Exchange Stabilization Fund and the Temporary Liquidity Guarantee Program, are unknown but doubtless amount to tens of trillions of dollars more.

Merely reckoning the unfunded obligations like Social Security together with the official debt figures yields a total of more than $60 trillion, well over four times the American GDP (by comparison, consider that the Greece's debt was in the range of 150 percent of the GDP).

This is the desperate state of the American national debt, which Standard & Poor's has finally recognized. Unless a massive political shift occurs very quickly, America, already the largest debtor in world history, can expect to see its bonds reduced to junk status as her towering debt and uncontrolled spending destroy our economy and our society as surely as has occurred in Argentina, Greece, Ireland, and many other nations.

No nation has ever borrowed itself into prosperity or spent itself into solvency, yet that is precisely what our political leadership is trying to do. The unhappy examples in Europe, which will soon include the likes of Italy and Spain, ought to be warning enough of the perilous path we are on, even if the warnings of Standard & Poor's go unheeded.

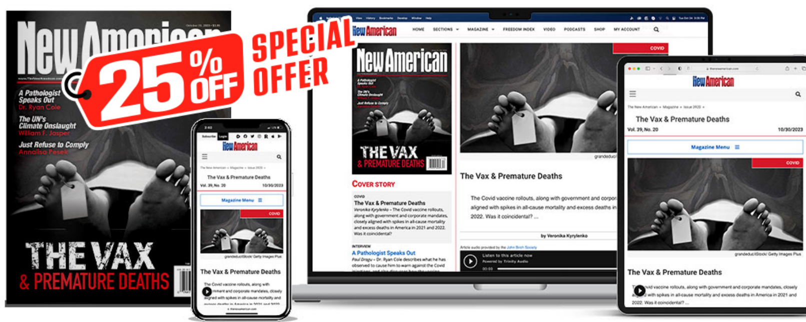
— Photo: AP Images

Subscribe to the New American

Get exclusive digital access to the most informative,
non-partisan truthful news source for patriotic Americans!

Discover a refreshing blend of time-honored values, principles and insightful perspectives within the pages of "The New American" magazine. Delve into a world where tradition is the foundation, and exploration knows no bounds.

From politics and finance to foreign affairs, environment, culture, and technology, we bring you an unparalleled array of topics that matter most.



Subscribe

What's Included?

24 Issues Per Year
Optional Print Edition
Digital Edition Access
Exclusive Subscriber Content
Audio provided for all articles
Unlimited access to past issues
Coming Soon! Ad FREE
60-Day money back guarantee!
Cancel anytime.