The American Debt Burden

Can America Repay its Public Debt?

Mohamed Rabie

In June 2015, the US public debt exceeded $18.3 trillion, or 105% of the US Gross Domestic Product or GDP. In light of these facts, can The US government repay its debt in the near future? Can it even service its debt without going deeper in debt? The answer to both questions is No: the United States has passed the point where it could service its debt without going deeper in debt, let alone repay it.

Can America do something to ameliorate the debt problem in the short run? Yes, it can do a lot to reduce the severity of this problem and limit its long-term negative impact. But to do so, the administration and members of congress need to "first" acknowledge the severity of the debt problem and its negative impact on US credibility and the American economy; and "second," they need to realize that the traditional fiscal and monetary tools of economic and financial management are no longer workable. If the American ruling elite continue to follow the mostly outdated policies and give priority to political infighting and special interests, the debt problem will only get worse. Senator Tom Coburn, commenting on the political infighting, wrote April 5, 2011, "of my Republican friends I would ask: what good is a Republican Party without a republic? And of my Democratic friends: what good is your commitment to the poor without an economy to sustain your commitments? (Tom Coburn: "While Washington Slept," *the Washington Post*, April 5, 2011, A21) The recurring fight over raising the debt limit proves that for members of congress, politics comes before policy, special interests come before the national interest, and ideology comes before nation.

For the United States to gradually reduce its debt as a percentage of its GDP, the annual increase of its GDP has to exceed the annual budget deficit. If the budget deficit, including interest payments, exceeds the annual increase in the GDP, the debt will grow in size as well as a percentage of GDP. On the other hand, for the United States to repay its debt over the long run, it has to have an annual budget surplus that exceeds the debt interest payments. According to the Congressional Budget Office (CBO), the last time the US had a surplus was in 2001. From 2001 to 2015, spending had continued to increase, while revenues had failed to close the growing deficit gap. For 2015, spending is expected to reach 20.5% of GDP, and revenues are expected to reach 17.7% of GDP, causing a deficit of 2.7% of GDP, or some $470 billion. However, the size of the deficit is expected to grow, reaching 5.9% in 25 years.

According to the Whit House, revenues in 2014 were $3.01 trillion, expenditures $3.51 trillion and the deficit $485 billion; and in 2015, expected revenues are $3.2 trillion, expenditures $3.8 trillion, and the deficit $583 billion. This means that the increase in GDP represents a fraction of the budget deficits, causing the debt to increase in size as well as a percentage of GDP. Based on the federal revenues and expenditures of the last few years, to begin to repay its debt, the federal revenues have to increase by more that 60 percent or expenditures decline by 40 percent, or revenues increase some and expenditures decline some.

According to the CBO, about half of the increase in the public debt in the coming 10 years will be due to interest payments; since interest rates are expected to start rising soon, interest payments will increase causing the debt problem to worsen further. Although interest rates on US Treasury bills have come down substantially since 2009, the decline does not reflect a better performing US economy; rather, it reflects a worsening outlook for the world economy.

Assuming an average interest rate of 2.5% annually and an average economic growth rate of 2.2%, annually, with no recessions or drastic changes in policy, the US public debt would reach $28 to $30 trillion by the end of 2022. Consequently, the annual interest payments would reach $750 billion, and the debt to GDP ratio would rise to 150 percent. Therefore, under current spending and tax policies, the United States is neither able to service its debt without going deeper in debt, nor reduce its size as a percentage of GDP, let alone repay it. Some people might think that a 2.2% annual growth rate is too low; unfortunately, they are mistaken. The times of high economic growth rates in the West are over; the world is passing through an era of diminishing expectations, and its capacity to produce most essential goods exceeds it capacity to consume or absorb what it produces.

Can the United States live with a continuously rising debt to GDP ratio like Japan? (Japan's public debt is estimated at 234 percent of its GDP.) I do not believe it can. The American socioeconomic conditions and cultural values are different from those in Japan, and therefore what works for Japan is unlikely to work for the United States. Nations usually borrow to close temporary budget deficits, or to invest in projects designed to increase the production capacity of their economies, which causes state revenues to subsequently rise and eventually close the deficit gap. The United States has been borrowing to finance unnecessary wars and wasteful conspicuous consumption. Meanwhile, the Japanese high savings rates have enabled the state to borrow from its citizens and recycle their money on their behalf. In contrast, the US government, due to low savings rates, owes about half of its public debt to foreigners who have the capacity to disrupt the American economy by undermining the value of the dollar and causing interest rates to rise substantially.

Despite these differences, using domestic savings to finance budget deficits seems to have caused the Japanese economy to stagnate and loose its dynamism. But since Japan's population is largely stagnant and its standards of living are high, Japan does not have to create millions of new jobs every year. In contrast, the United States has to create about 1.5 million new jobs annually due to population growth, and spend billions of dollars to help the needy due to rising poverty rates and widening income and wealth gaps separating the rich from the poor. Dependence on foreign sources of capital to finance deficits, therefore, does not allow the United States to have a growing debt ratio to GDP without damaging its economic and political credibility. Experts estimate that when debt reaches 90% of GDP, it causes potential economic growth to decline by some 1% annually. America has already passed this threshold by 15 points.

What are the US options to dealing with the debt problem? the United States has a few options: to default, which is considered no option; to double the current tax rates, which US Congress will never agree to do so; to go deeper in debt; or resort to printing money and risk inflation and weakening the dollar. Therefore, the only way to deal with this problem is to find a creative method to repay the entire debt now.

Economists have suggested several ratios of debt to GDP that are supposedly sustainable. No debt to GDP ratio is sustainable or unsustainable without qualifications. Sustainability is a function of three major factors: the annual economic growth rate, the size of the budget deficit, and the expected interest rates. Any state can continue to borrow until markets say, No more; just like what happened with Greece. At such a point, however, markets would have lost confidence in the economy and the state's ability to manage its financial affairs. Since almost all western states have failed to manage their economies properly during the last two decades, the question has become, not "too big to fail," but rather "too tall to fall." However, unless they take drastic measures, all highly indebted states will eventually fall under the heavy weight of the debt they are carrying on their backs.

If the United States were to repay its public debt now, the budget deficit would vanish overnight. Such an action would restore American consumer and business confidence, calm the financial markets and give the government an opportunity to grow the economy, while restructuring its spending and tax policies. And if the United States were to climb back within the coming 10 years to where its finance were in 2001, when revenues were 19.5 percent of GDP, and the budget was 18.2 percent of GDP, it will be in a position to contain its debt and start to gradually reduce its size.

If the United States continues to finance spending by borrowing and printing money, it would not take the financial markets long before losing confidence in the US economy and dollar. If this were to happen, the international pool of easy money would dry quickly, and interest rates would rise substantially, forcing the American government to rely solely on borrowing from the American people, printing money faster and raising taxes, which is a good recipe for a prolonged state of stagflation, if not depression.

Many states in the world and most western industrialized states have borrowed too much for too long and got accustomed to spending and living beyond their means. And in light of the low economic growth rates and high unemployment, and the growing burden of servicing the debt, anyone who thinks that any highly indebted state will be able to repay its debt in the foreseeable future is either misleading the public or deceiving himself. Austerity measures will not solve the problem; they failed to deal with the Latin American debt crisis in the 1980s, and they are failing today to deal with the Greek, Portuguese, Italian and Spanish debt crises. The political and social forces that celebrated the Greek rejection of the EU imposed austerity plan seem to suggest that citizens are no longer willing to tolerate severe austerity measures. Therefore, to revitalize capitalism and revive democracy, the public debt of all nations must be paid now; otherwise, no western state will be in a position to resume economic growth as usual, restructure it economy and culture or rebuild its weakened middle class to preserve its democratic traditions and way of life.

Professor Rabie is an author and a professor of international political economy. He studied, lived and taught in 4 continents, and lectured at more than 80 universities and research institutes worldwide. He has published 40 books and over 1,000 papers and articles. The interests, writings and activities of Dr. Rabie reflect a strong commitment to peace, freedom, social justice and human rights.

professorrabie@yahoo.com

www.yazour.com