ISSUES IN PERSPECTIVE

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Systemic Challenges Beneath the Façade of American Prosperity

Over the last year or so, Americans have been on a spending binge. The stock market has reached record levels. (Although, as I am writing, it is falling precipitously, having lost 1300 points in three days.) And the US Congress, at the insistence of President Trump, passed a massive tax cut. America's GDP is stable, unemployment is low and wages are slowly increasing. But all of this is a façade. One of the significant risks, with all this spending, the tax cuts and rising wages, is inflation, which is one of the reasons the stock market is falling. What I hope to address in this *Perspective* are the underlying systemic challenges facing America. They are serious and potentially very destabilizing. Let's review some of these systemic issues:

- First is the absence of significant savings in America. Between 2008 and the third quarter of 2017, the net worth of US households increased from $56 trillion to $97 trillion, but, in December, the US household savings rate was the lowest (2.4% of disposable income) since the negative savings rates in 2005 and 2006, right before the housing bubble burst. George Will reports that "many Americans, forgetting the most intractable fact—that nothing lasts—turned the equity in their homes into cash to fund immediate consumption. Today, 104 months after the recovery from the Great Recession began in June 2009 (when the savings rate was 6.6%), 2.5 million homes are still worth less than is owed on their mortgages." He also reports that as of 2013, 45% of working-age households had no retirement savings. Social Security provides 33% of seniors' annual income and 90% for the bottom third of retirees, but only about 35% of a typical household's pre-retirement income. Last year, Social Security became America's first trillion-dollar-a-year program. By 2035, its trust fund will be exhausted and benefits will thus need to be reduced 23%. In 2015, the Federal Reserve reported that half of those it surveyed could not gather $400 to cope with an emergency; one-third said they could not sell assets, tap retirement savings or turn to family or friends to pay three months of expenses. Will also reports that by 2017, median household savings ($14,500) for those near retirement age had declined 32% in a decade, and for the first time, older Americans had more credit card debt than younger Americans. Between 2003 and 2005, the indebtedness of those between ages 50 and 80 increased 60%. Today, those between 65 and 74 have five times more debt than that age cohort did two decades ago.

- Second, the tax situation in America is hardly positive! The bottom 50% of earners in America supply less than 3% of income-tax revenues. Indeed, 55% of American households pay no income tax, either because they earn too little or because they qualify for enough exemptions and credits to erase their tax liability. Further, 60% pay nothing or less than 5% of their income. In fact, 40% of earners are net recipients from the income tax because they qualify for refundable tax credits. So, into this curious state of affairs, the US Congress passed a massive tax cut. Listen to Alan Simpson (former Republican senator for Wyoming) and Erskine Bowles (former chief of staff for Bill Clinton), both of whom co-chaired the National Commission of Fiscal Responsibility and Reform: "Seven years ago and almost $7 trillion in new debt ago, we released a bipartisan package of tax and spending reforms . . . [in which we declared] that the era of deficit denial was over . . . Yet, the fundamental fiscal challenges we identified in 2010 remain." Here are their comments on the tax package Congress passed right before Christmas:

1. The US national debt will increase by $1.5 trillion but include "about a half-trillion dollars in phony savings from artificial 'sunsets' and other gimmicks. With interest, that means these tax cuts could add $2.2 trillion to the debt."
2. Economic growth is not going to wash away this new debt. Indeed, this new law will only increase the growth rate by 0.03 to 0.09 percentage points per year—and that growth will cut costs by only one-eighth or less.
3. The current tax code gives away roughly $18 trillion of tax breaks over the next decade. The new law cuts only $3.7 trillion of those tax breaks.
4. Higher levels of debt will crowd out productive investment, slow wage growth and ultimately undo any gains from this tax cut-reform package.
5. Enacting debt-financed tax cuts, which is what this new law does, will only make it much more difficult to substantively and effectively bring the US debt under control. There must be a reform in the growth of both health and retirement entitlements—and no one wants to do that. As a nation, we are only postponing the inevitable crisis.

For the above set of reasons, the Republican controlled Congress should be ashamed of itself. Donald Trump ran on the promise that he would erase the national debt in eight years. One of the banner issues for the conservative Freedom Caucus was deal with the debt through entitlement reform. The basic tenet of conservative Republican politics over the last two decades has been deal with the debt!!! No matter how one looks at this new tax law, the energizing center of the Party is dead! It is difficult for them to avoid the charge of hypocrisy and inconsistency. They give every appearance of being unprincipled.

- Finally a word about the budget process in Congress. The US Constitution is quite clear that the legislative branch of the US government has the power of the purse. But, the way Congress has gone about this recently makes little sense and smacks of insanity! Consider this:

1. Annual US budgets cover only the roughly one-third of federal spending that Congress has decided needs reapproval each year. Most entitlement programs (e.g.,

Medicare, Social Security) are automatically funded. This process affords no opportunity whatsoever to address the real issue of the massive deficits—entitlement spending.

2. Written as a procedure in the 1970s, Congress task is to pass 12 separate bills funding each area of government (e.g., housing, defense, agriculture, etc.), with each reported out by an appropriate congressional committee. In reality, Congress has not passed separate approbations bills since 1996. Doing so takes too many controversial votes. Instead, Congress passes massive bills that fund everything. So, it resorts to "continuing resolutions," while Congress tries to work out a deal on the various issues to get the massive funding bill passed. Because all of this merely preserves the status quo, it is often difficult for the various government agencies to even operate efficiently or effectively.

3. Congress has tried to institute "spending caps" but, in 2013 and 2015 for example, Congress has merely lifted these "spending caps." This hardly enforces budget discipline.

4. It takes only 41 or more votes in the Senate to block a budget bill. The result is that over the last two decades, the budget process has become a conduit for various disputes currently engaging Congress. Usually, those disputes have nothing to do with the budget.

In short, beneath the façade of prosperity in the US looms a fiscal catastrophe. The US national debt is now over $20 trillion and the current budget cycle we are in will increase that amount by another $1 trillion, for that is the amount the nation will need to borrow to pay its bills. Indeed, the Secretary of the Treasury just announced that because of the Trump tax cuts, this quarter alone the US government will need to borrow $441 billion!! As interest rates continue to creep up, the cost of the US government borrowing all of this money will also increase and the debt service will grab a higher and higher portion of US government spending. There are systemic challenges that no one in the national government seems to want to deal with. Instead, everyone keeps telling us that things could not be better. They are not! America is facing a monumental fiscal crisis.

See *The Economist* (27 January 2018), p. 22; Alan Simpson and Erskine Bowles in *The Washington Post* (29 November 2017); and George Will in *The Washington Post* (10 November 2017 and 2 February 2018).