You Can’t Eat Your Own Head

By Kerry Pechter *Thu, Jun 23, 2022*

The US faces an unsustainable fiscal imbalance of about $250 trillion over eternity, says an econometrics think tank. For several reasons, the analysis doesn't worry me.

Every so often the Penn Wharton Budget Model sends out a depressing new report about the un-sustainability of US government finances. The **PWBM** often depicts the federal government (though not in so many words) as up to its neck in ink that’s as red as Uncle Sam’s trouser stripes.

Based in Philadelphia, PWBM is a non-partisan econometrics group that analyzes proposed federal legislation and estimates the impact of new fiscal initiatives on the nation’s long-term budget. Its latest **release** describes US finances as not sustainable. PWBM’s economists wrote:

“We estimate that, under current law, the US federal government faces a permanent present-value fiscal imbalance of $244.8 trillion, or 10.2% of all future GDP… A positive permanent fiscal imbalance implies that federal debt payments continue to increase indefinitely relative to the size of the economy, which is not fiscally sustainable.”

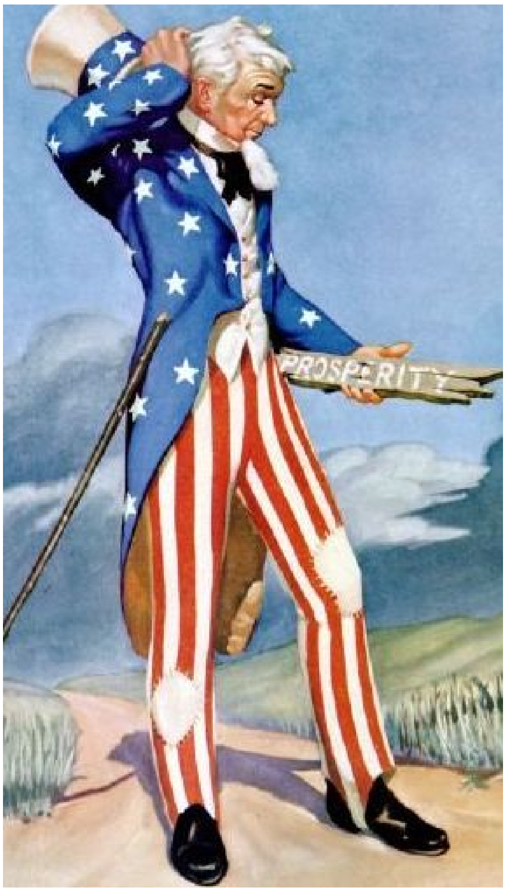
Those numbers come from a projection to perpetuity. The present value of the imbalance projected over just the next 75 years is a more manageable $104.3 trillion. That includes $27.5 trillion in US Treasury debt, $36.3 trillion in payouts in excess of tax receipts by Social Security, and [federal purchases of public goods and services] of $77.5 trillion. The total is reduced by the $37 trillion the government owes itself (intra-governmental debt).

“That [$104 trillion] is the extra resources that, if available today, would permit maintenance of current receipt and expenditure laws for the next 75 years (2021-95),” the new report said.

To solve this shortfall, the PWBM economists say:

“The government would save this money at the long-term borrowing rate, like a very large trust fund, and spend it down over time as needed, reaching full depletion by the 75th year.”

These numbers make the US government look like a household with lousy credit, or a private business not productive enough to earn its way out of its hole. That outlook is depressing—it implies that the US might need to sell its public lands, for instance, and put the money aside somewhere.



Fortunately, this analysis isn’t the only way to describe our situation.

Yes, the US would probably appear fiscally healthier if as a nation we manufactured more domestically, imported less, and financed more public expenditures with tax revenue than debt.

But PWBM’s bleak portrait of America’s financial future—despite the scholarly chops of the authors, the undoubted precision of the calculations and the internal logic of the underlying model—just doesn’t ring true.

History doesn’t validate it.

Over the past 15 years, we’ve seen repeated financial crises where the Federal Reserve and Treasury bailed out the private sector (and not the other way around). For more than 40 years, we’ve heard many predictions that our national “Don’t Tread on Me” snake is eating its own financial tail (and will eventually reach the head).

But the head never gets around to eating itself. Why?

Those who hold Treasury debt consider it wealth, not a burden. Lending to the government doesn’t make individuals or banks poorer. Just because the federal government spends all the money it borrows, and doesn’t “save” money, that doesn’t mean that it can ever be “broke.” (State and local governments are a different story.)

That’s a clue to the way our monetary system works. US money is borrowed into existence—by citizens, businesses and the federal government—from the banking system, which creates it through the act of lending. Money goes out of existence when loans are repaid or when federal taxes are paid. During the weeks, years or decades between its birth and disappearance, money passes (digitally, for the most part) from hand to hand and catalyzes essential activity.

To avoid an excessive build-up of demand, the federal government taxes some of the money it spent *into* the economy back *out* of the economy. So it’s easy to frame the government as a destroyer of precious liquidity.

That accusation can be made persuasive—but only by obscuring the roles of federal borrowing and taxing in the larger monetary cycle.

The US government could stop spending, lower taxes, pay down its debt, balance its budget, and fund only a military. But the deflation associated with such a deleveraging would devastate us all. It would make the US economy—not just the government—small enough to drown in the fiscal hawks’ proverbial **bathtub**.