Basic [Alarming] Federal Fiscal Cliff Math

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November 9, 2019

Of the amazingly few people aware that we are at the edge of a fiscal cliff, the vast majority agree that federal fiscal practices are unsustainable. How those practices end will profoundly affect nearly everyone.

Recent articles describing difficulty borrowing and that willingness to lend money to the US Government at current, already high interest rates, rests on the increasingly shaky assumption that fiscal responsibility is imminent indicate we may struggle to keep from quickly going over the edge. Going over the edge means a budget-cutting frenzy, default - bankruptcy, or printing a bunch of money. The latter is an especially devastating form of default because the hyper-inflation that will result from mass money creation greatly devalues debt repayments and causes economic chaos. Some budget-cutting is in order – the federal government does too much – but the big money is in Social Security, Medicare, and Defense, where big cuts are cruel or dangerous.

The official number for the total federal debt is $32.3 trillion, with large increases still imminent. Many people believe that the $25.5 trillion directly owed to the public is the more relevant figure. I’ll use the smaller number to avoid accusations of exaggeration. The current benchmark interest rate on federal debt is nearly 5%, which is widely seen as likely to rise. So, the critical basic math is the importance of 5% of $25.5 trillion, or $32.3 trillion. From annual federal revenue of just under $5 trillion, we will soon have to spend over a trillion on interest payments (nearly 30% of revenue); a share that will rise rapidly with ongoing debt growth. The 70% left over after making interest payments (~$3.6 trillion) is just over half of current annual federal spending!!!!!! Cutting spending on actual federal programs to ~$3.6 trillion without huge Social Security, Medicare, and Defense cuts will be very difficult. That’s why we’re in danger of a major default-threat financial crisis. The need to make huge spending cuts will certainly wipe out our ability to borrow money to help with the defense of our friends (Ukraine) and allies (Israel), which is dangerous enough. Loss of our fiscal capacity to respond to major national security threats is vastly more dangerous.

There is an urgent need to cap federal spending growth below revenue growth (to reassure federal debt holders that interest payments and debt repayment dollars will hold their value), eliminate wasteful spending (especially in Defense), prioritize significant spending cuts, accelerate economic growth, and seek additional revenue sources that don’t backfire by reducing economic activity.

My apologies for being light on details to keep this widely readable.

Does your personal vision of the future depend on economic stability, and at least minimal prosperity? If so, this issue is vitally important to you.