http://www.usnews.com/opinion/economic-intelligence/articles/2017-01-04/the-us-is-running-out-of-sources-for-borrowing-money

USNews 1/4/17

Borrowing on Borrowed Time

Antony Davies and James R. Harrigan

The official federal debt will soon cross the $20 trillion mark for the first time in American history. That's six times the federal government's annual income. While the official debt reached seven times the federal government's annual income at the end of World War II, that was prior to the days of unfunded liabilities. The official debt and the actual debt were thus the same. But when the government started promising future Social Security benefits that it wouldn't be able to afford, the official debt became just the tip of a monumental iceberg. Today, unfunded liabilities add another $100 trillion to $200 trillion to the federal debt. This makes the federal government's total financial obligations at least 36 times its annual income.

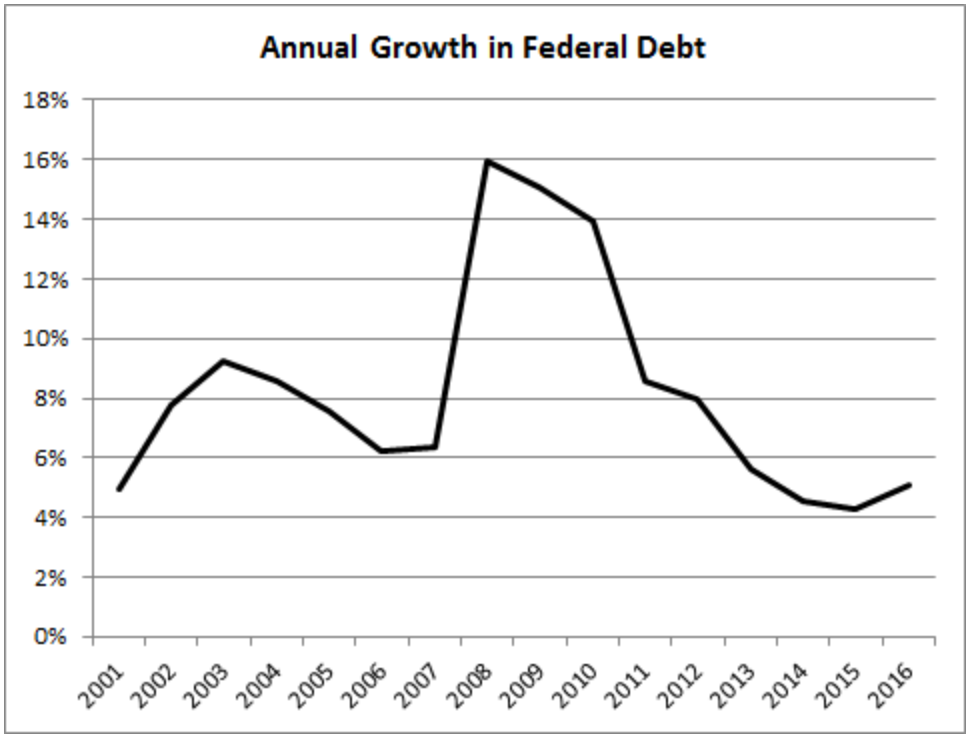
Gargantuan debt is old news though, and politicians know it. They are keenly aware that voters have stopped paying attention, which means they can keep borrowing with impunity. But there's a new financial problem looming that will soon gain people's attention.

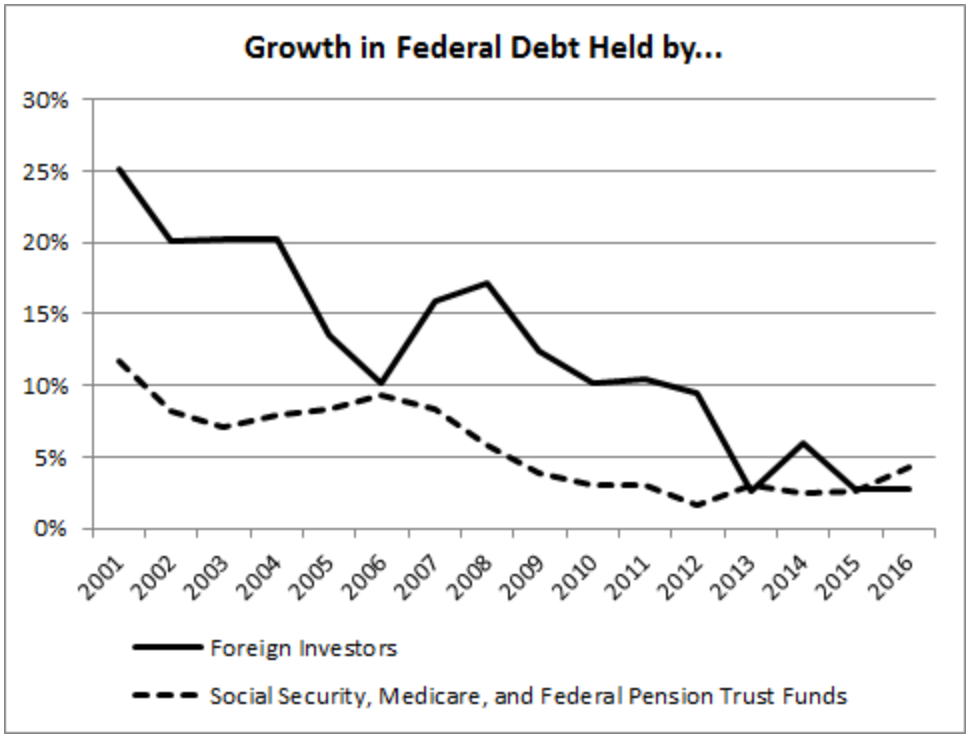
The US government is running out of places to borrow.

The federal government has borrowed so much that there are few places left on the planet where it can borrow more. Take a look at who has loaned the most money to the US government. At the top of the list are the Social Security, Medicare, and various federal pension trust funds. For decades, these trust funds have collected more money than they have paid out to retirees - in total, over $5 trillion more. But every time the trust funds generated surpluses, the federal government would borrow and spend them. That makes American retirees the government's largest creditor. The second largest creditor, the Federal Reserve, owns a bit less than $3 trillion of the government's debt. Foreign governments own $4 trillion of the government's debt. Foreign people and corporations own another $2 trillion. American citizens, companies, and local and state governments own the remaining $6 trillion.

Of these four groups, foreigners, Americans, the Federal Reserve, and the trust funds, three have been cutting back on their lending to the federal government for some time.

Since 2000, the federal debt has grown at an average annual rate of 8.2% (6.7% excluding the Great Recession years). That's about twice the average annual rate at which the economy has grown. Over just the past eight years, the federal debt has doubled from $10 trillion to just shy of $20 trillion. But while the government has been steadily borrowing more, lenders have been steadily lending less.

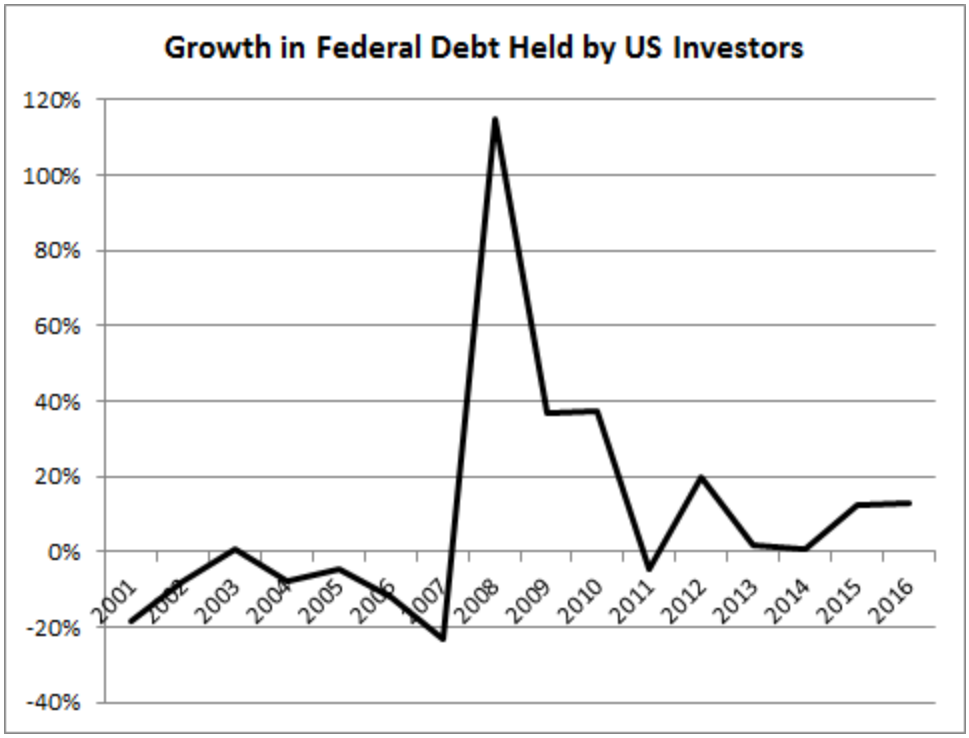

Annual Growth in Federal Debt
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016


Growth in Federal Debt Held by...
30%
25%
20%
15%
10%
5%
0%
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
Foreign Investors
Social Security, Medicare, and Federal Pension Trust Funds

Foreign investors have slowed the growth in their lending from over 20% per year in the early 2000s to less than 3% per year today. Foreign investors are no longer interested in loaning our government seemingly limitless amounts of money. And there is every indication that their willingness to lend will continue to wane.

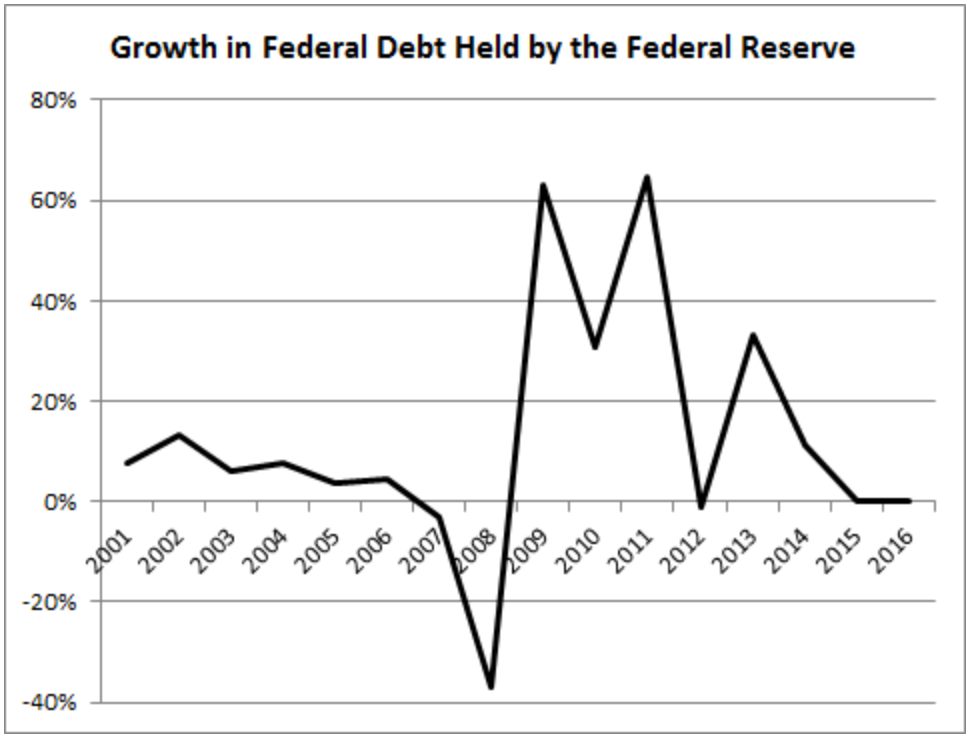
Things are even more dire with Social Security. This year, for the first time since the program was established, the Social Security trust fund will generate a deficit - it will pay retirees more money than it collects from workers. For 80 years, the federal government borrowed Social Security surpluses to fund its profligate spending. Unless Congress radically overhauls Social Security, Social Security will never again generate a surplus for the government to borrow. In fact, the situation will reverse because the government must now start paying back to Social Security those trillions of dollars it borrowed. Growth in lending from the trust funds, has slowed from 10% per year in the early 2000s to 4% today, and is projected to head into the negative numbers as early as this year. There is simply no money left there for the government to borrow.

Before the Great Recession, American investors were lending the federal government 10% less each year. The uncertainty of the recession caused a flight back to the perceived safety of Treasury Bonds, but that quickly dissipated. Since 2001 and excluding the recession years, American investors have been lending the federal government an average of 2% less each year.



If federal borrowing is growing steadily at an average pace of 6% per year, yet foreign and American investors are slowing their lending, and the trust funds have no surpluses left to lend, where is the government getting the money it's borrowing? And where will it get more in the future?

The answer is the Federal Reserve. Prior to the Great Recession, the Fed was increasing its annual lending to the US government by almost 6% per year. The Fed then dramatically increased its lending during the recession - that's what all the "quantitative easing" talk was about. On average, since 2001, the Fed has increased its lending to the federal government by over 11% annually.



The US government has borrowed more money than any government in human history. Politicians have convinced voters that government debt doesn't matter or that, by the time it does, some magical solution will present itself. The ugly truth, though, is that there simply aren't enough investors left on the planet willing to loan the US government enough to maintain its spending habits. So the Federal Reserve takes up the slack. And this is where things go from bad to worse - because the Federal Reserve prints the money it loans.

When the Fed prints more money, every one of the dollars already in circulation, from those in people's savings accounts to those in their pockets, loses some value. Prices go up in response. That's inflation.

Since the end of World War II, inflation in the US has averaged less than 4% per year. When the Fed starts printing money in earnest because the government can't obtain loans elsewhere, inflation will rise dramatically. How far is difficult to say, but we do have some recent examples of countries that tried to finance runaway government spending by printing money. Starting in 1975, Greece tried to jumpstart its economy through stimulus spending, which it paid for by printing money. For fifteen years, the Greeks suffered 20% inflation. Following the breakup of the Soviet Union, Russia printed money to keep its government apparatus running. The result was five years over which inflation averaged 750% and peaked at 2,500%. Today, in the face of a collapsing economy, Venezuela's government has resorted to printing money to pay its bills. The result is nearly 200% inflation, which the International Monetary Fund expects to reach 1,600% in 2017. And here, after the US abandoned the gold standard in 1971, the Fed ramped up its money printing. The result was 10% to 15% inflation for much of the 1970s.

For nearly a century, politicians have treated deficit spending as a magic wand. In a recession? Government must spend more money! In an expansion? There's more tax revenue, so government can spend more money! Always and everywhere, politicians argued only about how much to increase spending, never whether to increase spending. Past politicians left massive deficits, and the debt they created, for future generations to fix. The future has now arrived. There is simply no one left from whom to borrow.

Antony Davies is associate professor of economics at Duquesne University in Pittsburgh. James R. Harrigan is senior research fellow at Strata in Logan, Utah.