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Debt Myths, Debunked

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Sometime in early December, the federal government's official debt will likely cross the $20 trillion mark - an amount no country has ever owed. As we approach this milestone, there are a few myths regarding the debt that should be debunked.

Myth 1: The government owes $20 trillion.

Fact: The federal government actually owes around $120 trillion. The $20 trillion debt is the portion of the government's financial obligation that is legally binding. The other portion, the government's *unfunded liabilities*, is money the government has promised to people but will not be able and isn't legally required to pay. The lion's share is in Social Security, Medicare, and veterans benefits. Estimating unfunded liabilities is difficult, requiring estimating future interest, inflation, population growth, and mortality rates. Consequently, figures range from the astronomical (around $80 trillion) to the truly unbelievable (over $200 trillion). But even the lowest estimates exceed the annual economic output of the entire planet.

Myth 2: The government owes $120 trillion.

Fact: The "government" is composed of federal, state, and local governments, government agencies, and government sponsored enterprises. Ultimately, taxpayers are responsible for all these bodies' debts. The *federal* government's financial obligations total about $120 trillion. U.S. state and local governments officially owe $3 trillion and have another $5 trillion in unfunded liabilities themselves. Federal agencies and government sponsored enterprises owe another $8 trillion, which is not included in the federal government's numbers. This brings total U.S. government obligations to over $135 trillion, conservatively estimated.

Myth 3: The money the government borrowed from the Social Security trust fund isn't really debt because the government owes that money to itself.

Fact: The federal government has borrowed around $3 trillion from the Social Security trust fund, and another $2.5 trillion from other intragovernmental sources like the Medicare trust fund, federal retirement plans, and veterans benefits funds. This money doesn't belong to the government. It belongs to retirees, veterans, and the sick. When the federal government borrows this money, it isn't borrowing from itself; it is borrowing from people for whom the government is holding the money *in trust*. There is only one situation in which that $5.5 trillion constitutes the government's

borrowing from itself: if the government has no intention of paying the money back to the people to whom it is owed.

Myth 4: The government can't go bankrupt.

Fact: It depends on what you mean by "bankrupt." The federal government, in concert with the Federal Reserve, could print all the money it needs to pay its obligations. But this would cause serious inflation that would eat away the purchasing power of people's savings (see Venezuela for a current example). The effect of such money printing would be no different from the government's simply confiscating people's savings (see Greece for a recent example). Technically speaking, the government can't go bankrupt because it only promised to hand over a certain number of dollars; it didn't promise what the value of those dollars would be. Because the value of the dollars was never specified, the government can print enough to render the dollars nearly worthless. To the rest of us, the effect is the same as the government going bankrupt.

Myth 5: The government can solve its financial problems by raising taxes.

Fact: The government raises tax *rates*, not taxes. Whether higher rates generate more taxes depends on how people react to the new rates. Since the 1950s, the federal government's revenue has consistently averaged about 18 percent of the economy. This has been true regardless of fluctuations in income, payroll, corporate, capital gains, and estate tax rates. There is much debate as to why this has been so; but there is no question that it has been so. Regardless of what tax rates it sets, the federal government seems only to collect 18 percent of the economy in taxes.

Myth 6: We can fix this problem by taxing the rich.

Fact: There simply aren't enough rich people to tax enough to fix the problem. If we slapped a 100 percent income tax on the top 1 percent of households (those earning at least $430,000), the government would still only collect around $2 trillion in taxes. If we applied the 100 percent tax to the top 5 percent (households earning at least $210,000), the government would only collect about $3 trillion in taxes. That would cover just 15 percent of the official debt, or just 2 percent of total financial obligations. As a matter of fact, if the government taxed every person and company in the country 100 percent of their incomes, it still would not collect enough to pay the debt. But this is purely academic, because if we taxed everyone and everything at 100 percent, no one would work and the government would actually collect nothing at all.

Myth 7: The federal government could pay its obligations by selling the gold in Fort Knox.

Fact: The government's gold would not come close to covering its obligations. The federal government owns 8,000 tons, or about $300 billion worth, of gold. The federal government also owns almost 500 million acres of land that are worth about $1.8 trillion. Together, gold and land account for more than 70 percent of the government's $3 trillion in assets. If the government sold

all the gold and all the land it owns, it wouldn't raise enough money to pay for even two percent of its obligations.

Myth 8: The government needs to pay off the debt.

Fact: No, it doesn't. You don't need to pay off your credit card - you just need to make the minimum monthly payments. This is called *servicing the debt*. So too the government. It can keep rolling over the debt forever, as long as it keeps making its monthly payments. While it can service the $20 trillion debt, it can't service the unfunded liabilities. This means that the federal government is already bankrupt. The government doesn't, and can't, collect enough tax revenue to service its obligations let alone pay them. Politicians are simply hoping to serve out their terms before voters wake up to the reality that's already upon us.

Myth 9: There is no way to fix this mess.

Fact: There is. A simple plan fixes this problem. First: Cut all federal spending by ten percent. Tradeoffs in cuts can be made, but at the end of the day total spending needs to be ten percent less than it was last year. Second: Hold government spending constant for the next five years. Don't even adjust it for inflation. At the end of the sixth year, the federal budget will be balanced. Thereafter, government spending can grow, provided it never again grows faster than the economy. This recipe will stop the government's financial problems from getting worse, but it won't eliminate the government's obligations. The economy will do that. As the economy grows, the government's obligations will become smaller relative to its revenue, and after about 100 years of balanced budgets, the obligations will be largely irrelevant.

It took politicians about a century to create this mess. If they just stop making it worse, it will take the economy about a century to fix it.

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