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Perspective

Madoff-Like Political Shenanigans Put U.S. Taxpayers In Harm's Way

By MIKE COSGROVE Posted 06/10/2010

Suppose Bernie Madoff or some character of similar ilk had a system that generated $2.5 trillion in excess cash for a trust fund so that the $2.5 trillion could eventually be paid to retired people.

But Mr. Madoff instead spent the entire $2.5 trillion. And in place of the $2.5 trillion Mr. Madoff stuffed the trust fund with IOUs that he would need to redeem to provide benefits to those retired. Mr. Madoff, of course, didn't have the funds to redeem the IOUs.

It's possible that someone engaging in such practices could face prison time.

Congress implemented a similar scheme with the Social Security tax revenue that was in excess of the Social Security outlays. The Greenspan National Commission on Social Security Reform recommended an increase in the Social Security payroll tax in 1983. That tax increase was designed so that its revenue would exceed the amount necessary to fund current benefits and accumulate in a Trust Fund, which did occur.

However, Social Security is a pay-as-you-go system, not a savings system, so the excess tax revenue could be spent by Congress, and it was. Had Social Security been altered to a savings plan, the $2.5 trillion could have been saved, like a 401(k). Instead it was spent and Congress stuffed the trust fund with non-negotiable U.S. Treasury debt.

Now the Treasury needs to repay that $2.5 trillion to the Social Security Trust since the funds are needed to provide benefits to Social Security recipients. The rub: The funds have already been spent, so taxpayers will need to again pay that $2.5 trillion in the form of higher Social Security taxes.

As Mr. Madoff learned, one can't both spend it and provide benefits to those counting on it.

The February 2010 Economic Report of the President kicked this federal outstanding debt sleight-of-hand further down the road. The projected 2010 government debt-to-GDP ratio for the U.S. is listed at 65%, Page 147. The authors of this report conveniently exclude the approximate $4.5 trillion in Treasury debt held by federal government agencies such as Social Security.

Treasurydirect.gov lists the total public debt outstanding at approximately $13 trillion, of which $8.6 trillion is held by the public and $4.5 trillion is held by federal agencies. The Social Security Trust Fund holds $2.5 trillion of that $4.5 trillion.

What is the correct debt series to use for federal outstanding debt? It is the $13 trillion which places the debt-to-GDP ratio for the U.S. at approximately 90% in 2010. That ratio will increase significantly since the outstanding debt, under current policies, is rising much faster than nominal GDP.

This administration and Congress are engineering a government spending and entitlement train wreck that is bearing down on U.S. taxpayers. The authors of the 2010 Economic Report understand the implication of these excessive federal spending policies. Note the sentence on Page 148: "And higher taxes can reduce incentives to work, save and invest."

Global investors understand this slight-of-hand being run by the Congress. And this scheme is working for now as the government is in a less egregious financial situation than some countries in Europe. But global investors will eventually have alternatives to U.S. Treasury debt.

U.S. politicians still have time to reduce federal spending and benefits before global investors force it. President Obama would be in a much stronger position in 2012 if he starts the process today of rolling back federal spending and benefits. Equities would move higher immediately, and the U.S. economy would start creating rapid increases in net new jobs.

The major dark clouds hanging over the U.S. economic job machine are large impending tax hikes, increased costs for business formation and expansion, and fear of even more costs and excessive regulation down the road.

The Social Security scheme provides President Obama the opportunity to change direction by clearing the field with major entitlement reform and reduction in federal spending and benefits.

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