# America's Deficit Disorder

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**FrontPageMagazine.com | Monday, January 19, 2009**

Upon his January 20 arrival in the Oval Office, President-elect Barack Obama will face the worst recession to hit the U.S. economy since World War II, the Congressional Budget Office reported to the Senate Budget Committee on January 8. The U.S. Treasury deficit---what the government spends over and above its income---will nearly triple in 2009 alone, to $1.19 trillion. Worse, the cumulative U.S. budget deficit will reach almost $2 trillion in the next five years.

To put things in perspective, last October, the projected $1.2 trillion 2009 deficit was 8.2 percent of the nation's gross domestic product (GDP). That's still far more than the minimum 3% to 5% " savings rate" economists expect of average Americans this year, which in turn is a vast improvement from savings rates in recent decades. Meanwhile, the economic soothsayers also predict gross U.S. production, already falling, will slump at least 4% to 5% by next December, while federal revenues also drop some 6.6%.

All this only spells big trouble for overburdened U.S. taxpayers and businesses now keeping the government afloat. It will be like trying to stretch a 10-inch diameter buckskin over the head of a 30-inch diameter drum. And taxpayers and businesses will be asked to do most of the stretching.

Assuming that U.S. economic policies remain unchanged---and the Federal Reserve Board has already expended most available economic rocket fuel by cutting to nearly zero the "federal funds rate" charged on overnight interbank loans---Obama can't do much more than that besides printing money.

And print money, Obama surely will.

In fact, the Bush administration gave the greenback presses a galloping start. Since August, the Fed issued "tons of newly created dollars into the economy," doubling the monetary base---the nation's total bank reserves plus U.S. currency--- a "phenomenal increase" that had some (erroneously) worrying about the potential for steep inflation, reports the *Wall Street Journal*.

The federal government has already allocated at least $7 trillion to the nation's "economic rescue," including the $700 billion Troubled Asset Relief Program (TARP), last year's $168 billion Economic Stimulus Act, the $300 billion loan-loss backstop for Citigroup and $152 billion AIG rescue. Of those allocations, the U.S. has already torn through upwards of $2.7 trillion---not counting $167 billion in emergency tax rebates granted to consumers.

In this light, *Fortune* magazine's October 2008 prediction that Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson could handle the mess looks far too optimistic. The empty Federal Reserve tool chest resembles that of 1935, when Chairman Marriner Eccles had lowered discount rates as much as possible to create "easy money." You "cannot push on a string," a Maryland Democratic congressman had noted back then. "One cannot push on a string," Eccles agreed.

Now too, massive Fed and Congressional stimulation have not altered the U.S. economy's downward trajectory. Indeed, the U.S. economy in 2008 lost an aggregate 2.6 million jobs, more than in any year since World War II, putting 7.2% of the work force in the "unemployment" lines. Add in all part-time, volunteer and self-employed workers considered fully employed by conventional unemployment measures, and the key "unemployment" statistic undoubtedly has already have hit double digits. Factory orders, housing construction and retail sales decline precipitously and banks foreclose on millions of American homes.

The Fed has again created what "some economists" call a "liquidity trap." Printing money is a "vastly overrated" economic stimulant "even in ordinary times," according to *Wall Street Journal* veteran George Melloan. The "liquidity" the Fed has injected into the U.S. economy is like trying to "push on a string." Americans are not interested in or able to borrow. Whatever savings they have gets deposited in banks, for which deposits are liabilities that must be invested to keep banks afloat.

For the time being at least, the U.S. Treasury has profited nicely from this ugly dilemma. As investors and banks seek "safety," U.S. Treasuries have become a haven, bolstering the formerly beleaguered U.S. dollar, and pushing rates on 30-year Treasury bonds to just 3.06% and 10-year bonds only 2.39%.

But cheap credit does not spur new investment or economic growth. In his 1993 study of more than 5,000 U.S. manufacturing companies from 1971 to 1990, economics professor Steven Fazari found that business invest based on overall economic health and the growth in their own sales and profits. “Weakness in the economy is more likely to reduce investment than lower interest rates are to stimulate it.” But low rates can and will spring like a jack knife if and when investors find other outlets for their “easy” liquidity-induced cash.

Meanwhile, U.S. taxpayers still face the extraordinary deficit burden already heaped upon them---and only likely to grow under the Obama administration. As Melloan noted, *in the 1990s, “*Japan tried to spend its way out of its post bubble malaise,” but merely accumulated “a mountain of debt” and lost a decade to “little or no economic growth.”

Even if the national deficit increases no further, national debt would grow more onerous in the case of a Great Depression-like deflation tornado, such as shredded the U.S. economy and in 1933 raised unemployment to 24%. The debt will remain the same or even grow until it is paid off, while incomes and the tax base shrink. Keep in mind, as in 1933, interest rates and stocks have already declined steeply.

Moreover, to cover the U.S. deficit, taxes will certainly rise. In an inflationary environment, those new taxes could broadly pass to willing (or resigned) consumers. Now, however, in a contracting economy, they must be spread more narrowly to shrinking companies and a shrinking pool of workers. Companies are likely to respond by further slashing jobs, thus adding to the very grave potential for a deflationary spiral.

That such an enormous economic disaster could compound current financial woes is not hard to imagine, given the massive deflation already seen in basic commodities like oil: On January 14, the European Central Bank cut interest rates to 2%. “It looks odds-on that Eurozone consumer price inflation will fall well below 1.0% during 2009, and a brief period of deflation is very possible,” IHS Global Insight chief European and UK economist Howard Archer informed his research clients. Moreover, he expects European interest rates to halve again, to 1.0%. For all the horrors of galloping inflation, massive deflation is exponentially worse.

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