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A Rebuttal to Doom-and-Gloom forecasts such as Debt Collapse: The Decline and Fall of the USA

By Scott Baker

We do not have to submit to debt default or to austerity. We have all the resources we will ever need, if we learn where to look.

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There are several problems with this doom-and-gloom article "Debt Collapse: The Decline and Fall of the United States of America" by William Edstrom (full disclosure: I'm the OEN Editor who released it from the Queue).

Without refuting each of the numbers one by one, a few need special attention.
1. The Pension returns are supported by a single link to the site State Budget Solutions. While the site looks very official and unbiased, it actually seems to make a very biased assumption. Buried way down in the methodology section is this note "Plan liabilities were discounted according to the 15-year Treasury bond yield averaged over calendar year 2013. That rate was 2.734%." I wasn't sure at first if they meant that just the Treasury returns were calculated using these returns or the ENTIRE pension fund returns, so I checked the underlying spreadsheet, and sure enough there is a similar footnote for that indicating the 2.734% return is used to project returns for entire pension funds. Also, they say elsewhere "State Budget Solutions uses fair market valuation to determine the unfunded liabilities of public pension plans. Outside of the small world of public pensions, there is near-universal agreement that discount rates based on the assumed rate of investment return are far too risky. The approach SBS uses is to discount liabilities based on the approximate equivalent of a 15-year U.S. Treasury bond yield. This year's number is derived from the 2013 calendar year average of the 10 and 20 year bond yields." Well, promises of 8%/year certainly have proven to be overly-optimistic, but using historically low Treasury yields is overly pessimistic too, though perhaps not in Edstrom's view, since in his article he says he expects the stock market "will lose 86% of its value" based on some obscure calculation called the Tobin's q value. Now, Wall Street uses many things to generate stock market returns, many of them fraudulent (a good list may be found here), but relying on a single formula is not one of them.
And, ironically, if the nation's pension funds are dependent on upon stock market returns, it's

likely the regulators like the Fed and the SEC will turn the other way when these frauds are perpetuated, or even engage in them themselves. For the most part, this is a very unhealthy state of affairs, but it does open up one big possibility...

2. The government could simply rip up money it owes itself. Ron Paul, and later Alan Grayson, supported a bill a few years ago that would have wiped $2t in national debt that the government owed the Federal Reserve through Treasuries it owed to the FRB itself. This was seen as a way of getting back "under" the so-called debt ceiling, but it is revenue-neutral because the Fed already returns whatever money it collects on Treasuries minus its own expenses. But this may be the tip of the iceberg in terms of what the Fed actually owns now, because, as this article and this one by Paul Craig Roberts and this one by me points out, the Fed may be behind secret Treasury purchases in other countries masquerading as foreign purchases. If so, this is another possible source of revenue-neutral write-downs.

I won't venture to say how much "paper debt" can be ripped up this way, but it is certainly in the trillions, possibly in the 10s of trillions if you also include government bonds owed to the U.S. that could be cancelled out in a direct swap, but this really misses the bigger picture because...

3. Edstrom's article suffers throughout from the Loanable Funds Fallacy (LFF). LFF states that there is a finite amount of money and that if this is depleted, in the case of the government; no more money can be produced except by raising taxes or borrowing. While this may be true in the case of the states -- even leaving aside for the moment major state options l will discuss in a moment -- it is certainly not true for the Federal Government, which is monetarily sovereign under historical precedent, or the Constitution's Coinage Clause (Art. 1, Sec 8, Clause 5), which allows Congress to "coin Money." Edstrom throws out the possibility of the government "printing money" (I will discuss why this flippant characterization is inaccurate in a moment too) as potentially hyper-inflationary, even while he unquestioningly allows the deflationary result of debt default and Great Depression levels of economic contraction. But the opposite of deflation is inflation, so why not deploy inflation to counter deflation if that is what's required? Economists agree that deflation is the bigger of the two problems. Economists also agree that it was the tight monetary policies of the 1930s that led to the Great Depression. Milton Freidman even suggested dropping billions of dollars from helicopters if necessary to counter deflation, and former Fed Chair Ben Bernanke made a speech in the early 2000s suggesting the same thing, which got him dubbed "Helicopter Ben." And a funny thing happened on the way to Hyperinflation: it didn't happen. In fact, according to the CPI (itself rigged to under-count inflation, but certainly not to the levels that Edstrom worries about, nor from wage inflation but rather from asset inflation), we have suboptimal inflation right now, under 2%. This is especially evident in the oil and gas markets, where prices are hitting lows they haven't seen since the crisis in 2009, under $40/barrel for oil.

4. Edstrom also undercounts or discounts entirely, the positive benefits of some government spending. While military spending doesn't add to the national wealth pie overall (and its contribution to our national security can and should be seriously questioned when we are spending almost as much as the next 10 countries combined and the Pentagon cannot account for $8.5t since 1996), there are government programs that produce more wealth than they cost. They are investments. One of these is one that holds a good portion of the national debt that Edstrom is

so worried about -- and that we owe ourselves -- Social Security. Because of the Money Multiplier, we have a net gain from $0.80 to $1.00 every time $1.00 is spent. See my article here, citing two studies to back this calculation up. If we eliminated Social Security we would actually *lose* more money than we would gain.

Many economists realize that debt is not the problem it seems to be to people who are not monetarily sovereign themselves (you and me, and the states). Paul Krugman recently called for *more* debt, pointing out that "One answer is that issuing debt is a way to pay for useful things, and we should do more of that when the price is right." By the "price is right" Krugman really means the current Zero Interest Rate Policy (ZIRP). But we don't even need ZIRP if we issue the money ourselves, and bypass the Central Bank, as Lincoln famously did during the Civil War when the New York banks (there was no Central Bank at that time) wanted 24-36% interest. Lincoln asked Congress to issue $450m in United States Notes, a currency form that was issued 14 times overall until Treasury phased them out in 1996, our longest-lasting currency! These first forms of Legal Tender were not inflationary -- putting the lie to the private bank-favored argument that government will be unbounded by newly rediscovered ability to "coin Money." In fact, U.S. Notes can be purchased for over twice face value in Federal Reserve Notes on eBay because they are so scarce and in such high demand.

There are other problems with Edstrom's analysis. He discounts the revenue and asset side of the ledger too.

For example, California, which supposedly has one of the largest pension debt obligations, has about a quarter of a trillion dollars in its pension fund. It has to shell out about 4%/year to pay pensioners, meaning 96% of the fund remains to "make money on." Well, first of all, when did government become a profit making enterprise? It could, in theory, cash in that pension fund, with iron-clad promise to pay pensioners out of future taxes raised by a relatively small amount, and then, with the far better credit rating it would get from becoming newly flush with cash, open a Public Bank and charge ultra-low interest rates for in-state projects that would support the state economy, instead of "investing" that money in Wall Street gambling, which, as Edstrom points out, is actually more risky than casino gambling because the bets are insufficiently backed and the banks making them have to be regularly bailed out. In contrast, the Bank of North Dakota -- the country's only Public Bank (est. 1919) -- has never needed a bailout and in fact creates credit for the state and a dividend as well - $300m in one recent 10-year period.

So, there exist investment options for the states that would make their debt far less onerous than they are now and could even be a net gain.

And this is even leaving aside the very dubious assumptions about continued low returns cited by Edstrom's sole supporting link.

Newly created jobs, in a well-run public works program also generate wealth, of course, as is proven by the national wealth from the public works projects initiated under FDR that we are *still* enjoying today. Again, these are investments, not just liabilities, as Edstrom strongly implies.

Medicare is another example of this, and is a cheaper option than Obamacare, which is basically a subsidy for the private healthcare insurance companies. If Edstrom wants to rein in the cost of healthcare -- the largest in the world -- he should support Medicare for All, as Bernie Sanders does, and which, as Robert Reich and others have pointed out, is the solution, not the problem to high healthcare costs. Additionally, Medicare should be strengthened by being allowed to negotiate for lower drug prices. But even now, public payment of healthcare is a net benefit, not a net cost. *You can't just look at the spending side of the ledger without accounting for what's gained.*

And there's more. We have, according to Georgist economist Mason Gaffney, some $5.3t in economic rent, which mainly goes into undeserving private hands now. This is money Land/location holders make simply for holding those assets, not from any productive activity. This money, if properly collected, could eliminate the need for any other form of taxes, and the removal of this deadweight loss to the productive classes -- mostly in the middle class -- would greatly stimulate economic production, growth, and work towards eliminating the national debt in the best way possible.

I talk about these ideas, and much more, in my book "America is Not Broke!" Perhaps Edstrom and others will have a read, and stop regurgitating the scare stories of conservative outlets like those of the Pete Peterson Institute and other institutions and ultra-wealthy individuals like the Koch Brothers, who only want to increase the divide between them and the 99% to enrich themselves still further.