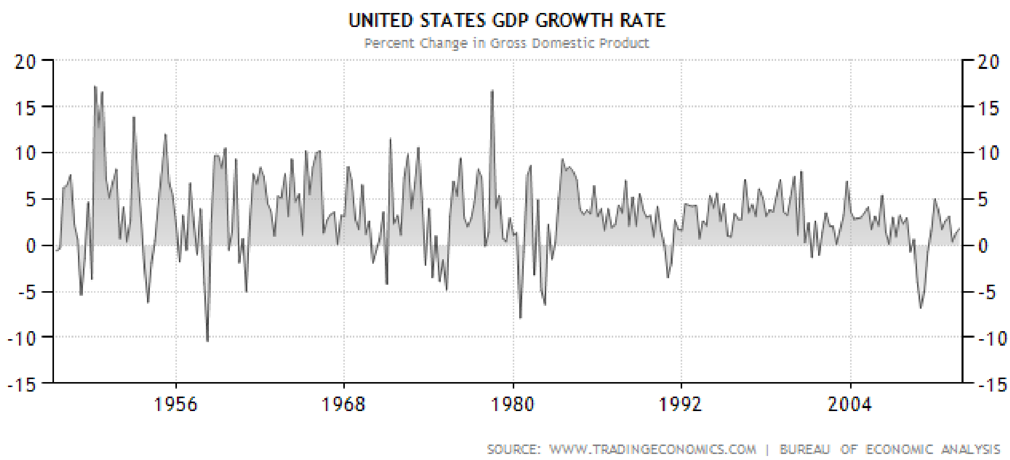
What are we thinking?

No matter who wins the election, it is now inevitable that the national debt at the end of the next administration will approach or exceed $20 trillion. There is no proposal from the Administration, Congress or any political candidate that would do anything but tweak this outcome very slightly. A couple of hundred billion dollars per year spending reductions are far too little to offset the spending growth. That leaves us dependent on the unlikely phenomenal growth of GDP and its tax base.

Our national debt is now at 100% of the GDP, a very dangerous percentage. If GDP does not increase over the next administration, the debt to GDP ratio would be about 133%. For reference, Greece is currently a little over 160% and hoping to get down to 120% by restructuring its debt, i.e., getting its debt holders to accept new bonds worth a fraction of the old ones. This is not just dangerous, it is disastrous if our own interest rates start to go up as they have in Greece. Our own interest rates are at record lows and have nowhere to go but up, especially as we try to rollover our debt and find fewer takers as our debt to GDP ratio soars.

To keep the debt to GDP at 100% over the next administration, the GDP would have to grow 7.5% each year. The only time we had growth of this kind in our modern history was in the early 1950s. The figure below illustrates our historical GDP growth since 1947. It has averaged a little over 3% per year over that period.



In order for GDP to grow more than average, people have to spend more than average. I contend that this is quite unlikely. The national savings rate has been far too low since 1985 and has declined precipitously from its historical average of 9% down below 0%* in 2005. It has now crept up to around 6%. The lost savings over those years is greater than the national debt—and that will remain with us for generations. Because employers have largely switched from retirement pension plans to employee financed savings plans, the savings rates should have increased from 9% to perhaps 15%.

It is literally impossible for the Baby Boomers to save more for retirement and spend more at the same time. The only way that Baby Boomers would be able to spend more is for them to get even more welfare. And the only way that can happen is for the government to print money and, as a practical matter, increase taxes. Those that follow the Baby Boomers also have saved far too little as well--and bear most of the burden of the large number of unemployed. I keep hoping that they are financially smarter than the Baby Boomers, but there is little evidence that would be true for the majority of them.

I used to believe that our children and grandchildren would be the ones to pay for the position our country is now in. I now believe that we will as well.

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*Government revisionists have readjusted 2005 savings rate upwards by about 2% to be more comfortable using the artifice of chained values.