CHAPTER 1

MARCHING TOWARD FISCAL ARMAGEDDON

IS AMERICA STILL economically healthy and wealthy?

Can we still trust our leaders with our lives, our liberties, our pocketbooks, our children's future?

How I wish we could say yes to the above.

But the sober truth is more chilling: The people we elected to run our country are bankrupting it instead.

They are literally spending more than we have at a runaway rate, like a locomotive steaming out of control. If we don't stop them, they will achieve what Adolf Hitler, Nikita Khrushchev, and Osama bin Laden never could: the destruction of American prosperity and the American Dream.

Harsh words, but I mean every one.

I'm talking about a chain of fiscal stupidities that could soon change your world forever. I'm talking about your job vanishing to Bangalore, your bank account emptied, your stocks in free fall.

I'm talking about your house on the market for a third of its former value with no buyers, your pension reduced to nothing, your monthly Social Security check too small to cover your rent or mortgage payment—assuming the government can still send you a check.

I'm talking about this blessed nation plunging blindly into insolvency. And why? Because our leaders—the people you and I elected to safeguard America's bounty—have squandered our country's money on schemes that would rightly land any nonpolitician behind bars.

Yes, our leaders: all those high-minded presidents, distinguished congresspersons, dedicated White House staffers—vast choirs of political opportunists singing hymns to rectitude while slicing and dicing pork from ever more specious national budgets.

Under cover of grandiose visions and national emergencies (most recently, our wars in Afghanistan and Iraq, in tandem with an economic slump), they have run up the government's yearly deficit—already more than $500 billion and rising in the year 2004 alone—in a binge of federal spending that is wildly out of control. Accordingly, the cost of borrowing more and more money to cover spending we can't pay for has itself veered out of control. Even at present low interest rates, the burden of paying ever more interest to finance ever-bigger yearly deficits can only accelerate the growth in the overall national debt itself. The result virtually guarantees national insecurity. If interest rates go up, as they must, we face actual insolvency. Yet our leaders blandly predict steady loan repayments ahead—without setting aside a penny to back up their assurances. Who are they fooling? Us—293 million plucked pigeons.

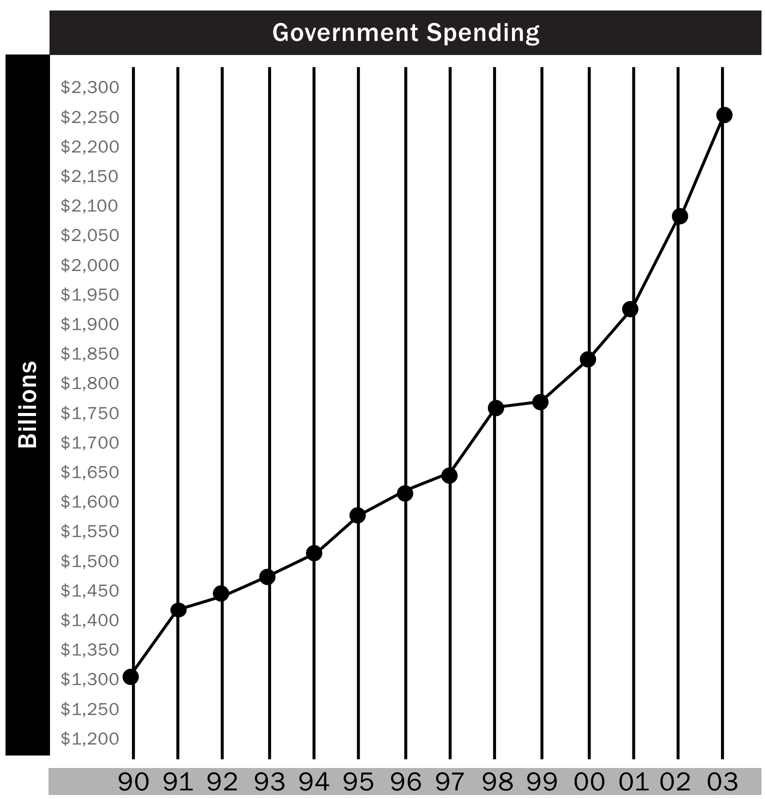
But what about those budget surpluses we were running in 1998 and 1999? Weren't they supposed to add up to more than $5 trillion in the next decade? Yes. But since then they've vanished like the morning mist, and the bright light of day reveals deficits stretching as far as the eye can see. While pledging fiscal discipline ("If Congress will not show spending restraint, I will enforce spending restraint"), President George W. Bush has cast aside a bipartisan commitment to balanced budgets and debt reduction adopted during the Clinton Administration. It's as if the Republicans, once exemplars of fiscal conservatism, have undergone some sort of gender change. President Bush has unapologetically run up a tab of new, unpaid-for initiatives, tax cuts, and debt service that, all told, will increase the deficit by an estimated $6.5 trillion over the next decade.

In plain English, our country is headed for national bankruptcy.

THE PATH TO POVERTY

Years and years of what amounts to pawning the family jewels to buy luxury cars and yachts have left the federal government in the kind of hock that used to send debtors to prison. As in most falls from grace, every wrong move has created worse ones, hastening and magnifying the dangers we face. Even so, the government's fundamental wrong move is clear—runaway spending. In the coming pages, I describe the financial Armageddon our country is striding toward at breakneck speed, along with charts showing the minefields ahead.

- WE'RE SPENDING TOO MUCH.



Source: Congressional Budget Office. Historic Tables

Washington insiders spout a lingo too exotic for mere voters, but the one word they never use—frugal—is too exotic for politicians. It means the great old virtue of economizing, of living within one's means. Hence the phenomenon of the mind-blowing numbers in the chart on page 5. Government spending over the past 14 years has nearly doubled, from less than $1.3 trillion per year to $2.3 trillion. It suggests that Congress seems to consider it un-American to pass a yearly budget smaller than the one before it. In fact, government spending has not declined from any year to the next in the past half-century.

The $2.3 trillion the federal government will fork out this year exceeds the revenues it will have in its coffers by more than $500 billion—and that doesn't even count the cost of the continuing occupation of Iraq, which President Bush did not include in his official budget and which could add an additional $50 billion to $70 billion or more to the deficit.

To get an idea of the magnitude of a number the size of 2.3 trillion, consider this: If you tried to count to just one trillion at a rate of one number per second, it would take you 31,688 years. Put another way, a trillion seconds ago, Neanderthals were wandering the plains of Europe.

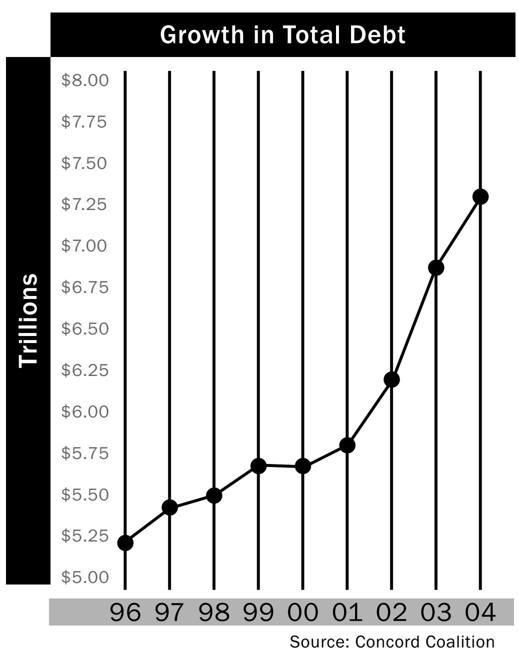
To be sure, two wars, a stock market crash, a recession—all have battered the budget in recent years. But make no mistake, the lion's share of the problem comes from relentless spending, made worse by big tax cuts aimed primarily at rich people. Last year alone, the government lost $242 billion of revenues to Bush's tax cuts, with the majority of the savings going to the wealthiest 1 percent of Americans. (Bush's own cut totaled $30,858.) The lost revenue could have significantly reduced the federal budget deficit. Instead, the tax cuts forced the Treasury to borrow more for running the government. This boosted the national debt, requiring extra interest payments to lenders. Put another way, last year's $242 billion favor for roughly 2.9 million Americans ultimately cost the other 290 million Americans some $256.7 billion, according to the nonpartisan Citizens for Tax Justice. Over the next decade, the total hit from those tax cuts will rise to $3.3 trillion if all of them are made permanent, as the President proposes.

Magnifying the budget damage wrought by tax cuts are this Administration's and Congress's undisciplined spending habits. In just two years, President Bush and the Republican-controlled Congress produced a 24 percent increase in discretionary spending, the biggest jump since World War II. This is 24 times the comparable number during the Clinton years. And, again, the current figure for discretionary spending doesn't include the ongoing cost of occupying Iraq.

Conservative economist Milton Friedman had it exactly right when he remarked not long ago: "What really matters is spending." Senator John McCain, one of the GOP's few visible wits, doesn't disagree. But in likening his party's big spenders to sailors on a binge, McCain wryly notes that "drunken sailors at least spend their own money."

- **WE'RE BORROWING TOO MUCH.**

Meet the mother of all scary numbers: $7,300,000,000,000. That's where the national debt hovers today on its fastest, steepest climb



since World War II (see the chart on page 7). And it's increasing by half a trillion dollars a year.

This colossus of borrowed cash is a monument to our leaders' shameless fiscal behavior. It dangles over us like a giant sword of Damocles, threatening to lop off America's future.

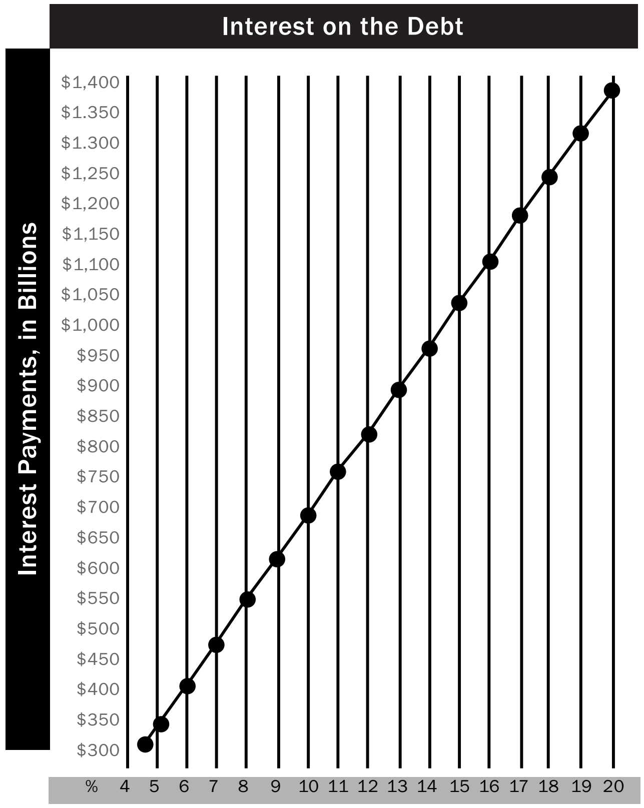
In 2000, the national debt was $5.7 trillion—a number that failed to alarm only because it eluded understanding (at one second per number, it would take 180,746 years to count). But then came the George W. Bush era. In three years, the debt has risen more than 25 percent. It is exploding, and no one in charge seems to be saying enough is enough. Congress keeps raising the debt limit, which, along with increasing spending, seems to be that august body's principal function.

Here's what the biggest national debt in the history of the world means to you personally. On September 30, 2003, the end of the federal government's fiscal year, each American family's share of what was then a $6.78 trillion debt (you can see how fast the debt grows) stood at $91,259. But not for long. Just since September 30, the debt has ballooned at an average rate of $1.4 billion every day. Unless something changes, that adds up—at a minimum—to another $511 billion a year, or nearly $7,000 more per American family, dumping an ever heavier burden on the shoulders of our children and grandchildren.

• INTEREST RATES COULD KILL US.

The most astonishing delusion of the Washington mind is that federal cash is limitless. In fact, the government lives on plastic and burgeoning debt.

Last year alone, interest on the debt claimed $318 billion of government revenues. To put that $318 billion into perspective, it accounted for 17 percent of our budgeted spending. If it had gone toward providing the country with something of real value, it could have paid for veterans' benefits, aid to the jobless, education initiatives, environmental protection, our space program, our federal courts and law enforcement, Debt Outstanding as of 2003



Source: Calculated by the author using data from the Bureau of Public Debt

and the Departments of Commerce, Interior, Energy, and State, plus international aid—with billions of dollars left over.

Instead, those dollars were thrown away as ransom for reckless fiscal policies of the past and present, things like those massive tax cuts and the second-lowest level of corporate income tax revenues since the Great Depression. In fact, 60 percent of U.S. corporations paid no tax at all last year. The revenue lost through Bush's tax cuts for business totaled $44 billion in fiscal 2002, $53 billion in 2003, and is projected to reach $64 billion this fiscal year—not one cent of which has been offset by spending cuts elsewhere.

Today's interest rates are at 46-year lows; they have nowhere to go but up. (Despite what you may have read, the Federal Reserve Board can't control them completely.) Even if by some miracle we never borrowed another nickel and quit adding more than $1 billion every day to the national debt, a rise in interest rates to the double-digit levels last seen in 1981, little more than two decades ago, would cause the payments on our current debt to consume every dollar of the government's tax revenues. There would be no money left to spend on anything else, from defense to Social Security to government salaries.

The more government spends, the more it has to borrow; the more it borrows, the more it has to spend for interest on its loans. Last year's $318 billion in interest on the national debt meant that we paid an average 4.6 percent. At 9 percent interest, we would pay roughly twice as much ($636 billion), leaving too little cash on hand to cover Social Security, Medicare, and Medicaid beneficiaries—and nothing to pay for nondefense discretionary programs such as education, justice, transportation, and other government functions we take for granted. The inevitable shortfalls would, of course, require still more borrowing and still more interest payments, ballooning the debt even more.

You get the picture: If interest rates climb and tax rates don't keep up, then at some point the government's interest payments will exceed its tax revenues. And that assumes that the debt isn't constantly expanding, which it is. The chart on the previous page shows the rising-interest path to fiscal collapse. At last year's income tax revenues of $1.3 trillion, total insolvency would occur when rates hit 18 percent, thereby pushing interest costs above total tax revenues. And if you think 18 percent interest rates are out of the question, think again. We surpassed that number in the early 1980s, a decade that many of us remember all too well.

To put it bluntly, this country is facing national insolvency in the near future. Interest rates on Treasury securities are at historic lows. And when they go up, as they most assuredly will, paying those rates will consume more and more of the government's income.

For every bump higher in interest rates, we will have to come up with more cash for our creditors—and the choices will be grim: We can either increase our overall debt and borrow more to finance it, risk recession by sharply boosting tax rates, or squeeze money out of desirable federal programs like Head Start for underprivileged children, benefits for the unemployed, or support for wounded veterans.

As the chart on page 9 vividly illustrates, unless we take drastic steps to halt our continuing budget deficits, we simply won't have enough revenue coming in to cover borrowing costs. Suddenly, the tidal wave of debt will swamp us, ending our ability to meet our obligations.

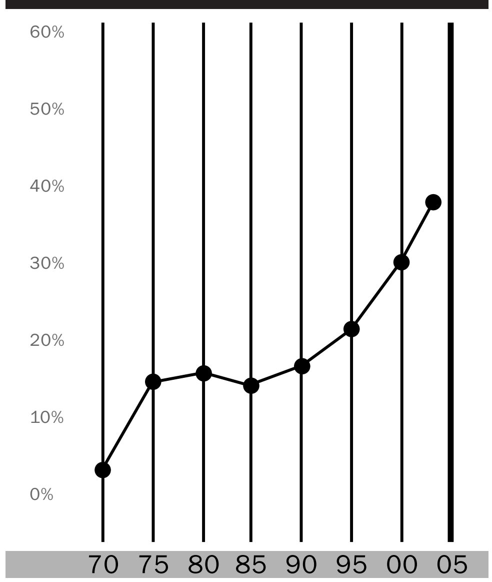
When that happens, America the beautiful will become America the broke.

Before that black day arrives, we can expect a series of frightening events caused by the government's insatiable spending spree and consequent need to borrow money. Interest rates will surely soar (hurting everyone, not just Uncle Sam). The government is not immune to the laws of supply and demand, and the more it borrows, the more its lenders will charge. This will force the Treasury to print more dollars, accelerating a plunge in the value of our currency (it has already fallen 30 percent against the euro in the last two years). How our lenders react will then depend a great deal on who and where they are.

- **WE DEPEND ON FOREIGNERS TO KEEP US AFLOAT.**

If you thought the only deficit we had to worry about is the one our leaders in Washington have been adding to every year, I've got more

Percent of Public Debt Held by Foreigners



Source: U.S. Treasury Department

bad news for you. We have a serious trade deficit problem. We import far more goods than we export.

Thanks to our huge and growing appetite for goods from abroad—such as our burgeoning dependence on foreign oil—last year's trade deficit reached a record $489 billion. In other words, foreigners ended up holding that many dollars more than they sent back to us in payment for the American goods they purchased.

Dollars are basically not spendable anywhere but here. Accordingly, the foreign holders used a sizable portion of their dollars to buy our Treasury securities. Put another way, they lent us back a large share of the dollars we paid them for their imports. Sound good? Not quite. Trouble is, we now owe approximately 40 percent of our publicly held national debt to foreign interests.

It's still true that he who pays the piper calls the tune; in other words, our destiny is increasingly controlled by foreign hands. They will tolerate our excesses only so long as it suits their purposes, which may or may not coincide with ours.

Let's suppose these investors grow worried about the rising flood of U.S. debt securities and the government's ability to pay interest on its massive debt. As a result of what they perceive as increased risk, they may well demand higher rent (aka interest) for letting us borrow their money to run our government. But when interest rates jump, boosting the cost of borrowing, the government is forced to take a bigger bite out of already insufficient revenues. The shortfall raises the budget deficit even more, thereby pushing interest rates still higher. And so the vicious cycle continues.

Foreign investors are more likely than domestic ones to insist on higher rates because they already take on an additional risk when they buy our Treasury bonds: If the dollar declines in value before they cash out their bonds, they will receive less when they convert the dollars into their home currency. And guess what? The dollar has been steadily declining in recent years. Remember, it lost 30 percent of its value against the euro in 2002 and 2003 alone, which means that a European holder cashing in a fixed-rate two-year U.S. bond took a 30 percent hit in terms of the euros he could buy with his dollars.

Because foreign investors view the dollar as nothing more than another asset they buy in hopes of making a return, increasing economic turmoil in the United States would probably provoke them to sell some, if not all, of their dollar assets, causing the currency's value to drop farther. As this vicious cycle gathered speed, foreign investors might quit buying Treasury securities altogether. They might even start cashing in the bonds they already held. That would force the government to print the money it couldn't borrow—a surefire trigger for inflation and another blow to the value of the dollar.

What would happen then? We can only guess, because such a debacle has never occurred in modern times. At the very least, the United States—and because of our wide-ranging influence, the rest of the world, too—would be plunged into economic chaos, all because of our unwillingness to rein in our reckless spending.

Being so beholden to foreign interests has other disadvantages as well. Common sense tells you that, as in the game of Monopoly, the players holding the most cash have the upper hand. For all our boasts about being the world's only superpower, our words carry less and less clout as our economic position weakens. Great Britain learned this humiliating lesson early in the last century, when its empire was in decline.

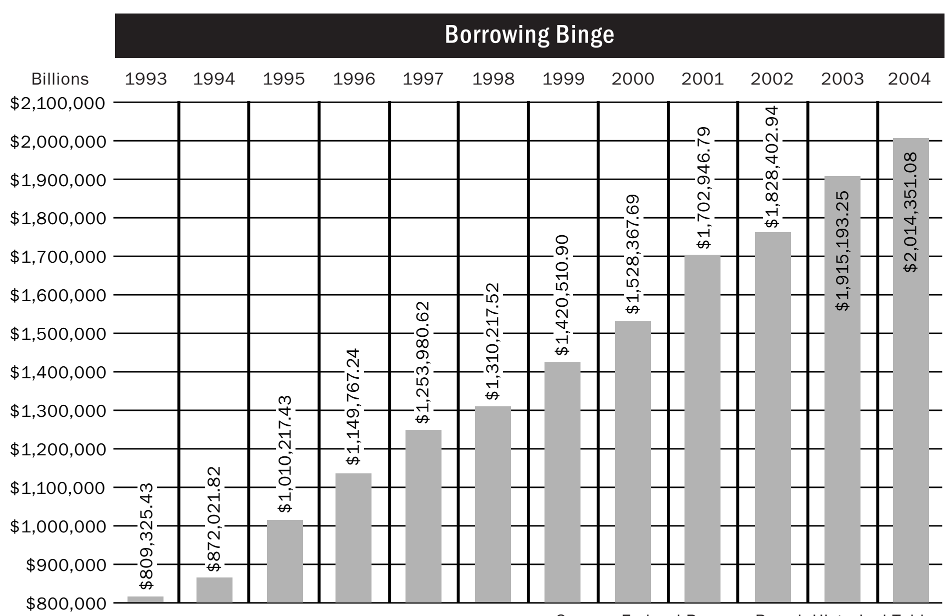
What is more, our unilateral foreign policies have made America increasingly unpopular among our traditional allies. A poll last year by the Pew Research Center, which surveyed 16,000 people in 20 countries, found deep dislike and outright fear of the United States in country after country—and not just in Muslim nations. Distrust and suspicion of our motives as a result of our war in Iraq extended to our allies in Asia, South America, and Europe. History suggests that if the world's disapproval intensifies enough, creditor nations will not hesitate to remind us who's holding the purse. Given that distrust and even hatred of the United States seem to be escalating, it's no great stretch to imagine our Asian, European, or Middle Eastern lenders threatening, however diplomatically, to turn off the cash spigot unless we heed their countries' wishes on some controversial economic or political issue. It might be tariffs, say, or disputes over trade rules—

matters that we mistakenly thought we could control simply because we are the world's superpower.

Hints of this worrisome subtext have already surfaced in the refusal by our traditional allies to pay a significant share of the costs of the war in Iraq, and in the European Community's chastening rebuffs of U.S.-based megacompanies, including General Motors and Microsoft. The tone is bound to become significantly harsher as the scenario of default plays out.

• THE DEBT CRISIS ISN'T JUST A GOVERNMENT PROBLEM. AMERICANS THEMSELVES FACE GREAT RISK BECAUSE MILLIONS OF US ARE SWIMMING IN PERSONAL DEBT.

We're in hock for a record $2 trillion of consumer debt. That includes bank loans, car financing, and credit-card debt. Real-estate-related borrowing adds another $7 trillion. In less than 50 years, we've quit being a frugal people who once repaired, rebuilt, reused, and saved till we could afford to buy. Now we shun saving, worship novelty, shop till we drop, and raise kids to expect instant gratification. Result: unprecedented levels of consumer debt and personal bankruptcies—



Source: Federal Reserve Board, Historical Tables

1.6 million households filed papers last year alone. If we can't get smart about our personal finances, how can we cope with the government's follies?

For the first time in history, Americans owe more than they take home in after-tax income. Personal debt is now three times bigger than the gross domestic product. Credit-card debt alone averages about $8,000 per household, another all-time high. Whose credit-card debt is rising the fastest? The answer may surprise you: senior citizens'.

Moreover, those paying the most for credit are the people who can least afford it. If you spread the credit-card debt only among families who don't pay up before financing charges kick in, it's more like $12,000 per household. Fees rise sharply, to an annual rate as high as 24 percent, at the first delinquency or even late payment. All told, about 25 percent of low-income Americans spend at least 40 percent or more of their earnings just to pay interest on their existing debt. How will these people escape their constantly increasing debt? What happens to their finances as credit-card interest rates rise?

As if credit-card debt weren't enough, we've had sharp increases (averaging 27.5 percent) since 2001 in mortgage borrowing, home equity loans, and the like. The mortgage-refinance boom that swept America in recent years, as interest rates fell to 46-year lows, tempted many homeowners to take cash payments when they refinanced, siphoning off some of their built-up equity. They used the cash they netted to pay down other debt, buy cars or other consumer goods, take vacations, or spiff up their homes. Unfortunately, they now have less equity in their homes—equity levels have fallen to 56 percent of the value of the home, on average—than ever before. Their mortgage providers talked up the virtues of *adjustable* interest rates—rates that seemed low then but could become crippling when (not if) interest costs shoot up again.

DENYING THE SITUATION

Yet the incumbents running for reelection loudly deny that anything is wrong. We have now reached Condition Red on the denial chart.

Most politicians hunger first and foremost to be reelected. Why? I'd like to tell you that it's so they can nobly serve their country. But their behavior suggests it's so they can continue to guzzle ignobly at the public trough. By their deeds, so at odds with their words, we can only conclude that they yearn to hang on and on in Washington, spending ever more tax dollars on special interests that return the favor by financing the politicians' reelection campaigns. And when they finally retire on hefty government pensions, they report for duty as fat-cat lobbyists, selling government access to the highest bidders. This is fiscal felony. A quicker way to spend the republic into insolvency is hard to imagine. Mark Twain cut to the bone in the 1890s when he wrote, "There is no distinctly native American criminal class, except Congress."

The only thing that's changed since Twain's time is the undreamt size of the national debt riding on American backs and budgets. Whatever happened to fiduciary responsibility? In Washington, that quaint term is used only to pull the wool over our eyes, the way a con man says "Trust me" before he steals you blind.

"Deficits don't matter," purr Vice President Dick Cheney and other members of the Bush Administration, as well as our U.S. senators and representatives who control the national checkbook. Whatever they claim, whatever deceits our elected officials spin to hide fiscal fecklessness from naïve voters, I am here to tell you that the huge tabs they're running up in our name, both at home and abroad, *do* matter. These numbers don't lie. America's supposed economic juggernaut is already dangling over a chasm, and the rope belaying us is fast unraveling. Nearly everything we take for granted—democracy itself—is under siege.

This looming crisis didn't spring up overnight. It is the product of years of false assumptions, misguided policies, and partisan politics—in some cases, downright despicable behavior—by our presidents and Congress, past and present. In the chapters that follow, I'll show you what's gone on and why we now face a potentially catastrophic threat to our way of life.

It is not my intent to exaggerate that threat, but I sense that even the shocking facts I will relate may not fully convey the grave danger I'm convinced we face. Sometimes it takes a jolt of imagination to visualize what such insolvency might mean. The next chapter paints a frightening picture of how the coming collapse—a sudden switch from abundance and liberty to poverty and bondage—might look and feel to a typical American family—a family that could well be your own.