Nation's debt level must be addressed now

by: BOB MCCORMICK Business Viewpoint
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On Aug. 2, President Barack Obama signed into law a plan that initially seeks to reduce the federal deficit by $900 billion over the next 10 years, with another $1.5 trillion to be cut based upon a yet-to-be determined course of action.

On Aug. 5, Standard and Poor's downgraded the debt of the U.S. Treasury to AA+ from AAA.

In the first two weeks of this month, the Dow Jones industrial average fell 874 points, or 7 percent.

The downgrade is a shot across our bow; and if we don't seriously address our deteriorating financial situation in the near future, future shots will not be warning shots but direct hits on our fiscal mismanagement.

Unlike the past several decades where the U.S. could borrow and spend at will and the rest of the world would go along, this time is different. We've hit a tipping point where our high spending and explosion of debt are having serious long-term consequences for the economy.

Our federal debt ratio compared to Gross Domestic Product is estimated to be roughly 100 percent by year-end, a level well above most other developed nations and many emerging ones, according to the International Monetary Fund.

However, the true concern lies in the future as baby boomers retire and start to draw on Social Security and Medicare. The first boomers turned 65 last year, so the ramp-up in spending is just now beginning. By 2016, the IMF estimates that our federal debt-to-GDP will be 112 percent, exceeded only by Italy, Ireland, Greece and Japan. That is not the group we want to be associated with when it comes to fiscal matters.

Amazingly, the deficit agreement that just became law did not address Social Security or Medicare by even one penny.

It is future entitlement spending that is the primary threat to our fiscal health. There simply are not enough younger people behind the baby boom generation to support the boomers in their retirement under the same rules that the boomers' parents have.

If we cannot reduce our future spending as a percent of GDP, we will face more serious consequences than a one-notch rating downgrade. As more and more boomers retire and draw on Medicare, Social Security and even Medicaid, the deficit numbers are forecast to grow to unsustainable levels.

We can complain all day long about how unfair it is and how we have earned what the government has implicitly promised us. But the numbers don't lie, and the decades of fiscal irresponsibility have finally caught up to us. The sooner we and our elected officials publicly acknowledge this and take actions directed to address the primary problem, the better off we'll be.

What is the likelihood of truly addressing this problem? To paraphrase Winston Churchill, Washington will likely rise to the challenge after it has exhausted all other options. This will make for volatile markets until they are convinced that Washington finally gets it. Based upon the Aug. 2 budget deal, Washington does not yet get it. But the stakes are so high that rationality should and must ultimately rear its head.

I would advocate that the rational solution includes a three-pronged approach of entitlement spending reductions, more competition in the health care sector as opposed to government control, and more government revenues.

Higher revenues do not have to mean higher marginal tax rates. A simplified tax structure with flatter tax rates and fewer deductions would likely allow government to grow its revenues while also encouraging economic growth.

This three-pronged approach offers the best chance to sustain strong economic growth, which will itself be a big help in getting our deficit under control.

The time is ripe for a change that both Republicans and Democrats should be able to believe in - a stronger, less debt-laden nation. If we accomplish that, investors will be rewarded.

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