

## **The State of World Finances**

*R. Marc Nuttle*

*Speech delivered February 9, 2011, on the grounds of the U.S. Capitol in the Capitol Visitor's Center in Washington, D.C. at a celebration of the 100<sup>th</sup> anniversary of Ronald Reagan's birth sponsored by National Tax Limitation Committee. Speakers included former Attorney General Edwin Meese; Bill Niskanen, former member of Ronald Reagan's Council of Economic Advisors; Congressman Paul Ryan, Chairman, House Budget Committee; and Congressman Tom Price, Chairman, House Republican Policy Committee.*

Thank you, Lew, for that gracious introduction. I very much enjoyed my time serving on the National Tax Limitation Committee team.

Today we are here to celebrate and honor the legacy of President Ronald Wilson Reagan. And in this effort, we find in our times a great debate about the size and role of government that is very similar to President Reagan's time.

The federal budget, its deficits, and the growing national debt are being questioned with intensity as the reality of the repercussions and consequences, generated by ongoing deficits, lead to an ever larger, insidious and threatening debt which impacts our every day lives. These deficits and the resulting debt are unsustainable.

The issue then and now is the maintenance and protection of individual freedom and the government's role not to only protect our freedoms, but to advocate and facilitate that which is our God-given right of freedom from government.

President Reagan would not have seen this as just an American concern. He would have approached it as a world mandate and that we, as Americans, have an obligation to participate in the eternal quest of worldwide freedom benefiting all humanity.

President Reagan believed in the exceptionalism of the United States of America. And he further believed that this exceptionalism must be extended to the benefit of all nation states. This was to be accomplished by providing a world order that had freedom at its core mission.

Many intellectual elitists would have us believe today that the establishment of the American ideal was simply a moment in time that passed into the twilight of history within a generation; that America is no more special today in its role to the concepts and precepts of a civil society than any other country, past or present. These intellectual elitists are muted in logical thought by their own academic arrogance. They say America couldn't have been that exceptional because they weren't there to proffer it. Some would say that American exceptionalism was a good idea at the time, but that time has passed. The ideal of individual freedom and less government must be compromised to make room for all possible theories of government. Regardless of their basis for rejecting American exceptionalism, they are wrong.

America is exceptional for three moral reasons. It is the first country in the history of the world to be established on the principle that God is sovereign over man and man is sovereign over

government. Second, it is the first country to break all hereditary titles. In the United States you are not born into a tribe, a royal order, or a station in life. You are born equal to every other child born that day, or before you, or after you. Third, the United States is the only country in the world where you can do anything you want as long as it's not against the law. In every other country, you must, more often than not, get the government's permission to take action and convince the government your endeavor is a good use of the king's government's resources.

In America, we trust the individual to make decisions for themselves in their own best interest and the interest of their families. In doing so, these decisions collectively are in the best interest of the nation state and the greater community. In other words, we advocate individual freedom and we trust the individual to pursue freedom as he or she sees fit.

These are the principles that dictate the exceptionalism of the United States of America. They are the principles that were the guiding light for the development of the greatest nation on earth. Ronald Reagan knew these principles. Ronald Reagan defended these principles. And Ronald Reagan advocated these principles with every breath he took.

That is why, when he stood in front of the Brandenburg gate at the Berlin Wall, and in direct opposition to the State Department, members of his own staff, and elected officials, he uttered those historic words, "Mr. Gorbachev, tear down this wall!" He saw the Soviet Union as a threat to the principles of freedom, principles that were the fabric of human happiness and fulfillment. He cared about these principles for the entire world and saw the Soviet Union as a threat to that world fabric.

Now what is the great threat today that must be addressed with the same commitment of absolute conviction to maintain our freedom?

It is the national debt.

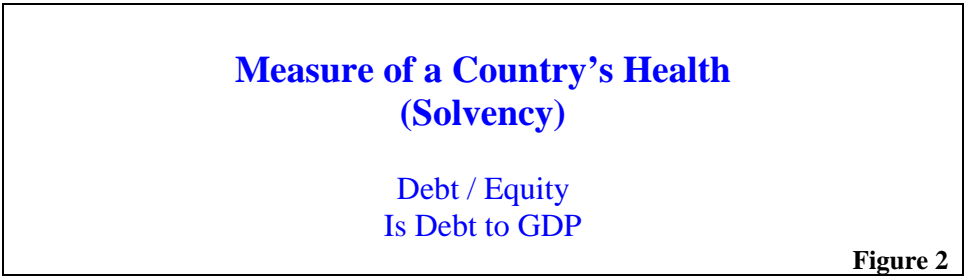
This is not a philosophical statement about whether or not there should be a debt. I'm talking about a debt that is so large that, under current deficit spending projections, it cannot be sustained beyond 2013. Either there will not be enough money in the world to borrow or the interest rate will be too high to afford the debt. When this occurs, either the government prints the money to pay for its obligations and the currency is destroyed, or government defaults on the debt, wreaking havoc on the world's economy.

As the manager of the world's primary currency, Ronald Reagan would have seen it as our country's responsibility to manage our finances in a way to allow for freedom to prosper. In his speech "A Time for Choosing," Ronald Reagan said, "Let us not take one step toward a thousand years of darkness." Darkness is total government control over our lives. If the United States fails to manage this debt, darkness will befall the world.

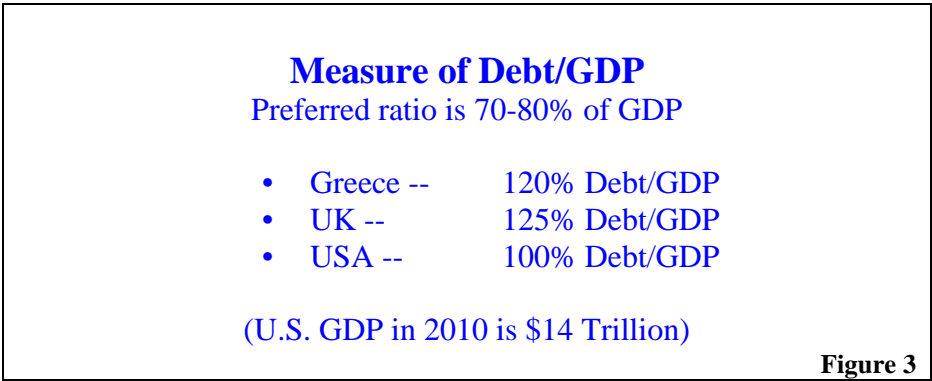
The current national debt is \$14 trillion or \$45,000 per capita. The current national deficit is \$1.5 trillion or \$7,250 per adult U.S. citizen.



The measure of a person or corporation's solvency is its debt to equity analysis. For a nation state it is debt to Gross Domestic Product (GDP).



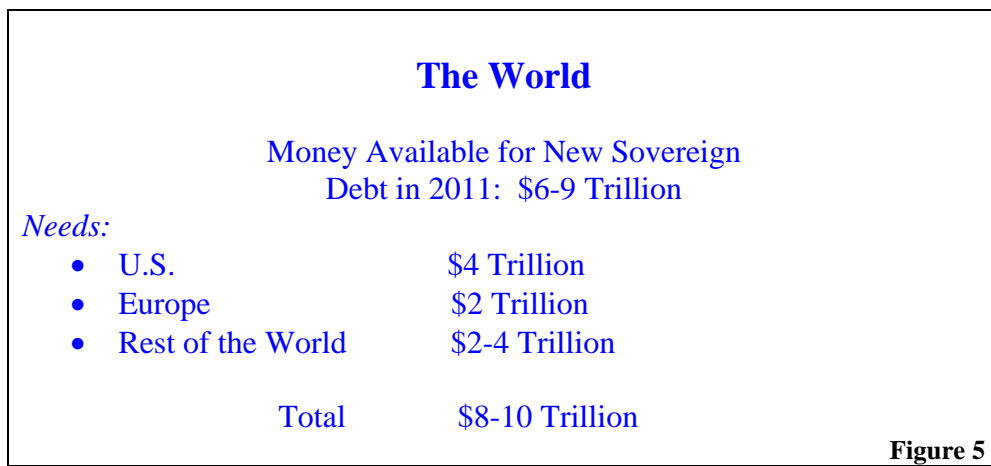
The preferred ratio of maximum debt to GDP is 70-80%. Greece is now at 120%, UK is at 125%, USA is at 100%. (U.S. debt in 2010 was \$14 trillion, U.S. GDP in 2010 was \$14 trillion)



Total assets of the world are estimated to be \$350-\$550 trillion. The total liquidity of the world available in all stock markets, bond markets and commodity markets is \$140 trillion. These assets, along with cash, are the primary sources of monies to fund government's sovereign debt.



Based upon world liquidity, the amount of money available to fund sovereign debt in 2011 is between \$6-9 trillion, 10-15% of world GDP of \$60 trillion. The world's government projections for deficit financing in 2011 is \$8-10 trillion. We are bumping the ceiling of the world's ability to cash flow ongoing sovereign deficit spending and accumulated debt.



The world's capacity of sustainable debt at 70% of GDP is \$42 trillion. Anything above 70% dictates that interest rates must rise if the world's economy is to grow. Currently, all governments' debt totals \$58 trillion or 97% of debt to GDP. By 2013, deficits will produce total debt of \$70 trillion and 116% of world debt to GDP.

To fund the ongoing cash flow of these deficits will require that monies are taken out of other exchanges, weakening those indexes. In other words, money taken out of a stock market to fund debt will cause the stock market to decline.

Total Capacity for World Debt in 2011 at 70% of GDP: <b>\$42 Trillion</b>		
Sovereign Debt:	<u>2011</u>	<u>2013</u>
U.S.	\$14 T	\$18 T
Europe	\$10 T	\$14T
Rest of World	<u>\$34 T</u>	<u>\$38T</u>
<b>Totals</b>	<b>\$58 T</b>	<b>\$70T</b>
Debt as a percent of GDP	97%	116%

**Figure 6**

There is a limit to how much money the countries of the world can borrow to fund T-Bills or government spending in a given year. The alternative to borrowing money is to print it. This is equally disastrous.

The current cost of U.S. government borrowing today is approximately 1.25%. This resulted in an interest payment on the debt in 2010 of \$187 billion. That is because economic activity is so sluggish that demand for capital is conversely low. Increased money supply and a sluggish economy has been what Japan has experienced the last two decades resulting in low interest rates.

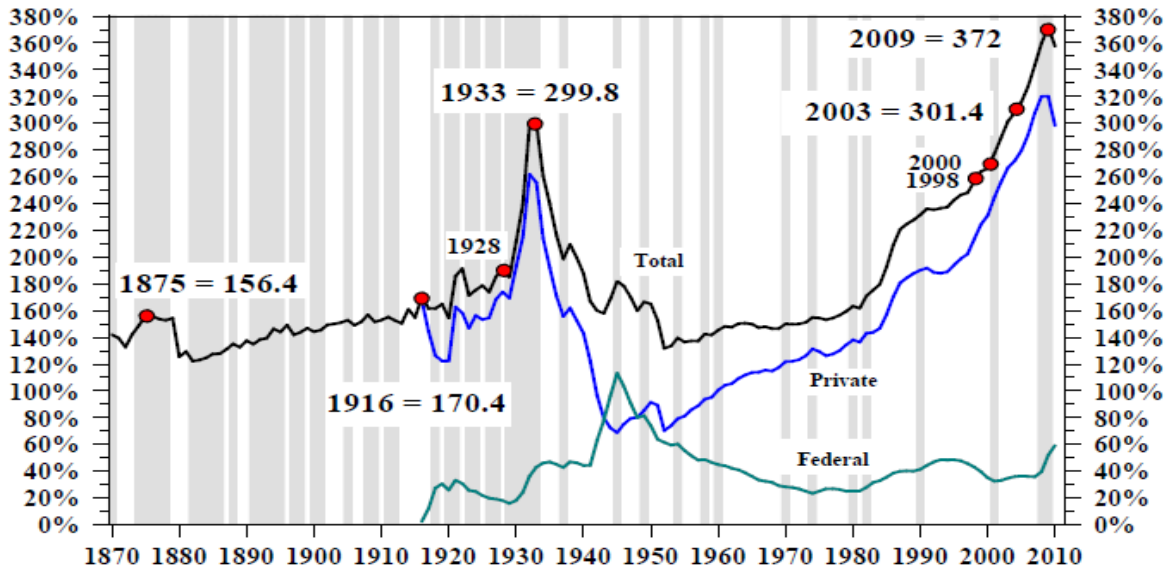
The catch-22 is that, if the U.S. economy is to grow, the cost of capital must rise. It is a cause and effect principle. The historical average cost of capital in the United States since 1850 has been 4%. If the historical average were met, the interest on the debt would go from \$187 billion to \$600 billion. To pay for this increased cost, the government would have to borrow even more money and a downward deficit-debt spiral begins. This puts direct pressure on private capital, equity markets and their indexes, and the dollar in general as a world currency.

<b>Impacts &amp; Pressures</b>	
•	Private Capital
•	Other Equity Markets
•	The Dollar as a Currency
At 4%, the interest on the debt goes from \$187 Billion to \$600 Billion	

**Figure 7**

To exacerbate the problem, total debt in the United States, including the federal government, the private sector, and corporate borrowing has exceeded the high-water mark of debt in 1933. We are currently at about 360% debt-to-GDP

## U.S. Debt as a % of GDP *annual*



Sources: Bureau of Economic Analysis, Federal Reserve, Census Bureau: Historical Statistics of the United States Colonial Times to 1970. Through Q3 2010.

The immediate cracks in our government foundation will appear first at the state level. Forty-six (46) states are in various degrees of negative cash flow. In the past two years, the states have been using federal stimulus money to balance their budgets. They are now facing the proposition that they must make structural cuts in their budgets to make ends meet. Their day of financial reality is here.

Congress must raise the debt ceiling by the middle of March to allow for further government spending. Currently the House is discussing a budget that includes approximately \$61 billion in cuts. This is less than 2% of the federal budget. However, any budget cuts will further impact the states. Approximately \$.75 of every non-defense dollar is coordinated with state spending. By the summer of 2012, unfunded mandates of the new health care system will begin to materialize at the state level. The states will find that the budget cuts they are making this year in March, April and May must be duplicated again in the spring of 2012.

The brewing demonstrations in Wisconsin are just the beginning. By 2012 most states will find themselves in a situation of budget impasse.

The next point of government moral, fiscal debate will be whether or not to extend the unemployment benefits which substantially run out by January 31, 2012. If the benefits are extended through 2012, this will further put pressure on the deficit-debt spiral. The catch-22 of interest rates will become clear. To borrow the money will bring burden on the world's equity markets, currency exchanges, and interest rates. If the government prints the money and implements a "quantitative easing three," rates may stay low for a while, but the currency will be debased. Ultimately printing the money without restraint will lead to inflation and higher interest rates, adding further to the deficit-debt spiral.

At current rates of world deficit spending, by the end of 2013 the world will be approaching a liquidity squeeze.

The budget must be balanced.

The debt must be reduced to 70% of GDP.

The question being asked in our capitol today is, "Can we stretch it out?" President Obama has presented a budget to Congress which is by its own estimate in deficit \$1.67 trillion. This world liquidity formula can only be addressed if the budget is cut by more than the net growth of the economy in real dollar terms.

Noted economist Paul Krugman has stated that it is possible, if we do nothing, the budget process and the economy will heal itself. However, he says it will take a very long time. Secretary of the Treasury Geithner has stated that the government's mission is to implement manageable deficits.

Right now, 42.8% of every federal dollar spent is printed or borrowed. The current revenue of the United States government is approximately \$2 trillion. For the budget process to heal itself, the economy would have to double in size without additional debt and the cost of interest being any greater than it is today. This is not feasible. Running current deficits will bring us to a liquidity wall in the near future.

President Reagan would have supported the states in their effort to remain solvent in their relationship with the federal government. He would not have supported unfunded mandates. President Reagan stated, "Government can't control the economy without controlling people," and it eventually uses "force and coercion to achieve its purpose." But most importantly, President Reagan believed that such government intrusion "interferes with the people's right to know."

We have not been telling the American public the truth. If they understood the extent of this debt crisis, they would rally to the cause. They would make the sacrifices necessary for their children's future. Mitch Daniels, governor of Indiana, and Chris Christie, governor of New Jersey, are attempting to tell the people the truth. The day of borrowing and spending has reached the point of unsustainability. If not corrected, pension funds, Social Security, Medicaid and Medicare will be severely curtailed or lost as government programs.

The late Milton Friedman, noted economist and an advisor to President Reagan, counseled that ultimately a government must balance its checkbook. He used the historical reference of the kings in the Middle Ages. If the king, who when he had the ultimate power, owned all lands and rents, whose word was law, controlled people as serfs, and had the power to mint the coin, could not borrow and spend his way out of trouble, what makes anyone think the government can do it today?

Ladies and gentlemen, make no mistake; our future is at risk, yet our destiny is in our hands. We have a responsibility to never take even one step toward a thousand years of darkness. Darkness

is too much government taking too much freedom for too little in return. It's much better to defend the balance of rights we've been guaranteed by the Constitution with every breath we take, regardless of the cost. We must never give in to the temptation to let someone else do for us that which we must only do for ourselves. Our children are too precious and their future too critical to the legacy of generations for us to be any less so resolved.

Thank you.