MERCATUS CENTER
George Mason University
Bridging the gap between academic ideas and real-world problems

RESEARCH SUMMARY

ASSESSING FISCAL SUSTAINABILITY

"The US is bankrupt—not in 30 years, 20 years, or 10 days. It's bankrupt today."
—Laurence Kotlikoff

The US fiscal gap now stands at an estimated $205 trillion, or 10.3 percent of all future US GDP. Closing this gap is imperative, and requires a fiscal adjustment of an *immediate* and *permanent* 37 percent reduction in spending (apart from servicing official debt), an *immediate and permanent* 57 percent increase in all federal taxes, or some combination of the two. The necessary size of this adjustment increases the longer it is put off.

This grave picture of America's fiscal position could effectively constitute a declaration of bankruptcy. But no one in Washington or on Wall Street would openly declare the United States to be broke. The question is, Why not?

According to a new study published by the Mercatus Center at George Mason University, the answer is that policymakers, financial analysts, the media, and even most economists focus on the wrong measure of fiscal sustainability—namely, the $12 trillion in official debt held by the public. The study's author, Boston University professor of economics Laurence Kotlikoff, says that what gets reported as official debt is economically arbitrary and politically driven, leaving the vast majority of the government's liabilities off the books.

To generate an accurate assessment of the US government's fiscal sustainability, Kotlikoff uses both *fiscal gap accounting*, which discloses the amount of adjustment needed to restore sustainability, and *generational accounting*, which looks at the impact of current and implied policy on specific generations.

Below is a brief overview. To read the study in its entirety and learn more about its author, please see "Assessing Fiscal Sustainability."

KEY FACTS

Conventional fiscal accounting points to debt held by the public—currently at about $12 trillion—as the measure of a country's fiscal sustainability.

For more information, contact:
Angela Kuck, 703-993-9338, akuck@mercatus.gmu.edu
Mercatus Center at George Mason University
3351 Fairfax Drive, 4th Floor, Arlington, VA 22201

- This method treats all future government spending commitments, from defense to Social Security, differently from the official debt, and has created a yawning discrepancy in the official-versus-actual measure of the US fiscal gap.

- For example, simply adding Social Security's unfunded liability ($23 trillion) to official debt ($12 trillion) and properly accounting for the $2.6 trillion of Social Security trust fund assets would put the government's official debt at over $37 trillion—more than twice US GDP ($17 trillion)—raising the US debt-to-GDP ratio above Greece's (1.7).

Achieving fiscal sustainability via generationally fair means requires an understanding of the overall adjustment needed to close the fiscal gap (fiscal gap accounting), and how much more any one generation will pay if another generation pays less (generational accounting).

- Applying fiscal gap accounting, the study finds that the US official debt is just 6 percent of the federal government's true fiscal gap of $205 trillion.

- Applying generational accounting, the study finds that placing the burden of the fiscal gap solely on unborn generations would require:

    - Giving all future American children a bill of $420,600, which would rise as the expected wages of each new generation rose.

    - Taxing future generations, on average, roughly 60 cents of every dollar they earn, net of government transfers received.

The fiscal gap already has had a real impact on national savings, income, and net domestic investment.

- In 1950, national saving and investment rates were 14 percent; today, they are 2 percent and 4 percent, respectively.

- These declines have reduced the growth in real wages and dampened the increase in living standards.

Past attempts by government agencies to do long-term fiscal accounting were quashed when the analyses began to reveal an enormous long-term fiscal shortfall. This suggests that policymakers are unlikely to provide the public with long-term fiscal gap analyses unless required to do so.

- The study supports the use of generational accounting that presents debt as the net tax liability (taxes less transfer payments) for people born in different years.

- More than 700 economists, including 12 Nobel laureates, have endorsed the bipartisan Inform Act (H.R. 2967), which would mandate that the Congressional Budget Office, the Office of Management and Budget, and the Government Accountability Office supplement—if not wholly replace—conventional fiscal accounting with fiscal gap and generational accounting, and do these analyses annually and for all proposed major fiscal legislation.