The Federal Debt Trap: Issues and Possible Solutions

By Ellen Brown
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"Rather than collecting taxes from the wealthy," wrote the New York Times Editorial Board in a July 7 opinion piece, "the government is paying the wealthy to borrow their money."

Titled "America Is Living on Borrowed Money," the editorial observes that over the next decade, according to the Congressional Budget Office (CBO), annual federal budget deficits will average around $2 trillion per year. By 2029, just the interest on the debt is projected to exceed the national defense budget, which currently eats up over half of the federal discretionary budget. In 2029, net interest on the debt is projected to total $1.07 trillion, while defense spending is projected at $1.04 trillion. By 2033, says the CBO, interest payments will reach a sum equal to 3.6 percent of the nation's economic output.

The debt ceiling compromise did little to alleviate that situation. Before the deal, the CBO projected the federal debt would reach roughly $46.7 trillion in 2033. After the deal, it projected the total at $45.2 trillion, only slightly less – and still equal to 115% of the nation's annual economic output, the highest level on record.

Acknowledging that the legislation achieved little, House Speaker Kevin McCarthy said after the vote that he intended to form a bipartisan commission "so we can find the waste and we can make the real decisions to really take care of this debt." The NYT Editorial Board concluded:

> Any substantive deal will eventually require a combination of increased revenue and reduced spending …. Both parties will have to compromise: Republicans must accept

> the necessity of collecting what the government is owed and of imposing taxes on the wealthy. Democrats must recognize that changes to Social Security and Medicare, the major drivers of expected federal spending growth, should be on the table. Anything less will prove fiscally unsustainable.

The Elephant in the Room

Omitted was any mention of trimming the defense budget, which currently accounts for more than half of the federal government's discretionary spending and nearly two-thirds of its contract spending. Rep. Ro Khanna (D-CA), who cast the sole dissenting vote on the recent $886 billion defense budget in the House Armed Services Committee, has detailed some of the Pentagon's excesses. For decades, he writes, legacy military contractors have charged the federal government exorbitant sums for everything from fighter jets to basic hardware. Lockheed Martin, for example, has used its monopoly on F-35 fighter jets to profit from maintenance that only they can provide, with the work needed to support and upgrade existing jets projected to cost taxpayers over $1.3 trillion. TransDigm, another contractor responsible for supplying spare parts for the military, was found to be charging the Pentagon more than four times the market price for their products.

Rep. Khanna concludes, "Keeping America strong starts at home. It means ensuring access to quality, affordable healthcare and education, strengthening our economy with good-paying jobs, and giving Americans the tools they need to pursue the American Dream…. Bloated military spending is not the answer…. We can't continue to sign a blank check to price-gouging defense contractors while Americans struggle here at home."

In an address to the UN Security Council on Ukraine aid on June 29, 2023, Max Blumenthal added fuel to those allegations. He said:

> Just June 28th, as emergency crews work to clean up yet another toxic train derailment in the United States, this time on the Montana River, further exposing our nation's chronically underfunded infrastructure and its threats to our health, the Pentagon announced plans to send an additional $500 million worth of military aid to Ukraine….
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> This policy, … which sees Washington prioritize unrestrained funding for a proxy war with a nuclear power in a foreign land … while our domestic infrastructure falls apart before our eyes, exposes a disturbing dynamic at the heart of the Ukraine conflict – an international Ponzi scheme that enables Western elites to seize hard-earned wealth from the hands of average U.S citizens and funnel it into the coffers of a foreign government that even Transparency International ranks as consistently one of the most corrupt in Europe.
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> The U.S. government has yet to conduct an official audit of its funding for Ukraine. The American public has no idea where their tax dollars are going. And that's why this week we at the Grayzone published an independent audit of U.S. tax dollar allocations to Ukraine throughout the fiscal years 2022 and '23.

Among other dubious payments they found were $4.5 million from the U.S. Social Security Administration to the Kiev government, and $4.5 billion from USAID to pay off Ukraine's sovereign debt, "much of which is owned by the global investment firm BlackRock. That amounts to $30 taken from every U.S citizen at a time when 4 in 10 Americans cannot afford a $400 emergency."

The Black Hole of the Pentagon Budget

The Pentagon failed its fifth budget audit in 2022 and was unable to account for more than half of its assets, or more than $3 trillion. According to a CBS News report, defense contractors overcharged the Defense Department by nearly 40-50%; and according to the Office of the Inspector General for the Defense Department, overcharging sometimes reached more than 4,000%. The $886 billion budget request for FY2024 is the highest ever sought.

Following repeated concerns about fraud, waste and abuse in the Pentagon, in June 2023 a bipartisan group of senators introduced legislation to ensure the Defense Department passes a clean audit next year. The Audit the Pentagon Act of 2023 would require the Defense Department to pass a full, independent audit in fiscal 2024. Any agency within the Pentagon failing to pass a clean audit would be forced to return 1% of its budget for deficit reduction.

Sen. Bernie Sanders (I-Vt.) observed that the Pentagon “and the military industrial complex have been plagued by a massive amount of waste, fraud, and financial mismanagement for decades…. [W]e have got to end the absurdity of the Pentagon being the only agency in the federal government that has never passed an independent audit.”

Sen. Chuck Grassley (R-Iowa) said the Pentagon “should have to meet the same annual auditing standards as every other agency…. From buying $14,000 toilet seats to losing track of warehouses full of spare parts, the Department of Defense has been plagued by wasteful spending for decades. … Every dollar the Pentagon squanders is a dollar not used to support service members, bolster national security or strengthen military readiness.”

But defense audits have been promised before and have not been completed. In 2017, Michigan State University Prof. Mark Skidmore, working with graduate students and with Catherine Austin Fitts, former assistant secretary of Housing and Urban Development, found $21 trillion in unauthorized spending in the departments of Defense and Housing and Urban Development for the years 1998-2015. As reported in MSUToday, Skidmore got involved when he heard Fitts refer to a report indicating the Army had $6.5 trillion in unsupported adjustments (or spending) in fiscal 2015. Since the Army’s budget was then only $122 billion, that meant unsupported adjustments were 54 times the spending authorized by Congress. Thinking Fitts must have made a mistake, Skidmore investigated and found that unsupported adjustments were indeed $6.5 trillion.

Four days after Skidmore discussed his team’s findings on a USAWatchdog podcast, the Department of Defense announced it would conduct its first-ever department-wide independent financial audit. But it evidently failed in that endeavor. As Bernie Sanders observes, the Pentagon has never passed an independent audit. It failed its fifth audit in 2022. Whether it will pass this sixth one, or whether the audit will lead to budget cuts, remains to be seen. The Pentagon budget seems to be untouchable.

Tackling the Other Elephant: The Interest Monster

If the sacrosanct military budget cannot be trimmed, what about that other massive budget item, interest on the federal debt? Promising proposals for clipping both the interest and the debt itself were made in conjunction with earlier debt ceiling crises. In November 2010, Dean Baker, co-director of the Center for Economic and Policy Research in

Washington, wrote:

> There is no reason that the Fed can't just buy this debt (as it is largely doing) and hold it indefinitely. If the Fed holds the debt, there is no interest burden for future taxpayers. The Fed refunds its interest earnings to the Treasury every year. Last year the Fed refunded almost $80 billion in interest to the Treasury, nearly 40 percent of the country's net interest burden. And the Fed has other tools to ensure that the expansion of the monetary base required to purchase the debt does not lead to inflation.

In 2011, Republican presidential candidate Ron Paul proposed dealing with the debt ceiling by simply voiding out the $1.7 trillion in federal securities then held by the Fed. As Stephen Gandel explained Paul's solution in Time Magazine, the Treasury pays interest on the securities to the Fed, which returns 90% of these payments to the Treasury. Despite this shell game of payments, the $1.7 trillion in US bonds owned by the Fed is still counted toward the debt ceiling. Paul's plan:

> Get the Fed and the Treasury to rip up that debt. It's fake debt anyway. And the Fed is legally allowed to return the debt to the Treasury to be destroyed.

Congressman Alan Grayson, a Democrat, also endorsed this proposal.

Taxing the Bubble Economy

In a July 8, 2023 article on Naked Capitalism titled "The United States' Financial Quandary: ZIRP's Only Exit Path Is a Crash," economist Michael Hudson points to the speculative bubbles blown by the Fed's Zero Interest Rate Policy, dating back to the Great Recession of 2008-09. The result is a Ponzi scheme, says Hudson, and there is no way out but to write down the debt or let the economy crash.

According to Fed insider Danielle DiMartino Booth, it is those speculative bubbles that Fed Chair Jerome Powell has attempted to pop with the drastic interest rate hikes of the last year, eliminating the "Fed Put," the presumption that the Fed will always come to the rescue of the speculative market. That tack actually seems to be working; but the approach has resulted in serious collateral damage to mainstream businesses and the productive economic base. (See my earlier article here.)

Another way to trim the fat from the "financialized" economy is a small financial transactions tax. That solution was also discussed in an earlier article (here), drawing on a 2023 book titled A Tale of Two Economies: A New Financial Operating System for the American Economy by Wall Street veteran Scott Smith. He argues that we are taxing the wrong things – income and physical sales. We actually have two economies – the material economy in which goods and services are bought and sold, and the monetary economy involving the trading of financial assets (stocks, bonds, currencies, etc.) – basically "money making money" without producing new goods or services.

Drawing on data from the Bank for International Settlements and the Federal Reserve, Smith shows that the monetary economy is hundreds of times larger than the physical economy. The budget gap could be closed by imposing a tax of a mere 0.1% on financial transactions, while eliminating not just income taxes but every other tax we pay today. For a financial transactions tax (FTT) of 0.25%, we could fund benefits we cannot afford today that would stimulate growth in the real economy, including not just infrastructure and development but free college, a universal basic income, and free healthcare for all. Smith contends we could even pay off the national debt in ten years or less with a 0.25% FTT.

Funding Infrastructure Through a National Infrastructure Bank

Another way to fund critical infrastructure without tapping the federal budget is through a 1930s-style work-around on the model of Roosevelt's Reconstruction Finance Corporation. HR 4052, a proposal for a national infrastructure bank on that model, is currently before Congress and has widespread support. The proposed bank is designed to be a true depository bank, which can leverage its funds as all banks are allowed to do: with a 10% capital requirement, it can leverage $1 in capital into $10 in loans.

For capitalization, the bill proposes to follow the lead of Alexander Hamilton's First U.S. Bank: shares in the bank will be swapped for existing U.S. bonds. The shares will earn a 2% dividend and are non-voting. Control of the bank and its operations will remain with the public, an independent board of directors, and a panel of carefully selected non-partisan experts, precluding manipulation for political ends.

America achieved its greatest-ever infrastructure campaign in the midst of the Great Depression. We can do that again today, and we can do it with the same machinery: off-budget financing through a government-owned national financial institution.

Granted, these proposals are not likely to be implemented until we are actually facing another Great Depression, or at least a Great Recession; but Michael Hudson and other pundits are predicting that outcome in the not-too-distant future. It is good to have some viable alternatives on the table for consideration when, as in the 1930s, politicians are compelled to seek them out.

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This article was originally published on ScheerPost.

Ellen Brown is an attorney, chair of the Public Banking Institute, and author of thirteen books including Web of Debt, The Public Bank Solution, and Banking on the People: Democratizing Money in the Digital Age. She also co-hosts a radio program on PRN.FM called "It's Our Money." Her 400+ blog articles are posted at EllenBrown.com. She is a regular contributor to Global Research.

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