

America as a negative-amortization nation

Lawrence Grossman

Sunday, March 21, 2010

Well, here's another uncomfortable warning.

We as a country are heading for a fiscal train wreck dramatically bigger than and apart from the historic \$1.5 trillion federal budget deficit that you've been hearing about. Here are the two simple facts.

First: The official national debt is approaching \$14 trillion.

Second: The actual national debt is estimated at \$116 trillion. The \$14 trillion figure is just the formally counted debt.

In light of the frightening similarity between this fiscal legerdemain and the negative-amortization mortgages that stood prominently at the intersection of the housing bubble and the financial crisis, it seems entirely reasonable to dub America a fiscally "neg-am" nation.

The actual national debt of \$116 trillion includes both financial obligations in the form of financial instruments, such as U.S. Treasury bonds, and unfunded promises by the government to provide services far into the future, like Social Security and Medicare.

The actual national debt equals about \$375,000 for each American, an amount far larger than one can imagine. But these estimates are accurate; in fact, they come from the 2008 Financial Report of the U. S. Department of the Treasury (fms.treas.gov/fr/index.html, p. 158).

You don't hear much about these unfunded debts; that may be because they are not formal obligations like bonds, or it may be because it is uncomfortable to talk about them. Nonetheless, they are very real

advertisement | [your ad here](#)



Click Here
To Learn More
About Our Participating
Neighborhoods!

 William Lyon Homes
Experience the pride.
www.lyonhomes.com

debts. Only the financially innumerate, and possibly the politically motivated, would deny that.

Of course, interest accrues on the debt. Assuming a modest interest rate of 4 percent, it's about \$15,000 annually per person.

Now if you're thinking that you're not paying that much, you're right. That's because you pay interest costs only on the official debt. The interest charges on the unfunded debt are being added to the principal each year.

The train wreck is just up ahead. The size of the unfunded obligations is growing by about \$4 trillion yearly. That is vastly greater than our budget deficit, which is at an all-time high. Our inability as a nation to meet entitlement promises will be brought into sharp relief at the end of this decade when the Medicare Trust Fund balance reads "empty."

How did we get here? For decades, Washington politicians have done the popular things - expanded services, made unfunded promises and cut taxes - without balancing the books. One ingenious justification for tax cuts is the assertion that tax cuts are investments in America that lead to new economic activity, which in turn supposedly leads to new tax revenue greater than the tax cuts. Tax cutting was presented as profitable.

Sound familiar? Maybe that's because it mirrors the sales pitch of bankers selling the neg-am loans. With neg-am mortgages, instead of paying normal interest and principal, borrowers annually pay no principal and just a portion of a low introductory interest charge. The unpaid interest is added to the loan balance.

That's how people were able to buy homes that they could not afford - the banks first lent them money for the purchase and then effectively lent them money to pay the interest.

The banks were able to issue those inappropriate loans to borrowers who thought their home values would rise faster than the unpaid interest. Like the tax-cut advocates, they calculated that borrowing was profitable. Of course, the housing bubble burst, the debt remained, the low neg-am interest option expired and was replaced by the normal but unaffordable interest rates, and millions of financial lives were destroyed.

In similar fashion, America has become a fiscally neg-am nation. The national debt during the past 30 years increased twice as fast as income. That trend dramatically worsened over the past nine years as the official debt doubled and budget forecasts for the decades ahead became increasingly threatening.

The day is approaching when our nation's neg-am fiscal budgeting options will expire. The adjustments necessary will be very unpleasant and possibly shocking. They will be a combination of significantly higher taxes, lower real Medicare and Social Security benefits, higher inflation, much greater debt, higher interest rates and greater foreign ownership of our resources and businesses.

I'm a numbers guy, not a policy wonk positioned to advance budgeting solutions. That's the job of our elected leaders. And I certainly recognize that in the middle of this Great Recession we don't want to undermine the recovery.

On the other hand, I do have one political judgment to share. I firmly believe that our elected officials created this neg-am nation by their failure to truly lead and by dishonestly "selling" government services and tax cuts without disclosing the true costs. If we are ever to get out of this deep financial hole, we must demand much more from our elected leaders. And we must demand honesty and courage of ourselves.

Lawrence Grossman is the principal of Grossman Financial Management in Benicia. He is a certified financial planner, SEC registered investment adviser and accredited investment fiduciary. He holds a master's degree in business administration from the Wharton School at the University of Pennsylvania. Send your feedback to us through our online form at SFGate.com/chronicle/submissions/#1.

<http://sfgate.com/cgi-bin/article.cgi?f=/c/a/2010/03/21/INVQ1CF7DS.DTL>

This article appeared on page E - 3 of the San Francisco Chronicle

© 2011 Hearst Communications Inc. | [Privacy Policy](#) | [Feedback](#) | [RSS Feeds](#) | [FAQ](#) | [Site Index](#) | [Contact](#)