Is 'The Fed' the Only Thing Keeping the US Government Solvent?

I have been writing for years that our government is essentially broke and the federal debt will never be repaid. Within this context, the Federal Reserve has been the great enabler of even more federal debt by its ZIRP policy. The Fed has opted for the slow-growth Japanization of the American economy as a lesser evil than letting interest rates on the national debt rise so as to precipitate a political crisis and potential default.

As John Tamny points out in his book, "Who Needs the Fed?" the Fed is becoming increasingly irrelevant in the private marketplace for capital; its primary role is to cram down interest rates on the federal government's debt and keep our broke government solvent (absent rampant money creation).

The Fed may cite the Brexit vote in the U.K. as a reason for not raising interest rates, but if it does, that will merely be a convenient pretext. Even if the Fed surprises markets by deciding to go forward with a rate increase, they will strive to avoid letting rates return to normal levels, because it remains painted into a corner.

One would think that the government would appreciate the Fed's manifold manipulations to help the U.S. Treasury "tote the note" on the government's mind-boggling debt, but the opposite has happened. Instead of being grateful for the Fed buying some time for Congress and the White House to get the government's fiscal house in order, President Obama essentially spit in the face of the Fed by calling for higher Social Security benefits for seniors. Such an action would give back some of the time that the Fed has bought and hasten the day of reckoning.

It doesn’t require exceptional vision to see that federal finances are on an unsustainable path. Nor is it a mystery why Obama would advocate such fiscal recklessness—politically, it is an election year, and so he will demagogue for votes, and ideologically, Obama is not just a big-government liberal, but his end game (I believe) is to bankrupt federal programs as the trigger event for the federal government nationalizing them. (It worked for Fannie and Freddie, so why not Social Security?)

I have no idea when the federal debt will trigger some sort of default (i.e., either an explicit “we-can’t-pay-you” default or via the less direct method of paying off nominal debts with depreciated dollars). As Japan has shown, simple inertia can keep a bankrupt government going longer than any bankrupt private enterprise could dream of. I find it interesting, though, that Donald Trump stirred up a minor tempest in May when he mentioned the possibility of asking Uncle Sam’s creditors to take a haircut on the Treasury debt they hold.

Trump backed off in response to the consternation his comments aroused, but he deserves credit for being willing to acknowledge that the federal government’s debt is an enormous problem. One of the unpleasant facts of life is that defaults happen. In fact, our federal government already has defaulted on its monetary commitments a couple of times—one in 1933, when FDR peremptorily confiscated Americans’ gold coins, devalued the dollar and voided gold clauses in contracts, and the other in 1971, when Richard Nixon closed the gold window to foreign holders of dollars.

Frankly, several generations of Americans have been swindling our youth by saddling them with an unconscionable debt burden, and younger Americans have every right to repudiate that debt. That is a radical assertion, I know, but remember that one of the reasons our founders rose in rebellion against Great

Britain was over the principle of taxation without representation. Well, our youth did not have a say or vote in all the spending that has produced the debts that many now expect them to honor. Why should they? Not only did they not vote for it, they were not (in most cases) the beneficiaries of the deficit spending that generated all that debt.

In talking about a partial repudiation of the national debt, I recognize that not only foreign holders of federal debt would take a haircut, but so would domestic holders, including Social Security recipients. We are talking about a realignment that could be even more jarring than the Brexit vote. Such a volatile, contentious issue is not desirable in and of itself. Please don’t think I want this. I’m just one of the messengers saying that a national debt default of some form is inevitable, and as difficult as it is, we must face it and talk about it.

How might the younger generation go about getting the debt monkey off their back? There are trillions of dollars worth of wealth locked up in the third of U.S. territory owned by the federal government. Maybe the leaders of the rising generations will negotiate a settlement, retiring debt at 50 cents on the dollar in exchange for ownership of those assets.

There are, of course, many caveats to such a course of action, and this is neither the time nor place to explore them all, but this one crucial point must be made: It will accomplish no long-lasting good to retire or greatly whittle down the federal debt if the political process that produces that debt continues. The only way to avoid bankruptcy is not to spend oneself into it. Whether such fiscal restraint is possible in a democracy is debatable, but we are not in a position to avoid having to deal with this problem. We are trapped in the black hole of debt.{eoa}

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