

# **IOUSA Not OK: An Analysis of the Deficit Disaster Story in the Film IOUSA**

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## Analysis of IOUSA's Deficit Disaster Story

The movie IOUSA portrays a picture of the United States as a country hopelessly addicted to debt. According to the film, the country is about to fall off a cliff if the budget and the economy continue on their current course. While there are certainly many grounds to be concerned about the country's economic condition, the view presented in IOUSA is one-sided and misleading.

This analysis puts many of the issues raised in the movie in a broader context and features a [minute-by-minute viewer's guide](#) of inaccurate or misleading statements in the film. It is important that the public be well informed about economic issues and not allow itself to be railroaded into ill-considered policy choices.

There are seven key points that the public must understand in order to fully grasp the issues raised in the film:

1) The national debt is not literally a generational transfer. This is easy to see because everyone who holds the debt (government bonds) today will eventually be dead, leaving the possession of the bonds to their children and grandchildren. In other words, the interest on the debt will be paid from some members of future generations to other members of future generations. (We will deal with issues created by foreign ownership below.) The debt can involve a generational transfer only insofar as it slows the economy's growth, so that it produces less in the future.

2) The high dollar (not the budget deficit) is what causes the trade deficit. No one buys foreign made goods at Wal-Mart because the government is running a budget deficit. They buy foreign made goods because a high dollar has made foreign goods cheaper than comparable U.S.-made goods. The high dollar also makes U.S. exports more expensive for people living in other countries.

3) A large trade deficit requires that we either have a very large budget deficit or extremely low private savings or some combination. This is an accounting identity. If we are borrowers internationally then we must have very low domestic savings. And we are borrowers internationally *because* we have an over-valued dollar. In other words, the high dollar requires us to either have large budget deficits or to have low private savings.

4) The stock and housing bubbles led to an enormous reduction in private saving through the wealth effect. Research shows that \$100 in additional stock wealth will lead to \$3 to \$4 of additional consumption, meaning that saving drops by this amount. The housing wealth effect is estimated at being \$4 to \$6 of additional consumption for every \$100 of housing wealth.

This means that a \$10 trillion stock bubble would be expected to reduce annual saving by \$300 billion to \$400 billion. An \$8 trillion housing bubble would be expected to reduce annual saving by between \$320 billion and \$480 billion. These bubbles have been the main cause of the low savings rate in the United States over the last 15 years.

5) During times of economic weakness (like now), deficit spending actually helps the economy to grow. In such times deficit spending is also likely to increase investment. In this case, deficit spending makes our children and grandchildren richer than if we did not have deficit spending.

6) High and rising private sector health care costs in the United States are responsible for the bulk of the federal budget deficit problem. (Government health care programs like Medicare and Medicaid pay for health care provided by the private sector.) If health care costs are not contained, then the economy will be devastated regardless of what we do with the federal budget. If they are contained, then there is no budget problem.

7) Social Security has a dedicated stream of financing that keeps it fully funded until 2049 according to the most recent projections. Given this stream of funding, it would be no more justifiable to cut back benefits in the near future than to default on the federal debt.

These items are discussed in more detail below.

### **1) The Burden of the Debt on the Young – It's Not What the IOUSA People Told You**

Government debt can either increase or decrease the wealth of future generations. The debt itself is not a measure of the financial impact across generations. What matters is how the debt affects the strength of the economy when the government borrows the money.

It is easy to see that the national debt is not really a measure of intergenerational burden. While the taxpayers collectively can be seen as owing the debt, taxpayers (or at least some of them) also own the debt. This is not a payment across generations; it is a payment within generations.

If the United States let the debt rise to \$10 trillion and then left the debt at \$10 trillion for 100 years, just paying the interest, then in 2108 some of our children, grandchildren and great grandchildren would be collecting the interest on the \$10 trillion, which would be paid from the taxes that the government collects.

This flow of money from taxpayers to bond holders doesn't on net make people better or worse off 100 years from now. It is simply a redistribution from some members of future generations to other members of future generations. None of the interest is flowing to those of us alive now, since virtually all of us will have passed into history by then.

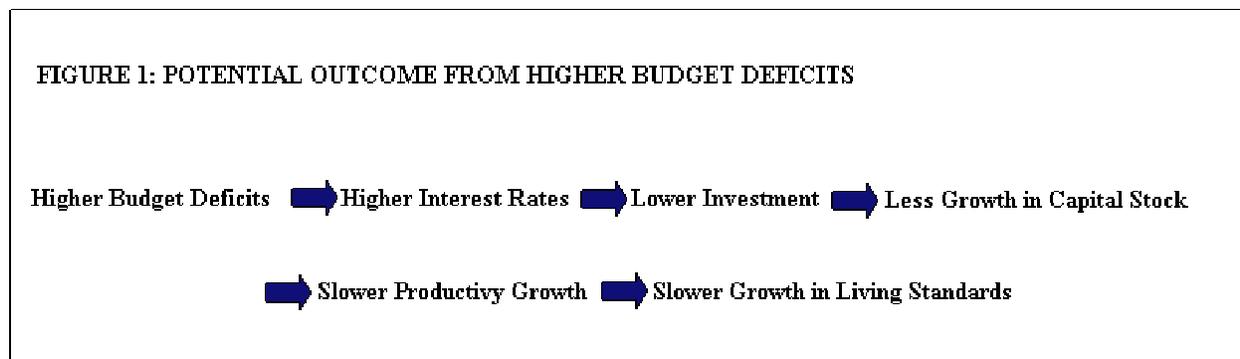
Whether or not the debt has made future generations poorer will depend on how it was incurred. If we ran up debts so that we could finance schools and colleges, and make sure that our children and grandchildren were well educated, then we probably made them richer than if we didn't run up debt but left them illiterate. Similarly, if we ran up the debt to construct a modern physical and information infrastructure, then we probably made future generations much wealthier than if we had handed them a country that was debt free, but had no Internet and no computers.

In short, the debt is not an accurate measure of whether we have been generous to or short-changed the generations that come after us. The answer to that question depends on the economy and society that we pass on. There are many scenarios in which we would have impoverished future generations, even if we were to hand them a government that is free of debt or alternatively left them very wealthy, even if there is a substantial government debt.

There is an economic argument whereby deficits can reduce the wealth of future generations. If the economy is at its capacity (e.g. everyone who wants to work is already employed), then if we run a large deficit due to additional government spending or tax cuts, then we may be pulling people away

from building up the economy's capacity. Specifically, the government's borrowing needs can lead to higher interest rates.

Higher interest rates can in turn lead to less investment. If businesses invest less in machinery, computers, and other investment items, then productivity will grow less rapidly. Productivity, how much workers produce in an hour of work, is the main long-run determinant of living standards. This sequence is shown in **Figure 1** below. (Productivity almost always grows, so the issue is how fast it grows – it is almost impossible to envision a future in which workers are not substantially more productive in 20 or 30 years than they are today.)



If a deficit leads to high interest rates, which in turn reduce investment, then they will have slowed the economy's growth and made future generations less well off than they would have been without the deficits. But it is important to remember that the way deficits can hurt future generations is not directly through the debt burden, but rather because they can reduce investment and therefore slow productivity growth.

The measure of the deficit's impact on the living standards of future generations is not the size of the debt in dollars or even the size of the debt relative to the size of the economy. The impact of the deficit on future living standards would be reflected in the rate of productivity growth. If the deficit has actually hurt the living standards of future generations, then it would be because deficits lead to slower productivity growth than the country would have otherwise seen.

In fact, even as the economy has run up substantial deficits in recent years, productivity growth has been strong for most of the last 15 years. Productivity has grown at an average annual rate of 2.5 percent in the years from 1995 through the second quarter of 2008. This means that for each hour of work, we are getting 38.6 percent more of output today than we did in 1995. In principle if the country as a whole is spending the same percentage of its time working in 2008 as in 1995, then we can be enjoying a standard of living that is 38.6 percent higher than in 1995.<sup>1</sup>

While there is an issue that a greater share of the economy's output might be diverted to foreigners because of the foreign debt (see below), we still derive more income each year from our ownership of foreign assets than foreigners do from their ownership of U.S. assets. At the moment at least, we

<sup>1</sup> This is not exactly true because there are some differences between the way productivity growth is measured and the way that improvements in living standards are measured. For a discussion of this, see Baker, D. 2007, "The Productivity to Paycheck Gap," Washington, D.C.: Center for Economic and Policy Research, [<http://www.cepr.net/index.php/publications/reports/the-productivity-to-paycheck-gap-what-the-data-show/>].

are still in the process of making our children much wealthier than we were, in spite of our \$9 trillion debt.

## 2) If You Don't Like the Trade Deficit, Then You Think the Dollar is Too High

In an international economy, there is a second way that a budget deficit can reduce the living standards of future generations. It can cause the country to run a trade deficit, which in turn leads it to borrow money from abroad. As a result, a portion of the U.S. capital stock (shares of stock, government bonds, home mortgages etc.) will be owned by foreigners rather than people in the United States.

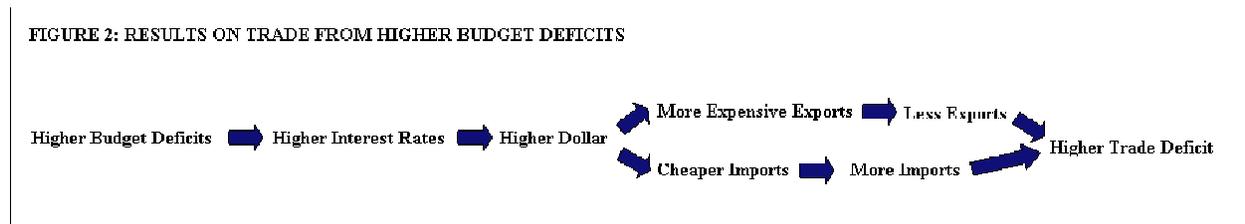
This means that the income from these assets (e.g. dividends on shares of stock, interest on government bonds, or mortgage payments) will be sent to people living in other countries rather than people in the United States. Since these income flows will be going overseas rather than to our children and grandchildren, they will be less wealthy than if we had not run trade deficits and incurred debt to foreigners.

While budget deficits can lead the United States to run trade deficits, they do so by pushing up the value of the dollar. No one buys imported clothes at Wal-Mart because the government is running a budget deficit. If people buy imported clothes at Wal-Mart, then it is because imported clothes are cheaper than comparable U.S. made clothes.

The main factor that determines how cheap or expensive imported clothes are is the value of the dollar. If the dollar rises in value by 10 percent against other currencies, then all the goods that we might import from other countries suddenly cost us 10 percent less than before the rise in the dollar.<sup>2</sup> This will cause us to buy more imported goods.

Similarly, if the dollar rises in price by 10 percent against foreign currencies, then this will make U.S. exports cost 10 percent more for people living in other countries. Therefore, people living in other countries will buy fewer exports from the United States.

If we buy more imported goods and sell fewer exports, then our trade deficit increases. The way that an increase in the trade deficit can be tied to a budget deficit is that a budget deficit can lead to higher interest rates, as discussed in the previous section. Higher interest rates make dollar-denominated assets like government bonds or bank deposits more attractive for foreigners. If foreigners invest more money in U.S. bonds, bank deposits, and other assets, it will cause the dollar to rise as shown in **Figure 2**.



<sup>2</sup> In reality, the relationship is somewhat more complex because changes in currency price are not typically passed through one to one.

So it is possible for a budget deficit to lead to a trade deficit, as claimed in IOUSA, but *only* by causing the dollar to become over-valued. The value of the dollar is the main factor determining the trade deficit. Those who are concerned about the trade deficit must want to lower the value of the dollar. There is no other plausible mechanism for reducing the trade deficit.

### **3) The Trade Deficit Requires Either Large Budget Deficits or Low Household Saving**

Accounting identities are very powerful. In finance and economics, an accounting identity is a statement that by definition must be true. One standard accounting identity is that the trade deficit (broadly defined) is equal to the difference between domestic saving and domestic investment.<sup>3</sup> In other words, if our trade deficit is equal to \$700 billion (about 5 percent of GDP), then domestic saving must be \$700 billion smaller than domestic investment. This means that because we have a large trade deficit, we must have very low national saving.

As this is by definition true, it is not possible to have a large trade deficit and have high net national saving.<sup>4</sup>

National saving is equal to public saving (the budget surplus) plus private saving (corporate and household saving). If national saving is very low, then we must either have extremely large budget deficits or very low household saving, or some combination of the two. Over the last decade, in which the trade deficit has exploded, we have run both large public deficits at times and had very low household saving. The household saving rate has been below 1.0 percent since 2004. It had been over 8.0 percent on average through the 50s, 60s, 70s, and 80s.

The trade deficit is in turn attributable to the high dollar, as noted above. This means that those who are concerned about large budget deficits and low household saving should be concerned first and foremost about the high dollar. By leading to a large trade deficit, the high dollar effectively requires either large budget deficits or low household saving, or both.

### **4) The Stock Market and Housing Bubble Caused People to Stop Saving**

The immediate factor that led households to consume more and save less over the last 15 years was the ephemeral wealth created first by the stock market bubble and later the housing bubble. The wealth effect from stocks and housing has been well documented.

According to research from the Federal Reserve Board and elsewhere, households consume an additional 3-4 cents annually for every dollar of additional stock wealth they own.<sup>5</sup> At the peak of the stock bubble in 2000, there was approximately \$10 trillion in stock bubble wealth. This would have led people to consume an additional \$300-\$400 billion a year compared to a situation in which there was no stock bubble.<sup>6</sup> This would have lowered the saving rate in 2000 by between 4 and 6 percentage points, roughly the size of the actual falloff in the saving rate from the pre-stock bubble

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<sup>3</sup> See Appendix I.

<sup>4</sup> The country could have low net national saving because investment is high rather than because saving is low, but it is very difficult to substantially increase investment.

<sup>5</sup> See for example Dynan, K. and D. Maki, 2001. "Does the Stock Market Matter for Consumption?" Working Paper 2001-23. Washington, DC: Board of Governors of the Federal Reserve Board.

<sup>6</sup> The calculation of bubble wealth is the difference between the stock market at its 2000 peak value and the value that it would have had if stock prices were at the long-term average for the price to earnings ratio of 15 to 1.

days. In other words, the stock bubble of the 90s was the main factor causing households to reduce their saving.

The same thing happened with the growth of the housing bubble in the current decade. The wealth effect for housing is estimated at between 4 and 6 cents for every dollar.<sup>7</sup> This means that the \$8 trillion housing bubble would have led to an increase in annual consumption of between \$320 billion and \$480 billion. This also would have lowered the saving rate by between 4 and 6 percentage points.

In short, most, or all, of the decline in the savings rate over the last 15 years is attributable to the wealth effects associated with the stock and housing bubbles. Those who are concerned about the failure of families to save for the future should have been concerned about the growth of these bubbles, which led to sharp declines in saving rates.

### **5) During a Period of Economic Weakness, a Budget Deficit Can Increase Growth and Make the Economy Wealthier**

While a budget deficit can in principle lead to higher interest rates and therefore reduced investment and lower productivity growth when the economy is operating near capacity, it can also help to boost the economy when the economy is facing a downturn. During a recession, the main problem facing the economy is a lack of demand. If the government can boost demand through either increased spending or cutting taxes (and thereby increasing consumption), then it can increase output and employment.

Higher output can lead businesses to invest more. This will increase productivity growth and make future generations richer. Similarly, if the government spends money building infrastructure, or in other areas that can increase productivity (e.g. education, energy conservation or research), then budget deficits can help to make future generations richer. In fact, well-targeted investment can increase productivity growth even when the economy is not in a recession.

It is important to note the point in a business cycle when the government runs a deficit. Budget deficits during a recession are likely to lead to both short-term and long-term benefits to the economy.

### **6) Projections of Exploding Private Sector Health Care Costs Are the Reason for Huge Budget Deficits**

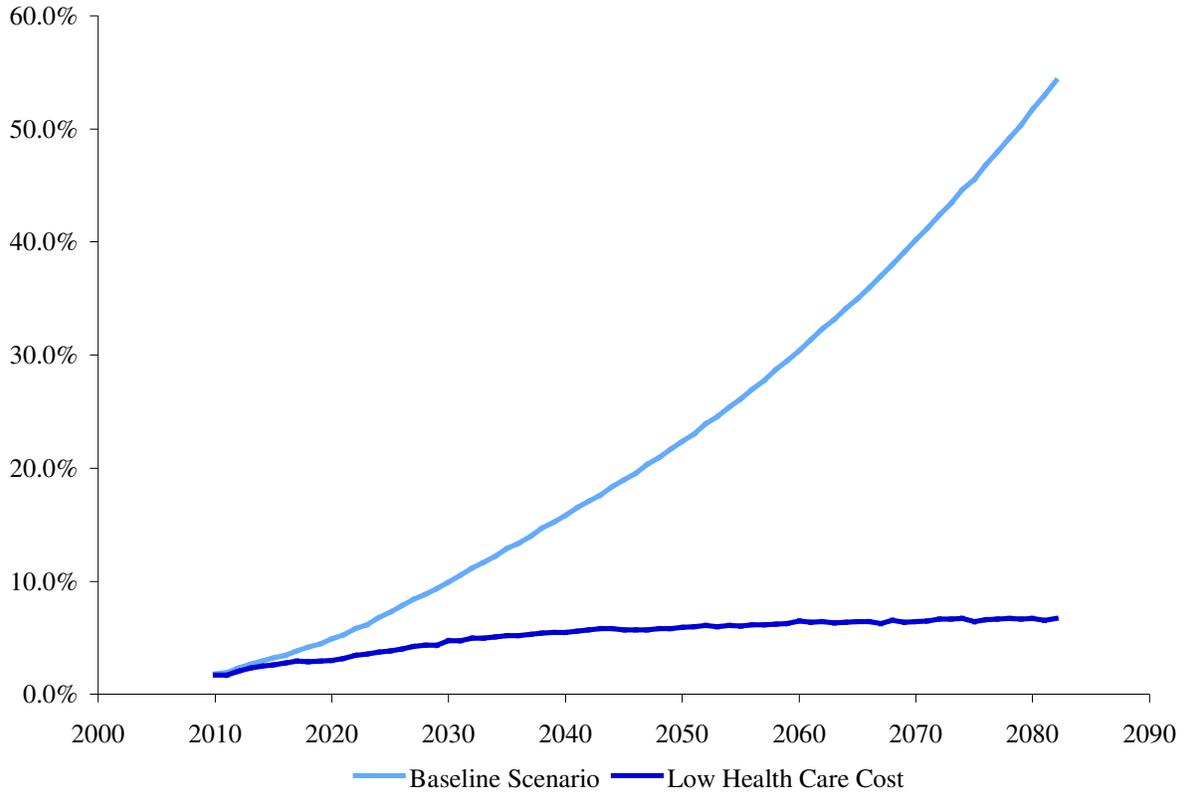
The federal government pays for almost 50 percent of the country's health care costs through Medicare, Medicaid, and other health care programs. Almost all of the payments in these programs go to private sector health care providers (hospitals, doctors, nursing homes etc.). The government projects that private sector health care costs will rise far more rapidly than the economy grows. This assumption leads to projections of massive deficits in the next few decades.

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<sup>7</sup> Case, K., R. Shiller and J. Quigley, 2001. "Comparing Wealth Effects: The Stock Market Versus the Housing Market." Cambridge, MA: National Bureau of Economic Research.

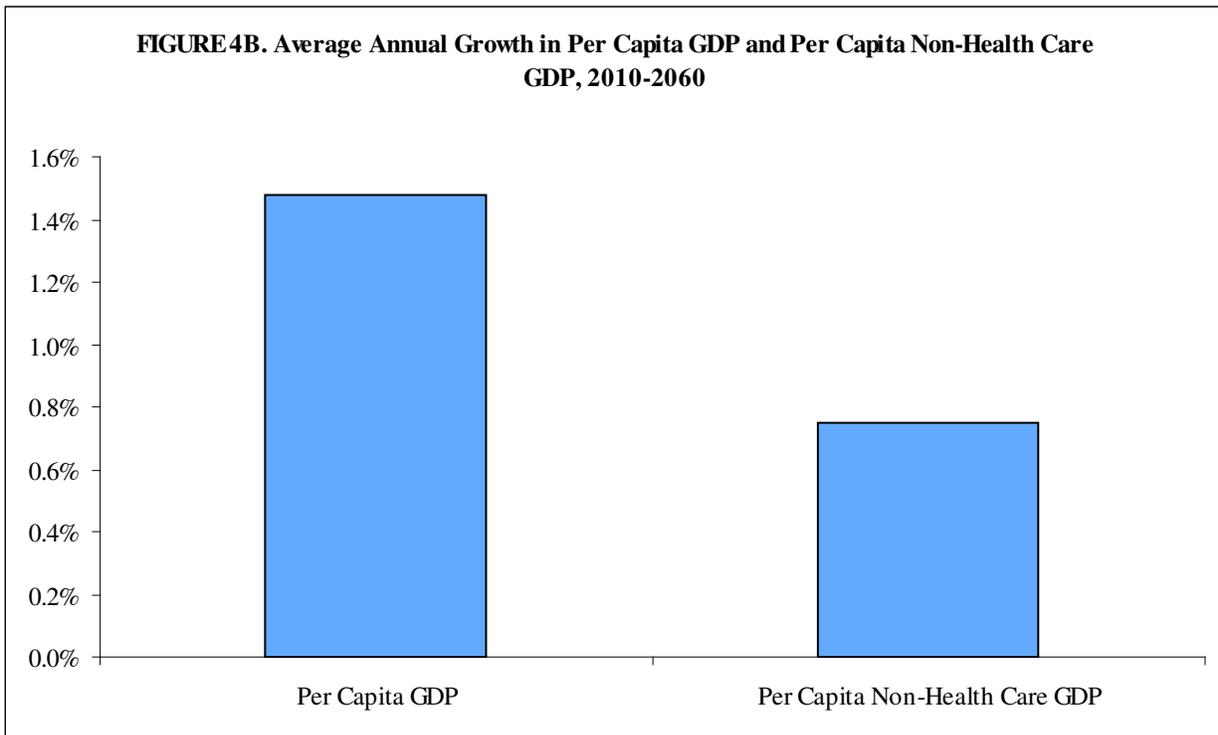
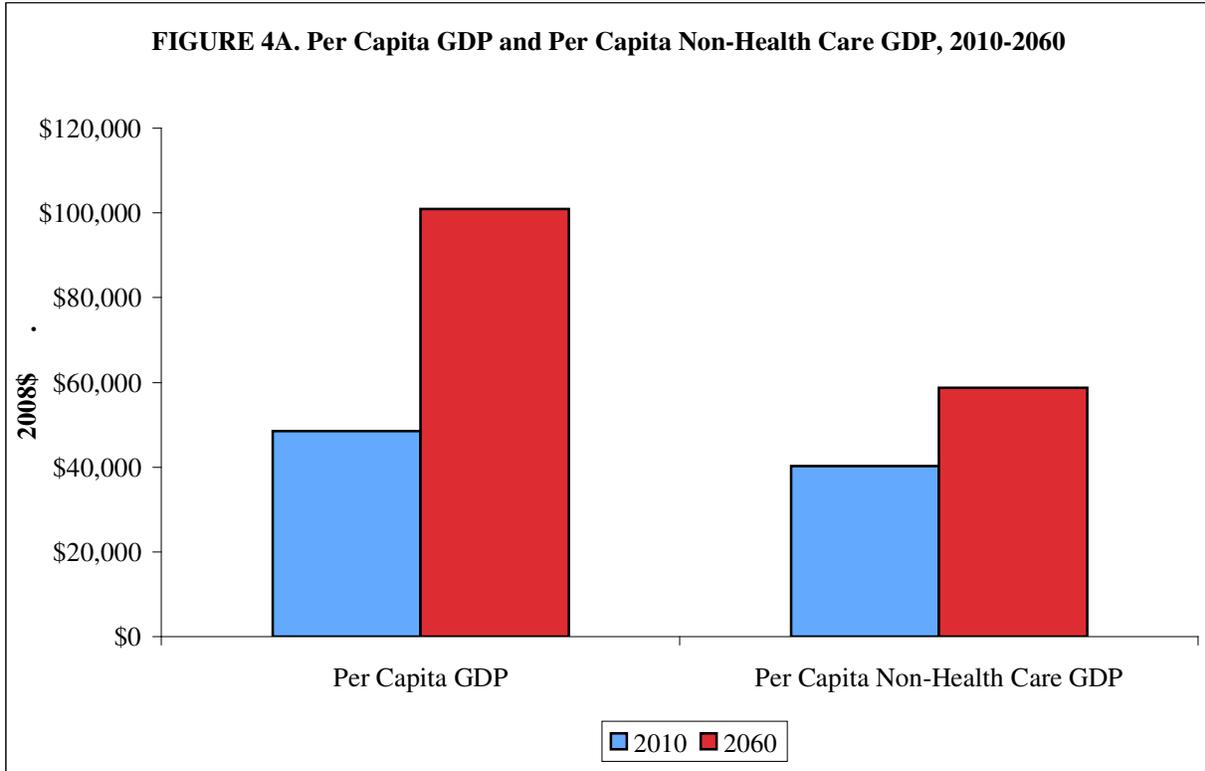
While these projections of exploding health care costs imply that budget deficits will be a huge problem, if the United States can contain its health care costs, then budget deficits will be very manageable as shown in **Figure 3**.

**FIGURE 3. Federal Budget Deficit (% of GDP)**



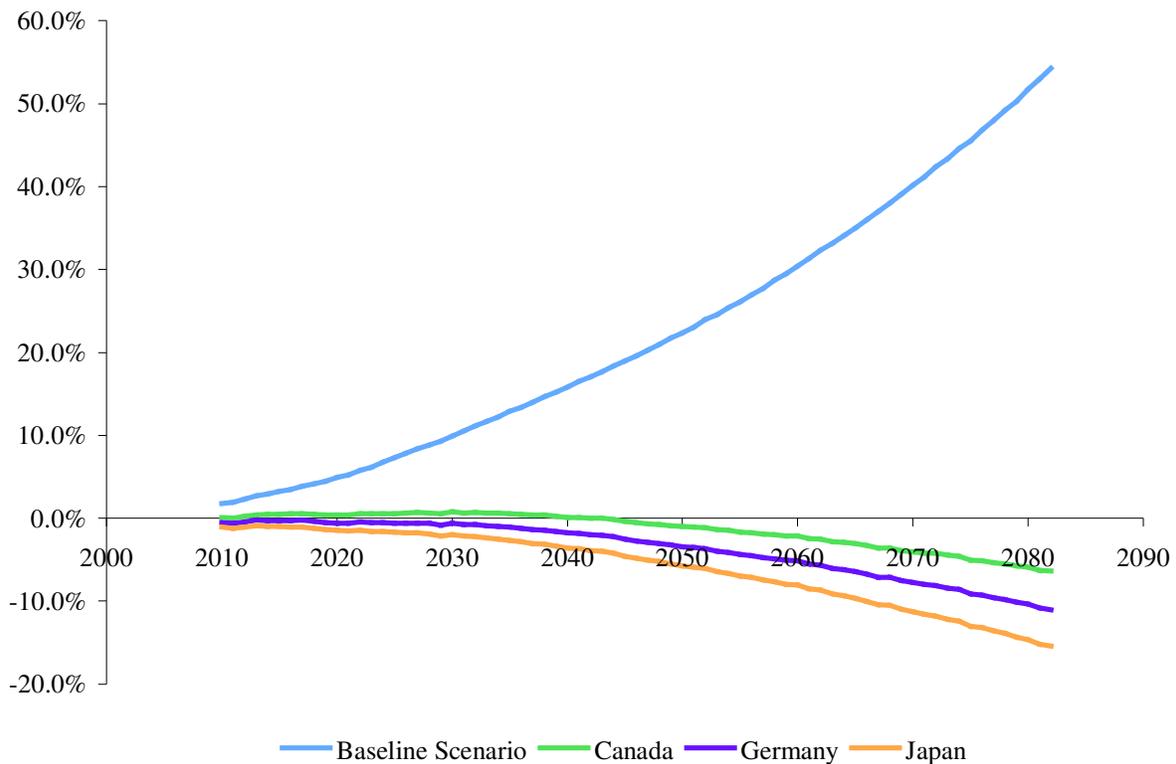
In other words, the real problem facing the country is a broken health care system. If health care costs continue to grow at the projected rate, then future generations will see relatively little gain in their living standards, even if we eliminate all government spending on health care.

Figures 4A and 4B show the projected growth in per capita GDP and per capita non-health care GDP over the years from 2010 to 2060.



The health care system in the United States is uniquely inefficient. We pay far more per person than other rich countries, yet we rank near the bottom by outcome measures like life expectancy. If the United States could make its system as efficient as that of other wealthy countries, there would be no budget deficit problem. As **Figure 5** shows, the government would show large surpluses for the indefinite future if per person health care costs were the same in the United States as in other wealthy countries.

**FIGURE 5. Federal Budget Deficit (% of GDP)**



## 7) Social Security Has Its Own Designated Funding Stream

There are many people who want to cut Social Security. While people are free to advocate whatever they like, it is important to note that Social Security has its own dedicated stream of funding with the Social Security tax. This tax, along with the interest and principal on government bonds purchased with tax revenue, is projected to leave the program fully solvent through the year 2049.<sup>8</sup>

This means that there is little reason to be cutting benefits in this program any time for several decades. In effect, workers have already paid for their benefits. Of course, if the government were in a sufficiently desperate situation then we would have to consider defaulting on the obligation to the

<sup>8</sup> Congressional Budget Office, 2008. "Updated Long-Term Projections for Social Security," Washington, DC: Congressional Budget Office, [<http://www.cbo.gov/ftpdocs/96xx/doc9649/08-20-SocialSecurityUpdate.pdf>].

country's workers by defaulting on the government bonds held by the Social Security system; but then it would also be reasonable to consider defaulting on the other government bonds held by investors. Investors could much more easily survive a partial default (e.g. 80 cents on the dollar) than most Social Security beneficiaries.

As noted above, if we fix the health care system, the long-term deficit problem is easily manageable. However, if the deficit problem ends up being sufficiently severe (presumably because we failed to fix the health care system), then there would be no justification for cutting Social Security without also making holders of the national debt share in the pain.

## The “Heroes” of IOUSA

The next section goes through the assertions made in IOUSA point by point, following the sequence of the film itself. However, before beginning this analysis, it is worth pointing that many of the authority figures who are presented as truth tellers in IOUSA could as plausibly be cast as villains who bear considerable responsibility for the country’s current economic problems.

For example, former Federal Reserve Board Chairman Alan Greenspan allowed for the unchecked growth of a \$10 trillion stock bubble in the 90s and an \$8 trillion housing bubble in the current decade. As noted above, these bubbles were primarily responsible for the low saving rates decried in the film. Mr. Greenspan also ignored the reckless mortgage lending that led to the subprime meltdown and subsequent credit crisis. In addition, he played an active role in preventing the regulation of credit default swaps, the growth of which played a central role in the financial crisis.

Former Treasury Secretary Robert Rubin was an active proponent of the high dollar policy in the late nineties that led to the record trade deficits that are highlighted as a serious danger in the film. As Treasury Secretary, Mr. Rubin was also an important actor in preventing the regulation of credit default swaps. After leaving the Treasury, Mr. Rubin became a top executive at Citigroup, which played a central role in financing the flood of subprime mortgages in recent years.

Peter Peterson is a wealthy investment banker who made millions of dollars from the “fund managers’ tax break,” a clause in the tax code that allows some of the wealthiest people in the country to pay a lower tax rate than school teachers and fire fighters. He even lobbied Congress to protect this tax break.<sup>9</sup> If every person in the country benefited from government largess to the same extent as Mr. Peterson, the problem of the debt would be hundreds of times larger than that indicated in IOUSA.

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<sup>9</sup> “Tax Break Helps a Crusader for Deficit Discipline,” *New York Times*, February 15, 2008, available at <http://www.nytimes.com/2008/02/15/business/15pete.html?scp=3&sq=%22peter%20peterson%22&st=cse>

## IOUSA by the Clock

*Time in Film – Claim being made*

### **3:30 – Our current standard of living is unsustainable, barring drastic action.**

As noted in [point 6](#) above, the only real threat to future standards of living is our health care system, with its out of control costs. If we can contain health care costs in the same way that every other wealthy country has done, then we will be able to both keep our budget deficits under control and sustain a healthy rate of growth of income.

### **4:18 – The problem is described as “fiscal cancer, with catastrophic consequences.”**

As noted in [point 6](#) above, if we can contain health care costs in the same way that every other wealthy country has done, then we will be able to both keep our budget deficit under control and sustain a healthy rate of growth of income.

### **6:25 – Robert Bixby describes current fiscal policy as unsustainable and headed off a cliff.**

As noted in [point 6](#) above, if we contain health care costs in the same way that every other wealthy country has done, then we will be able to both keep our budget deficit under control and sustain a healthy rate of growth of income.

### **7:00 – Robert Bixby compares the size of the 1988 budget document to the size of the 2008 budget documents, noting that the 2008 budget has several volumes.**

The main reason for the increase in the size of the budget documents is that there are more requests for details and analysis from people like Robert Bixby.

### **8:40 – The fiscal wake-up tour “spans the political spectrum.”**

Actually, it has a representative from the Heritage Foundation, a conservative think tank, and people from the Brookings Institution, a centrist think tank. It does not include anyone from a clearly identifiable liberal or progressive think tank.

### **11:00 – The large military and social spending of the 60s were two key factors that led to a downturn at the end of the 70s.**

Actually, there is serious debate among economists about why productivity growth slowed in the 70s. It is not at clear that the budget deficits of the 60s were important factors. The slowdown of productivity growth in the 70s was almost certainly the most important factor behind the economic difficulties of the decade.

### **13:00 – In 1992, 22 percent of the budget was financed through borrowing and passed on to our children and grandchildren.**

It is true that 22 percent of the budget in 1992 was financed by borrowing, but it is misleading to claim that it was passed on to our children and grandchildren. The economy was still recovering

from a recession in 1992. If the government had either cut spending or raised taxes to reduce the deficit, then the unemployment rate would have been higher and growth would have been slower. As a result of the large deficit in 1992 the economy recovered more quickly and therefore created more wealth to pass on to our children and grandchildren. See [point 5](#) above.

**15:10 – The film refers to ways to balance the budget, implying that this should be a target for fiscal policy.**

In fact the government can run deficits forever, as long as the growth of debt does not exceed the growth in GDP. The essential condition for fiscal stability is that the ratio of debt to GDP does not rise over time.

**16:00 – The films refers to deficits of \$200-\$300 billion as not doing well.**

In fact, the government could sustain deficits of this size forever. With deficits at these levels, the ratio of debt to GDP would be falling.

**16:29 – These deficits are described as being unsustainable over the long run.**

Deficits in the range of \$200 billion to \$300 billion can be sustained indefinitely. If the U.S. government ran a deficit of \$300 billion annually for the next hundred years, then the ratio of debt to GDP would fall to less than 4 percent.

**17:10 – The film reports the 2008 deficit as \$410 billion.**

It doesn't note the fact that the recession was a major factor increasing the size of the deficit in 2008.

**17:31 – The film refers to the fact that the U.S. government had just 5 surpluses in the last 40 years.**

It would have been worth noting that the deficits were sufficiently small so that the debt to GDP ratio fell consistently from the end of World War II to the 1982. The ratio of gross public debt to GDP fell from 121.7 percent at the end of the war to 32.5 percent in 1982.

**18:08 – In less than 10 years, Social Security will pay out more than the program takes in taxes.**

This fact is completely meaningless from the standpoint of Social Security. The program is projected to hold more than \$5 trillion in government bonds at that point. The Congressional Budget Office projects that these bonds, together with annual tax revenue, will be sufficient to keep the program fully solvent until 2049 with no changes whatsoever.

The fact that Social Security will pay out more than it collects in taxes in ten years also has no meaning for the budget as a whole. Once the annual surplus of tax revenue over spending peaks and begins to decline, Social Security imposes a strain on the rest of the budget in the sense that it is lending less money each year than it did in the prior year. The peak was hit in the 2008 fiscal year.

**18:59 – Senator Judd Gregg says the debt absolutely guarantees that our children will have a worse quality of life than we do.**

None of the standard projections from the Congressional Budget Office, the Office of Management and Budget or any other authoritative source supports Senator Gregg's assertion.

**19:40 – Alice Rivlin blames just 3 programs (Medicare, Medicaid and Social Security) for most of the deficit problem.**

As noted above in [point 6](#), the problem with Medicare and Medicaid is the broken U.S. health care system. Social Security will be fully financed from its designated tax until 2049 (see [point 7](#)). Therefore, it makes no sense to blame Social Security for the budget problem. The projected increase in its outlays over the next four decades is covered by taxes already collected or that will be collected.

**22:22 – The film shows a young woman complaining that government debt is like her parents incurring serious credit card debt and expecting her to pay it off.**

Actually, this woman will inherit a much wealthier country than her parents did. In fact, she may even inherit a claim to some of this debt if her parents pass on government bonds to her. See [point 1](#) above.

**27:00 – Robert Rubin says that there are very difficult trade offs in cutting spending or raising taxes.**

It would have been worth mentioning reforming the health care system as a third possible way to deal with excessive deficits. See [point 6](#).

**27:37 – The film talks about projections of government surpluses long into the future at the end of the 90s.**

A substantial portion of the surpluses in the late 90s and the projected surpluses for future years was attributable to capital gains tax revenue associated with the stock bubble. The fiscal picture would not have appeared so bright in the absence of the bubble.

**30:30 – The film complains about families spending more than they earn.**

It would have been appropriate to mention the extent to which the ephemeral wealth of the stock bubble in the 90s and the housing bubble of the current decade led people to consume more and save less. See [point 4](#) above. Those who were concerned about insufficient savings should have been warning about these bubbles.

**31:30 – The film complains about easy credit and a consumption oriented society.**

See comment above.

**32:50 – Representative Ron Paul complains about inflation.**

This is a peculiar comment since the rate of inflation had remained remarkably low through most of the period in question. There was an increase in the rate of inflation in 2007 and in the first half of this year, but this appears to have dissipated quickly.

**37:30 – Former Federal Reserve Board Chairman Paul Volcker tells viewers that the lesson of the 70s is “don’t let inflation get started.”**

As noted above, this experience seems not to apply to the current decade, since inflationary pressures have quickly dissipated.

**38:00 – The late Tim Russert is shown saying “prices are sky-high.”**

As noted above, this experience seems not to apply to the current decade, since inflationary pressures have quickly dissipated.

**38:20 – The film shows the headline: “fiscal crisis looming.”**

It is not clear to what this is meant to refer.

**43:00 – The film asserts that inflation most hurts those who are least well off.**

It is not clear what evidence the film has for this claim. Some less well off people, for example Social Security beneficiaries, are protected against inflation because their benefits rise in step with the rate of inflation. In general, borrowers – such as people with mortgage debt – are benefited by inflation, while lenders are harmed.

**43:30 – Greenspan asserts that the Federal Reserve Board’s monetary policy can’t affect saving.**

This is not true. Under Greenspan, the Fed allowed the growth of first a stock bubble in the 90s and then a housing bubble in the current decade. Families increased their consumption believing that this bubble-generated wealth was permanent. If the Fed had pursued policies to burst these bubbles then the saving rate would have been higher.

**44:00 – The movie asserts that “money must hold its value for people to save.”**

Actually, the savings rate was fairly high in the 70s, the decade when the country experienced its worst period of inflation in the post World War II period.

**45:50 – The movie ranks countries by the size of the trade deficit.**

The United States has the largest economy in the world. It would not be surprising that it would have the largest trade deficit, if it were running a budget deficit. The proper way to make international comparisons is to show the deficit as a share of GDP.

**47:45 – Warren Buffet comments that the U.S. has consumed considerably more than it produces for the last 6-8 years.**

This is due to the over-valued dollar. See [point 2](#) above.

**51:00 – The film asserts that we are dependent on foreign countries to finance the budget deficit.**

This reverses causation. If foreign countries chose not to buy U.S. government bonds, then the dollar would fall. This would reduce the size of the trade deficit, thereby increasing domestic savings. With higher domestic saving, the United States could finance its own budget deficit. See [point 2](#).

**54:55 – The film reports that China’s money is invested in Treasury bonds that could be pulled out.**

What matters is that China is investing in U.S. financial assets, not that they are investing in U.S. Treasury bonds. While it is unlikely that China would maliciously sell its dollar holdings, it would cause the United States economy just as much trouble if China suddenly sold \$1.5 trillion of stock as if its sold \$1.5 trillion of government bonds.

**57:00 – The film shows a news announcement reporting that China is holding treasury bonds that it could threaten to unload.**

See comment above.

**60:00 – Warren Buffet says that in 20 to 30 years, if 2 or 3 percent of GDP goes to service the foreign debt, then it would lead to political instability.**

There is no obvious basis for this assertion. There are countries that devote a larger share of GDP to foreign debt service (e.g. New Zealand) without any apparent problem.

**62:30 – The film presents a person commenting that “hopefully we will be able to turn deficit clock backward.”**

While it is essential that the debt to GDP ratio be kept at a manageable level, there is no obvious reason that paying off the national debt should be a goal.

**63:50 – The film notes the shift from surpluses in 2000 to deficits.**

This discussion neglects to mention the impact of the stock crash and recession on the deficit.

**69:03 – Former Defense Secretary Donald Rumsfeld is shown saying we can’t track \$2.3 trillion of transactions.**

There is no context or explanation for this comment. For example, viewers have no idea if this refers to decades of transactions or just a relatively small number of years. We also don’t know if it means that we have no idea how the money was spent (this is very unlikely), or just that we don’t have full accounting for these transactions.

**71:20 – The film adds the current debt plus projected future spending on Social Security, Medicare, and Medicaid over the next six decades to get a deficit of \$53 trillion.**

It is unlikely that any viewers would have any idea of where this number comes from or what it means, although it is no doubt very scary. As noted above in [point 6](#), the bulk of this debt figure stems from the projected explosion of private sector health costs.

**71:40 – The film asserts that if current trends continue, we would just have enough money to pay interest and some Social Security payments or we could double federal taxes.**

Alternatively, it could have reported, “if we don’t fix the private health care system, we would just have enough money to pay interest and some Social Security payments or we could double federal taxes.” See [point 6](#).

**72:00 – Bush tax cuts are just 10% of the problem, the Iraq War just 3 percent.**

These problems are small compared to the projected cost of Medicare and Medicaid, due to the projected explosion of private sector health care costs. See [point 6](#).

**73:00 – When baby boomers retire there will be a tidal wave of spending.**

There is projected to be a tidal wave of spending because of the projected explosion of private sector health care costs. If the health care costs follow their projected path, there would be a tidal wave of spending even if we did not have a large number of retiring baby boomers. See [point 6](#).

**75:00 – Robert Rubin tells viewers that there is no free lunch.**

Actually, eliminating waste in the health care system by reducing payments to drug companies and highly paid medical specialists, and adopting a more efficient health insurance system, would seem like a free lunch to almost any one who does not derive their income from these sectors.

**81:00 – The film tells viewers that debt of \$56 trillion is \$184,000 for every American.**

Most viewers have no idea of where this \$56 trillion figure comes from, as noted above. Most of this debt is attributable to higher Medicare and Medicaid costs due to the projected explosion of private sector health care costs, as noted in [point 6](#). It would also be helpful to tell viewers that this debt is equal to approximately 7 percent of projected income. This would be far more informative.

## Appendix I: Accounting Identities

National income, or GDP ( $Y$ ) may be broken down into several pieces. Consumption ( $C$ ), Government spending ( $G$ ), Investment ( $I$ ), and trade surplus, or exports minus imports ( $X-M$ ). Thus,

$$Y = C + G + I + (X - M)$$

$$Y - (C + G) = I + (X - M)$$

In addition, national savings may be broken down into private and public parts. If we call private savings  $S$ , and identify public savings as taxes minus government spending ( $T-G$ ), then

<i>"private savings"</i>	<i>"public savings"</i>	<i>"national income"</i>	<i>"national spending"</i>
$S$	$+$	$(T - G)$	$=$
		$Y$	$-$
		$I$	$+$
		$(G - T)$	$-$
	$-$	$I$	$=$
$S$		$(G - T)$	$-$
$(S - I)$		$(G - T - I)$	$=$
$(S - I)$		$(G - T - I)$	$=$
<i>"private savings"</i>		<i>"investment"</i>	<i>"budget deficit"</i>
		$(G - T - I)$	<i>"trade deficit"</i>
		$(M - X)$	

Thus, the difference between private savings and investment is equal to the difference between the budget deficit and the trade deficit.

## Appendix II: Long-Term Projections of Federal Budget Deficits 2010-82 Under Various Health Care Scenarios

### *Sources*

The primary data source for these projections is the Congressional Budget Office's *Long-Term Budget Outlook* for December 2007.<sup>10</sup> The corresponding short-run data to the Long-Term Outlook comes from the CBO's *Budget and Economic Outlook* for January 2007.<sup>11</sup> Population data comes from the 2008 OASDI Trustees Report Table V.A2<sup>12</sup> Intermediate Assumptions.

### *Methods*

#### GDP and GDP deflator:

The GDP deflator is taken from the *Budget and Economic Outlook* extended to 2082 by assuming 1.8 percent growth in prices. Gross Domestic Product is then computed by multiplying the Real GDP series from the *Long-Term Budget Outlook* by the GDP deflator. The GDP deflator and real GDP are then rebased to 2008 dollars.

#### Federal Primary Surplus:

Baseline revenues and expenditures as a share of GDP are based on CBO's Alternative Fiscal Scenario (Figure 1-1). Federal expenditures on Medicare and Medicaid as a share of GDP under all alternative health care cost scenarios are based on the "0% Scenario" of CBO's Figure 2-4. The "Canada" scenario assumes costs of 64.13 percent of the "0% Scenario" starting in 2009; the "Germany" scenario assumes 51.48 percent; the "Japan" scenario assumes 39.34 percent.<sup>13</sup> Federal revenues under all alternative health care are increased by the difference in income and payroll taxes under different "Extended-Baseline" Scenarios in Figure 5-4.

#### Debt:

Interest on start-of-year debt is assumed to accumulate at a nominal 5.0 percent annual rate. Short-run adjustments to debt ("Other means of financing") are applied to the debt based on Table 1-6 of the *Budget and Economic Outlook*.

Total Health Care Expenditures under the baseline scenario come from Figure 2-3—Alternative Fiscal Scenario.

<sup>10</sup> <http://www.cbo.gov/doc.cfm?index=8877>. Supplemental Data provided by CBO is reported by corresponding Figure in the *Long-Term Budget Outlook*.

<sup>11</sup> <http://www.cbo.gov/doc.cfm?index=7731>

<sup>12</sup> <http://www.socialsecurity.gov/OACT/TR/TR08/lr5a2.html>

<sup>13</sup> Relative costs of health care expenditures by country in PPP terms taken from the World Bank's latest *World Development Indicators* database.