

**Brian S. Wesbury** – Chief Economist  
**Robert Stein, CFA** – Senior Economist  
**Strider Elass** – Economic Analyst  
**Andrew Hull** – Economic Analyst

## No, The US Is Not Greece

Two-hundred and thirty-five July 4<sup>th</sup>'s ago, the United States became reality. While there have been plenty of stumbles along the way, other than during the Civil War, doubts about its continued existence have been few and far between. Lately, however, government spending and debt levels have created a mainstream fear that the US is possibly on its last legs – destined to become a future version of Greece.

We don't agree and, no, we are not sticking our heads in the sand. Our problems are clear. The budget deficit will be about 8.5% of GDP in 2011, down slightly from 9% in 2010 and 10% in 2009. These deficits are impossible to sustain over the longer run.

Meanwhile, the total public debt of the US is now \$14.3 trillion and future promised, but as yet unfunded, Social Security and Medicare benefits amount to about \$60 trillion in present value terms. Combined, this \$75 trillion is roughly five times annual GDP. With numbers like these, how could we not think serious, economy-threatening problems are on the way?

Well, for one thing, the very obvious problems in Greece (and other countries and the states) and the fact that politicians can't hide from the Internet are forcing the issue. Second, the political landscape in the US has changed – perhaps because of point one. Third, the solutions are relatively simple in reality, even though very complicated politically.

Part of the solution is higher revenues, and this will happen *even if tax rates are not increased*. In the past 12 months, revenues have climbed by about \$220 billion over the previous 12 months – or, about 0.5% of GDP. We expect revenues to continue this trend, rising from their current level of 14.5% of GDP back to about 18.5% of GDP (a 4% move).

Meanwhile, current debt-limit negotiations are likely to cut federal discretionary (non-entitlement, non-interest) spending.

In the 1990s, discretionary spending fell from about 9% of GDP to 6%. So let's say, we go from 9% today to 7.5%, which could be a "low hurdle" given the eventual reduction in operations in Iraq and Afghanistan. Combining this 1.5% of GDP cut with the 4% rise in revenues (total of 5.5%), could bring the annual deficit down to 3% of GDP.

Of course, that still leaves the long-term entitlement problem. But even there we can see the outlines of solutions looming in the distance. For Medicare and Medicaid, which are much bigger problems than Social Security, we think ultimately the forces of smaller government win. We do not know whether it will be in 2012, 2016, or 2020. But one of those elections is likely to result in a Republican in the White House with control of both the US Senate and House. And at that point, they can enact major reforms along the lines of some recent proposals to turn Medicare into premium support and turn Medicaid into block grants to the states.

Parliamentary rules will allow the GOP to enact these changes with only a simple majority in the Senate (with no chance for a Democratic filibuster). And to reverse these reforms, because it would make future budget deficits larger, Democrats would need 60 votes in the Senate!

On Social Security, any change requires 60 votes in the Senate. This means tax hikes (to fill the gap) are as much in play as benefit cuts and this is why it will likely be put off for many years into the future. In the meantime, news stories suggest even AARP is now willing to consider some reductions in benefits. In other words, fiscal reality is beginning to bite.

In the end, the road to fiscal redemption is a long one and we'll be on it for many years. But we think the ultimate destination will be smaller government and more manageable deficits than most investors realize.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-27 / 7:30 am	Personal Income - May	+0.4%	<b>+0.3%</b>	<b>+0.3%</b>	+0.4%
7:30 am	Personal Spending - May	+0.1%	<b>+0.1%</b>	<b>0.0%</b>	+0.4%
6-28 / 9:00 am	Consumer Confidence - Jun	61.0	<b>59.9</b>		60.8
6-30 / 7:30 am	Initial Claims - Jun 25	421K	<b>422K</b>		429K
8:45 am	Chicago PMI - Jun	54.0	<b>55.7</b>		56.6
7-1 / 8:55 am	U. Mich. Consumer Sentiment	72.0	<b>72.0</b>		71.8
9:00 am	ISM Index - Jun	51.8	<b>52.4</b>		53.5
9:00 am	Construction Spending - May	0.1%	<b>+0.2%</b>		+0.4%
<i>sometime</i>	Domestic Auto Sales - Jun	4.2 Mil	<b>4.1 Mil</b>		4.1 Mil
<i>during the day</i>	Domestic Truck Sales - Jun	5.2 Mil	<b>5.3 Mil</b>		5.2 Mil