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Viewpoint

Debt, Tax Burdens Holding Back Growth

By MIKE COSGROVE

Suppose you go home tonight and find a gold mine in your back yard worth $600 billion. That gold mine is an asset to you and increases your net worth by $600 billion, since there is no liability associated with your new discovery.

The Fed's $600 billion quantitative easing program, known as QE2, is the equivalent of a new gold mine for the U.S., since there is nothing to pay back.

QE2 is the Fed electronically printing enough money to buy $600 billion in U.S. Treasury bonds. That $600 billion increase amounts to roughly 50% of the federal deficit, so the Fed is effectively monetizing half the deficit this year. QE2 also acts as a tail wind for equity prices and, in general, higher prices across the spectrum.

QE2 was likely cobbled together by policymakers to boost the asset side of the household balance sheet. But QE2 may easily backfire if inflationary expectations increase enough to push mortgage rates significantly higher and act to delay any housing recovery for several more years.

Bernanke Returns Favor

In terms of timing, it looks a lot like Chairman Bernanke and Treasury Secretary Geithner may have hatched QE2 in the midst of the public's apprehension in the summer of 2010. The public had major concerns about the regulatory overhaul of 16% of the U.S. economy in the form of ObamaCare and out-of-control federal government spending. The handwriting was already on the wall in the summer of 2010 for what the November 2010 elections might produce.

Administration officials knew that President Obama would need an improving economy in 2011 to recover from a potential worst case in the November 2010 elections. The president also needed a running start for the 2012 election with a better economy.

Obama reappointed Bernanke in August 2009. Administration officials may have figured that it was time for the chairman to pay back the president. Chairman Bernanke made the case for QE2 from August 2010 up until its rollout in November 2010. That just happened to be a month after the start of the 2011 federal fiscal year that runs from October 2010 to September 2011. It also coincided with the beating the Democrats took in last fall's election.

Homeowners Shocked Twice

Administration officials may have panicked over the magnitude of that deficit and, along with the regulatory overkill of ObamaCare, what it might mean for the economy in 2011. One will never know what, if any, pressure was used on Bernanke, but the timing of QE2 makes it a question.

Real growth in the economy is primarily influenced by pro-growth tax and regulatory policies, not quantitative easing. But QE2, since it is an asset, may have helped to temporarily offset the mammoth increase in the federal debt.

The rapid increase in the outstanding gross federal debt from $9.2 trillion in January 2008 to the current $14 trillion represents a major increase in liabilities to those 50% or so of federal income tax filers who pay nearly all the federal income tax. Owners of those bonds consider them to be an asset.

But to taxpayers, that nearly $5 trillion increase in government bonds represents a liability in the form of higher taxes.

The $5 trillion increase in federal debt amounts to an increased liability of about $66,000 for each of 75 million individual tax returns that pay nearly all the federal income tax. To place that in perspective, the loss in homeowners' equity is about $95,000 for each of the approximately 75 million homeowners in the U.S. since the 2006 peak in home equity.

Homeowners have been shocked twice. One shock is the loss in home equity and the second shock is the large hike in expected taxpayer liability since 2008. Taxpayers know that their tax liability is simply postponed. Knowing that, taxpayers may act to increase their savings by that amount.

The federal government outstanding debt burden and implied tax burdens are so large that they hamper new business formation and job growth and slow the pace of economic expansion.

Bernanke's $600 billion gold mine helps overcome the increased tax liability of federal debt, but the gold mine only amounts to about $8,000 per each of 75 million taxpayers. So that $600 billion needs to turn over several times to reach the increased taxpayer liability of $66,000 since January 2008. If that should happen, it will likely mean higher inflation and the outstanding Treasury debt can be paid back with cheaper dollars.

Chairman's Gamble

Bernanke knows the importance of expectations. The expectation of increased taxes is already there. The chairman is gambling inflationary expectations remain modest and Treasury bond yields remain low long enough for job growth and the housing market to improve.

But until it is clear to business and investors that Congress has limited the size of the federal debt, regulations and tax burden, the U.S. growth rate will be constrained and unemployment will remain elevated.

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