



The Gang Who Couldn't Talk Straight

A copy of the annual Economic Report of the President arrived at my desk the other day, replete with a giant bald eagle on the cover and formatted, incredibly enough in OVERSIZED print – fit for an aging boomer population. My compliments to the chef, at least for the exterior garnishments. The verbiage however, was another story. It's not so much that the report was a compilation of untruths or even half-truths. It's just that it failed to tell the truth, the whole truth, and most definitely nothing but the truth. Although submitted by ex-CEA Chairman and newly christened Fed Chairman Ben Bernanke, it was as if it had been written by Dick Cheney, a man who not only cannot shoot straight but seems to have difficulty talking straight as well. If there were WMD in our economic future, you'd be hard pressed to find them here. Mild innuendos about global and demographic challenges yes, but nothing that couldn't or wouldn't be overcome with good old American ingenuity, hard work, and a fawning foreign investment public nearly trampling each other to get their hands on attractive U.S. "investments." Nowhere to be found was the catchy phrase à la Tennessee Williams referring to the "kindness of strangers" or a suggestion of "living on borrowed time." Our 700 billion dollar current account deficit, in fact, could and might continue "indefinitely" as long as we use the capital inflows in ways that promote future growth, the report intoned. Ah, but that, it seems to me, was the critical rub. **Have we, can we, will we use capital to**

foster future growth or must we earmark it for future liabilities that have been under-reserved? Have we borrowed from the future to pay for today's party and will our future creditors allow us to pay it back on our own terms with low yields and a strong dollar? While the gang that couldn't shoot (or talk) straight expressed few doubts, I as you can probably tell, have mine. Let me summarise a few of the pertinent chapters of this year's report to help you make up your own mind.

Education

As we shall see in future paragraphs, the U.S. is beset with the necessity to provide services and funding for an aging boomer population. Chapter 2 of the Council's report speaks to skills for the U.S. workforce and suggests the obvious – that education will be a key contributor to the economic growth which will provide these future services, and that the "U.S. can create a workforce that will thrive in the fast-changing world economy." A few pages in, however, the report offers a Cheneyesque comment that the "U.S. still has great potential for increases in the schooling levels of its residents." Turns out that "great potential" was a misplaced euphemism for "failing grade." The Council's own math and science rankings on international tests are shown in Chart 1 and they don't even include those of Japanese and Asian competitor nations. If grades were awarded on a curve, a D+ for our graduating seniors would be the honest result. "Potential" indeed – as in nowhere to go but up! If these students

Brain Drain

Rankings of Selected Advanced Countries by Average Score on International Tests

Age 9		Age 13		Age 15		Last year of secondary school	
MATH	SCIENCE	MATH	SCIENCE	MATH	SCIENCE	MATH	SCIENCE
Hong Kong	Japan	Hong Kong	Hong Kong	Hong Kong	Japan	Netherlands	Sweden
Japan	Hong Kong	Japan	Japan	Netherlands	Hong Kong	Sweden	Netherlands
Netherlands	USA	Netherlands	Netherlands	Japan	Australia	Norway	Norway
USA	Netherlands	Australia	USA	Canada	Netherlands	France	Canada
Italy	Australia	USA	Australia	Australia	New Zealand	New Zealand	New Zealand
Australia	New Zealand	Sweden	Sweden	New Zealand	Canada	Australia	Australia
New Zealand	Italy	New Zealand	New Zealand	France	France	Canada	Germany
Norway	Norway	Italy	Norway	Sweden	Sweden	Germany	France
		Norway	Italy	Germany	Germany	Italy	USA
				Norway	USA	USA	Italy
				USA	Italy		
				Italy	Norway		

Note: The last year of secondary school is 12th grade in the United States but varies in other countries. In countries that track students, students in all tracks were tested in their last year of secondary school; the last year may differ within countries for students on different tracks. Students who dropped out of school before the last year of secondary school were not tested. Data are for 2003 except for last year of secondary school (1995).

Source: Department of Education (National Center for Education Statistics).

Chart 1

are whom we boomers are relying upon to take care of us during our old age, then we'd better petition Congress to release Dr. Kevorkian from prison instead.

Social Security and Private Pensions

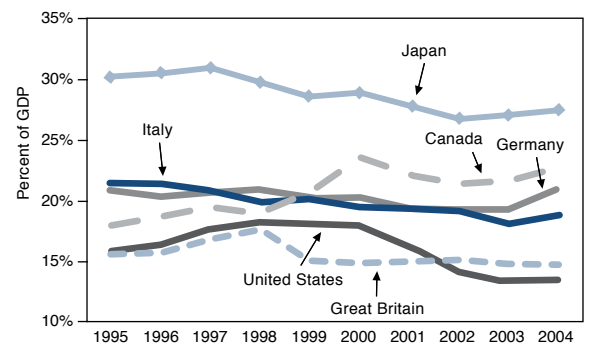
The Council's report seems confused as to whether Americans are adequately prepared for the inevitable aging of the boomer generation. "What does 'Retirement Preparedness' mean?" they query at one point. They later suggest that it means the accumulation of wealth necessary to maintain a desired standard of living, but then wonder whether either our future wealth will be enough or our "desire" for benefits too much to guarantee preparedness. What shouldn't be confusing for our "straight talk" challenged gang is their own opening quote that "recent newspaper headlines suggest that Americans have stopped saving and are at risk of sharp reductions in both private and public benefits." Thank God

for a free press I suppose because the gang only suggests that these concerns have "some basis" in fact. 75 pages later, in a chart buried in a lengthy denial of the current account deficit, comes the evidence displayed in Chart 2. The headlines it seems, are right. Americans (consumers, businesses and government) have indeed stopped saving and now rank at the bottom of the interna-

On Life Support

Gross National Saving Rates (1995-2004)

The United States has had the lowest rate of national saving among advanced economies since 2002.



Source: International Monetary Fund, *World Economic Outlook*, September 2005.

Chart 2

tional totem pole just like they do with education. If “savings” are the prerequisite for future private and public pension solvency as the Council suggests, then dial 911 and get the emergency room set up, you straight-talkers you. Paddles!

Health Care Spending

Our gang really tries to con us when it gets to the topic of healthcare. Medical expenditures they suggest resemble a discretionary outlay – sort of like moving up from a Chevy® to a BMW® or substituting a Heineken® for a Budweiser®. “As the United States grows richer and older,” they write, “Americans are likely to continue to spend a rising share of their growing incomes on health.” The “older” part is hard to dispute. That we would willingly allocate growing incomes on healthcare if given the chance and/or a more efficient system is debatable. Also under contention should be their follow-up statement that “our healthcare spending overall has returned good value with Americans living longer and healthier.” Say what? Have they heard of the obesity/diabetes crisis? Have they checked into (and out of) a hospital lately to verify that “good value?” How about checking out their own chart and its projections for the next two decades (Chart 3). National healthcare will consume **23%** of GDP in 20 years time vs. 6% in 1965 and 16% today. Who amongst you straight-talkers are going to suggest a way to pay for that?

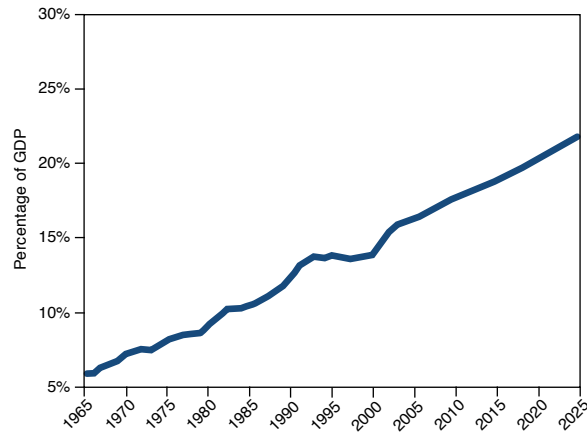
The Current Account Deficit

It’s in chapter 6 that the gang really becomes its most imaginative. Why admit to a chronic malady known as the current account deficit when tautologically you can discuss, and in fact label the entire chapter “The U.S. Capital Account Surplus!” A surplus sounds better than a deficit does it not? And if these

Black and Blue Cross

National Health Expenditures as a Percentage of GDP

National health expenditures have risen dramatically and projected to continue rising.



Source: Department of Health and Human Services (Centers for Medicare and Medicaid Services) and Council of Economic Advisers.

Chart 3

surplus inflows reflect foreign investor preferences for “higher risk-adjusted U.S. returns,” then all the better. You see folks, it’s not that we’re spending too much, it’s that foreigners are “pushing” (yes those are the authors’ words) in these funds because we’re so damned productive and we’ve got no recourse but to reap the rewards and shop ‘til we drop. Well, maybe as the gang suggests we should save a little of it to bring down this capital account surplus, but it’s really China, they claim and other Asian countries which need to promote higher domestic demand. Nowhere in the chapter is there a chart on the current account deficit. Instead we are treated to the rosier mirror image appearing in Chart 4 – “Net Capital Inflows.” Additionally, we are told that these inflows (deficits) can continue indefinitely as long as we use these investments (spending) to promote economic growth.

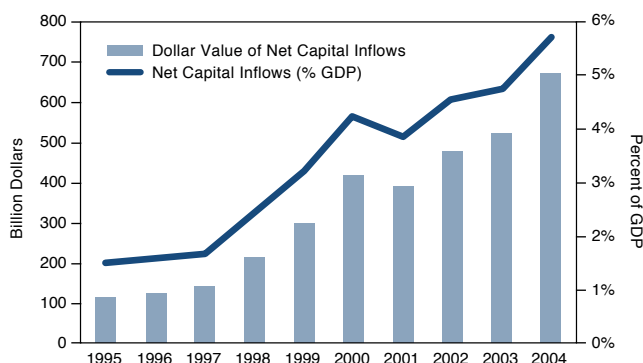
Well, it’s at this point that any reasonable straight shooter would draw the following conclusion: If pensions, healthcare, (and defence), are going to drain such an increas-

ingly significant share of GDP in future years, where does the money come from to promote economic growth of the sort that will pay for all of this? And how can we believe that America's value added/productivity advantage in the one sector where we remain competitive – technology – will continue if our math and science report card keeps getting a D+? Let's talk turkey; let's shoot straight, folks, without the requisite hyperbole that seems to define America's modern age and current politics. **We can't do it all – not just because our reach constantly exceeds our grasp but because this time we have exhausted our savings, lost our competitive edge and squandered our educational heritage.** We have grown soft – THEY have grown stronger. We have lost a sense of why we have prospered – THEY have learned to replicate our work ethic of yesteryear. The solution as the Council rightly suggests, is to save more, get smarter, trade more freely and to maintain a competitive tax base. Well yes – thanks for the straight talk after all – but that is a plateful and it will require the long-term acquiescence of those strangers who will wish nothing more than to supplant us at the top of the economic/geopolitical totem poll.

Mirror, Mirror on the Wall

Net Capital Inflows to the United States

Net U.S. inflows have risen in recent years in absolute terms and as a percent of GDP.



Note: Includes net inflows on the capital-financial accounts. Net statistical discrepancies in the financial account.

Source: Department of Commerce (Bureau of Economic Analysis).

Chart 4

Instead, our solutions more likely will pursue an easier trail, characterised by currency devaluation, the inflating away of long-term pension liabilities, and the payment of rising healthcare expenses via higher personal and corporate taxes. Investment markets in the United States will not ultimately prosper under such an increasingly odorous environment. It is only sensible, therefore, to diversify globally. Sorry for the straight talk folks, but don't you think it's about time?

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