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**FEDERAL BUDGET AND CURRENT ACCOUNT DEFICITS LOOM OVER  
U.S. ECONOMY, BUT PRIVATE SECTOR MAY POSE GREATER IMMEDIATE  
THREAT, SAYS NEW PAPER FROM LEVY ECONOMICS INSTITUTE**

**Record Levels of Household Debt, Decline of American Industries and Pensions,  
and Katrina Fallout Are Top Policy and Spending Priorities, Scholar Says**

ANNANDALE-ON-HUDSON, N.Y.—While policymakers, economists, and the media have focused a great deal of discussion on the seeming free fall in the federal budget deficit and the deficit in the current account balance, a new study from The Levy Economics Institute of Bard College refutes the notion that America is on the verge of bankruptcy. In a new Policy Note, *The Fiscal Facts: Public and Private Debts and the Future of the American Economy*, Senior Scholar James K. Galbraith argues that both deficits are products of longstanding conditions and policies in America and abroad that are not easily reversible and also do not necessarily warrant such great alarm. He also suggests that the U.S. economy faces more immediate danger from record levels of household debt and the decline of leading U.S. corporations and their pension plans, especially in the airline and automobile industries.

“The metaphorical ‘bankruptcy of the United States,’ under which foreign asset holders rush to dump U.S. assets and provoke a run on the dollar, is a possible but not a likely or a looming event,” writes Galbraith, who contends that the dollar’s status as the world’s principal currency may endure because it is not in the interests of China and Japan—two of America’s biggest creditors—to allow the dollar to collapse, and also because there is no viable alternative at the moment. He maintains that the greatest risk to the international monetary system is not the size of the current account deficit, but reckless foreign policy, such as a war over Taiwan or with Iran, and the likelihood of ensuing tension with China.

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Regarding the budget deficit, Galbraith says that concerns about Social Security and the need for higher taxes or budget cuts may be overblown and are outweighed by the danger of bankruptcies in the private sector. “We are living, obviously, in the twilight of the great American airline We are approaching, with each passing day, the twilight of the great American automotive corporation. What other major corporate bankruptcies lie in wait? How many more pension plans will fails?” he asks, stressing that the prospects for American households are even more ominous given the record debt levels, relative to income, that households have amassed in recent years. “Debt service remains manageable only because incomes have been growing, however slowly, while interest rates have remained low, but one or the other of these conditions is not likely to endure,” Galbraith maintains.

Galbraith says the risks created by record household debts are exacerbated by the potential for either recession or higher long-term interest rates; the continuing economic impact of Hurricane Katrina on New Orleans, evacuees from the city, and other affected communities and utilities; and new punitive bankruptcy laws. “Escape from debt has become much more difficult, and for those whose finances fail in the future, the new law in effect imposes a high tax on future work effort,” writes Galbraith. “It will have the effect of pushing many Americans out of the workforce and many others into the cash economy. The credit card companies should have been careful about what they wished for.”

Furthermore, the fiscal condition of the U.S. government does not require an assault on Social Security, or the immediate passage of budget cuts or higher taxes, Galbraith contends. “The United States remains, on the whole, a wealthy country. There is no compelling fiscal reason why it cannot afford to address its ongoing problems,” he writes, stressing that the reconstruction of New Orleans and a the creation of a viable plan for the rehabilitation of the Gulf Coast are urgent priorities that the government can afford to accomplish without reneging on its other social commitments. He rejects the claim that large deficits will raise interest rates and therefore discourage investment. “First, interest rates were higher when the budget was in surplus than they are today, when deficits stretch to the horizon. Second, investment, as a share of GDP, is higher today than its long-term historical average and not far below the peak values of the boom years of 1999-2000,” he argues. “The real danger to the national economy would be a failure to use the resources we have in common to restore health to private balance sheets before it is too late.”

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Policy Note 2006/2, *The Fiscal Facts: Public and Private Debts and the Future of the American Economy*

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