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Prize for Being the Biggest Liar is: Taxpayers Foot the Bill!

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by

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Here's your quiz question for the day: Who is the biggest liar of them all?

The answer will surprise you, and, yes, you're allowed to consult your daily newspaper or favorite Web sites. Gird yourself. You may be overwhelmed by the number of candidates.

Here are just a few:

- Bear Stearns paid millions of dollars to settle federal charges of illegal loan collection practices.
- Bank of America, UBS, Merrill Lynch, Morgan Stanley and Wachovia deceived investors by selling them risky auction-rate securities as perfectly safe.
- GMAC Bank and other student loan companies engaged in deceptive advertising.
- IndyMac Bank routinely issued liar loans until it went broke.
- Countrywide engaged in deceitful lending.
- J.P. Morgan Chase, Citigroup and CIBC paid billions to settle charges of engaging in securities fraud. • The supposedly independent rating companies – Standard & Poor's, Moody's and Fitch – gave bond insurers triple-A ratings to fatten their wallets when D-minus was what they deserved.
- HSBC and Citigroup specialized in structured investment vehicles to conceal their risky mortgage holdings.
- Freddie Mac failed to fully disclose its portfolio losses.
- AIG hid huge losses on its credit default swaps.
- Lehman Brothers failed to come clean about its real estate losses.

- Lehman Brothers, Morgan Stanley, Citigroup and Merrill Lynch competed with one another in developing abusive tax-evasion schemes.

In addition to conning the public, these companies conned each other and themselves. That's why so many are going under.

So let's ask a rude question: Where did they learn to make deception a basic operating procedure?

Answer: Washington, D.C., the home of the federal government and the source of current efforts to rescue our economy.

When it comes to deception, misleading accounting and lack of disclosure, Uncle Sam is the father of all con artists. Indeed, as large as the current crisis is, all the losses racked up by the Nitwit Sector pale when compared with what our government has done.

Consider these parallels:

Structured investment vehicles. The banks, following in Enron's brilliant footsteps, got in trouble with "structured investment vehicles" – off-balance-sheet ventures that increased their risk but weren't visible. The government parallel is "government-sponsored organizations," or GSOs for short.

Fannie Mae and Freddie Mac, the two GSOs just taken over, have saddled our government with an additional \$5 trillion in debt, which, of course, is being kept off the books. We've also inherited Fannie's and Freddie's assets; they should also be booked, except no one seems to know precisely what they are or what they're worth.

Official debt vs. real obligations. The official federal debt is \$9.5 trillion, of which about \$5.3 trillion is held by the investing public and \$4.2 trillion is held in government accounts such as the Social Security and Medicare trust funds.

But the official liabilities pale in comparison with the off-book entitlements – obligations to pay current and future Social Security, Medicare and Medicaid benefits.

Yes, the government can count on future tax receipts to help cover these obligations and its other spending. Unfortunately, there is a gigantic gap between the value of future tax collections and the value of future entitlement payments. Economists call this the fiscal gap – the current value difference between the government's projected spending and its future tax receipts.

The U.S. Treasury calculated this figure in 2002 when Paul O'Neill was running the shop. It was \$45 trillion. No one learned this because Mr. O'Neill was fired before he could disclose it in the 2003 president's budget. The study he commissioned was censored two days after he was given the boot. It may be the main reason he was terminated. We discussed this gap in detail in our book, *The Coming Generational Storm*.

Democrats are no better when it comes to honest discussion of our long-term finances. The Clinton administration censored a similar study in its first term after the study had been carefully prepared by the Office of Management and Budget.

Today, while Democrats decry the Republican administration's failure to foster reforms for Fannie Mae and Freddie Mac, they have conveniently forgotten their opposition to reform when it was proposed in 2003.

Today, things are worse. The passage of Medicare Part D alone has added about \$8 trillion in unfunded liabilities. To put that in perspective, the expected cost of providing pills for seniors is right in the ballpark with the unfunded liabilities of the entire Social Security retirement program. Today the fiscal gap is nearly \$70 trillion.

The \$70 trillion fiscal gap is the real measure of our government's indebtedness. To put the figure in perspective, the Federal Reserve recently reckoned the net worth of all the households in America at a mere \$56 trillion.

But politicians of both parties continue the convenient fiction of our \$5 trillion-plus in public federal debt. Coming up with \$70 trillion is impossible without radical reform of entitlements. That's the last thing Sen. John McCain or Sen. Barack Obama wants to discuss in the run-up to the election.

So Washington's deception remains business as usual. It continues to provide a terrible example to Wall Street and the public.

If our indignant politicians want Wall Street to clean up its act, they need to set a proper example. They can do this by presenting an accurate accounting of our government's promises and commitments.

That means presenting the country's long-term fiscal gap analysis on an ongoing basis. They also need to tell the public how much our children's taxes will have to rise or how much their benefits will have to be cut if no action is taken.

As things now stand, our children are facing massive tax increases – far beyond anything they can pay. Continuing inaction and deceit in Washington will surely backfire as the years go by with no entitlement reform. The consequence of inaction will be a perpetually weak dollar, high interest rates and high inflation as our government prints massive quantities of money to pay bills it can't afford.

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