Debt and denial

Paul Krugman
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Last year America spent 57 percent more than it earned on world markets. That is, our imports were 57 percent larger than our exports.

How did we manage to live so far beyond our means? By running up debts to Japan, China and Middle Eastern oil producers. We're as addicted to imported money as we are to imported oil.

Sometimes large-scale foreign borrowing makes sense. In the 19th century the United States borrowed vast sums from Europe, using the funds to build railroads and other industrial infrastructure. That debt-financed wave of investment left America stronger, not weaker.

But this time our overseas borrowing isn't financing an investment boom: adjusted for the size of the economy, business investment is actually low by historical standards. Instead, we're using borrowed money to build houses, buy consumer goods and, of course, finance the federal budget deficit.

In 2005 spending on home construction as a percentage of G.D.P. reached its highest level in more than 50 years. People who already own houses are treating them like A.T.M.'s, converting home equity into spending money: last year the personal savings rate fell below zero for the first time since 1933. And it's a sign of our degraded fiscal state that the Bush administration actually boasted about a 2005 budget deficit of more than $300 billion, because it was a bit lower than the 2004 deficit.

It all sounds unsustainable. And it is.

Some people insist that the U.S. economy has hidden savings that official statistics fail to capture. I won't go into the technical debate about these claims, some of which resemble arguments used not long ago to justify dot-com stock prices, except to say that the more closely one looks at the facts, the less plausible the "don't worry, be happy" hypothesis looks.

Denial takes a more systematic form within the federal government, where Dick Cheney is doing to budget analysis what he did to intelligence on Iraq. Last week Mr. Cheney announced that a newly created division within the Treasury Department would show that tax cuts increase, not reduce, federal revenue. That's the Bush-Cheney way: decide on your conclusions first, then demand that analysts produce evidence supporting those conclusions.

But serious analysts know that America's borrowing binge is unsustainable. Sooner or later the trade deficit will have to come down, the housing boom will have to end, and both American consumers and the U.S. government will have to start living within their means.

So how bad will it be? It depends on how the binge ends. If it tapers off gradually, the U.S. economy will be able to shift workers out of sectors that have benefited from the housing boom and the consumption spree into sectors that produce exports or replace imports. Given time, we could bring the trade deficit down and bring housing back to earth without a net loss in jobs.

In practice, however, a "soft landing" looks unlikely, because too many economic players have unrealistic expectations. This is true of international investors, who are still snapping up U.S. bonds at low interest rates, seemingly oblivious both to the budget deficit and to the consensus view among trade experts that the dollar will eventually have to fall 30 percent or more to eliminate the trade deficit.

It's equally true of American home buyers. Most Americans live in regions where housing remains affordable. But a detailed new study by HSBC, a multinational bank, confirms what I and others have been saying: most of the rise in housing values has taken place in a "bubble zone" along the coasts, where housing prices have risen far more than the economic fundamentals warrant. According to HSBC's estimates, houses in the bubble zone are overvalued by between 35 and 40 percent, creating trillions of dollars of illusory wealth.

So it seems all too likely that America's borrowing binge will end with a bang, not a whimper, that spending will suddenly drop off as both the bond market and the housing market experience rude awakenings. If that happens, the economic consequences will be ugly.

All in all, Alan Greenspan, who helped create this situation, can consider himself lucky that he's safely out of office, giving briefings to hedge fund managers at $250,000 a pop. And his successor may be in for a rough ride. Best wishes and good luck, Ben; you may need it.