Economic Policy Institute

Briefing Paper

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AMERICA'S INHERITANCE: MORE THAN JUST DEBT

by Todd Schafer

In recent years, the notion has made the rounds in Washington that every baby born in this country begins its life saddled with $17,000 of government debt. However, the financial health of any individual, business, or government can be assessed only upon review of its liabilities us *well us* its assets. And, from the perspective of national economic inheritance, the issue is total capital formation (i.e., national wealth), not just federal assets and debts.

Failure to consider both sides of a financial ledger can create dramatic distortions. For example, cable tycoon Ted Turner has bragged that he is more indebted than some *nations.* If his personal financial position were assessed only in terms of his debts, then he would indeed be one of the poorest men in the world. Clearly he is not, and his debt has financed an empire of valuable assets. We need to look at a government balance sheet just as we would Mr. Tumer's.

The analysis that follows, based on asset and liability numbers included in the Office of Management and Budget's *FY95 Budget,* depicts such a federal balance sheet. It will show that, even *with a conservative definition of assets,* the government's net liabilities per person come roughly to $1,000, not the $17,000 claimed by those with one-sided ledgers. The analysis will also show that the nation's wealth-much of it in assets based on the public infrastructure-stands at a healthy $196,000 per person. And while important issues remain regarding the distribution of that wealth, the United States is still the richest nation on earth-debt and all.

None of the following should suggest that the federal debt run-up in the 1980s is of no concern. The assets of the federal government, net of its liabilities, have dropped dramatically from their 1980 level of $5,500 per person. They dropped not because Ronald Reagan and George Bush borrowed more, but because they did not invest the proceeds of the borrowing in productive assets. Thus, a 50% increase

in per capita liabilities was not matched by an increase in assets. Indeed, the per capita value of federal assets fell 3%. Projections for the rest of the decade suggest that, although the debt will be in check, neglect of our assets will continue, and the federal balance sheet will worsen still.

This analysis is presented to offer a context in which to consider the debt. It warns that if we continue to restrict investment in order to limit debt, the inheritance of the next generation will include a crumbling physical, human, and technological infrastructure too weak to maintain future living standards.

Federal Liabilities

The per person liabilities of the federal government are both over- and understated by the $17,000 figure cited above. The true tally would adjust for the portion of the debt that the government literally owes itself and for other federal liabilities not reflected in the public debt.

The $17,000 figure was arrived at simply enough. The total federal debt in 1993 of $4.35 trillion was divided by the Census Bureau's estimate of the 1993 U.S. population, 258 million. That works out to $16,850 apiece, a dramatic 150% real increase from the per capita debt level of 1980.

However, a substantial share of the gross federal debt is owed to the various federal trust funds or the Federal Reserve. Since, by definition, this federal government "debt" is simultaneously an "asset" of the federal government fund from which it was borrowed, the net effect on the federal balance sheet is zero. This intra-governmental debt amounted to about $1.4 trillion in 1993, or about $5,500 per capita. Netting this sum from the total per capita debt yields about $11,300 apiece. While this is somewhat less daunting than the $17,000 figure, it still represents a per capita debt level roughly two-and-a-half times the one inherited by Ronald Reagan.

Publicly held debt is not the only liability of the federal government: there are a variety of contingent liabilities arising from the federal government's loan guarantees, insurance programs, and employee pensions. According to OMB, the present value of these commitments amounted to nearly $1.8 trillion-or $6,800 per capita-in 1993. Due to a change in the federal pension system, this represents a small decline from the level of 1980.

Taken together, the federal government's liabilities are actually slightly worse than the number circulating in Washington: about $18,000 for every man, woman, and child in the country. This represents a 50% increase during the Reagan/Bush years (Table 1).

Table 1
Federal Liabilities
(1993 dollars per capita)

	1960	1970	1980	1990	1993
Gross federal debt	-7,68 1	-6,555	-6,911	-14,064	-16,850
Intra-governmental debt	-2,120	-2,675	-2,434	-4,519	-5,536
Debt held by public	-5,561	-3,880	-4,476	-9,545	-11,314
Insurance and pension liabilities	-4,262	-5,389	-7,654	-7,087	-6.7%
Total federal liabilities	-9,823	-9,269	-12,130	-16,632	-18,110

Source: EPI calculations using OMB and CEA data, 1994.

Federal Assets

Fortunately, the federal government also has significant assets, in various forms. As financial assets, the federal government had, for example, gold and foreign exchange holdings worth over $170 billion in 1993. Likewise, it holds thousands of mortgages and millions of other loans worth about $160 billion in present-value terms, discounting for likely defaults. In total, the federal government has financial assets worth about $560 billion, or $2,200 per capita.

In addition, the federal government has vast physical assets in the form of buildings, federally owned infrastructure, land, and mineral rights totaling roughly $1.75 trillion. Unfortunately, this level of physical capital holdings represents a marked decline from earlier years. Nevertheless, federal physical assets on a per capita basis still total over $6,700.

Combining financial and physical assets, the federal government has roughly $8,900 in holdings on a per capita basis.

To limit the balance sheet to only assets owned by the federal government, however, would understate the federal role in capital accumulation. More and more, the federal government offers grants to state and local governments so that they may undertake capital projects. Since all U.S. citizens are also citizens of a state and local government, this capital remains under their "ownership.'* Similarly, the federal government makes funds available to individuals to invest in their education. In either case, while the federal government does not legally own the financed capital, it is responsible for its existence.

The best example of federal capital financing is grants to the states for construction and rehabilitation of the nation's roads and bridges. In 1993, these grants totaled about $16 billion. In fact,

federal capital investment financed by grants in 1993 exceeded direct federal capital investment by nearly 2 to 1.

In addition, the federal government has financed an estimated $800 billion of the nation's education capital stock and $800 billion of its R&D capital. Together with the more than $500 billion in physical assets acquired via federal grants, the federal government is responsible for assets totaling $8,200 per capita.

Adding this entry to the assets actually owned by the federal government brings the total of assets directly attributable to federal expenditures to more than $17,000 per capita (Table 2). Note that this figure understates the total federal role in capital formation, since it reflects funding that is attributable to federal outlays only; capital formation arising as the result of federal tax expenditures—e.g., R&D tax credits, investment tax credits, etc.-is excluded.

Table 2
Federal Assets
(1993 dollars per capita)

	1960	1970	1980	1990	1993
Federally owned assets					
Financial	1,783	1,687	2,938	2,413	2,165
Physical	9,133	7,827	8,295	7,699	6,746
Total	10,916	9,514	11,233	10,112	8,911
Federally financed assets					
Physical	609	1,200	2,196	2,145	2,072
Education	432	1,151	1,827	2,713	3,079
R&D	897	2,258	2,415	2,909	3,048
Total	1.937	4,609	6,438	7,767	8,198
Total federal assets	12,852	14,123	17,670	17,879	17,109

Source: EPI calculations using OMB and CEA data. 1994.

Federal Balance Sheet

Thus, in 1993, federal liabilities exceeded federal assets by about $1,000 per capita. By contrast, in 1980, the net per capita position of the federal government stood at a healthy $5,500. Clearly, then, the federal balance sheet worsened markedly during the Reagan/Bush years. However, the decline is much less severe than when viewed simply on the basis of debt. The $1,000 in liability per person suggests a more favorable financial position than the "$17,000 of debt for every, man, woman, and child" stance.

It is important to remember that there are two causes of the federal government's worsening balance sheet since 1980. The first is obvious: federal liabilities have been rising dramatically. Second, ***and equally important, the*** value of federal assets has failed to increase; in fact, it has declined.

As shown in the table below, increasing liabilities do not necessarily indicate a worsening balance sheet. Consider the period 1960430, when federal liabilities increased by about $2,300 per capita. Because assets grew by over $4,800 per capita over the period, the federal balance sheet improved. But that earlier period was characterized by high levels of public investment; the accumulation of federal debt in the 1980s was not for similar purposes. Thus, the problem was not borrowing per se, but rather how the proceeds were spent

Table 3
Federal Balance Sheet
(1993 dollars per capita)

	1960	1970	1980	1990	1993
Total federal assets	12,852	14,123	17,670	17,879	17,109
Total federal liabilities	-9,823	-9,269	-12130	-16.632	-18,110
Net federal assets	3,029	4,854	5,540	1,247	-1,001

Source: EPI calculations using OMB and CEA data, 1994.

What will the future bring to the federal balance sheet? First and foremost, we know that the rapid rise in federal debt is over for this century. In fact, following the Administration's own estimates, we can expect real growth in the federal government's publicly held debt of only about $800 per capita, an increase of just 1.2% a year (compared to the annual 7.1% experienced between 1980 and 1993) (Table 4). In addition, if the federal government's contingent liabilities continue to decline as they have since 1980, we can expect total federal per capita liabilities to remain virtually unchanged through 1999.

Improvement on the debt side, however, does not mean that the slide in the federal balance sheet is over, because a similar rebound on the asset side of the ledger is unlikely on our current budget trajectory. While OMB does not project the value of the federal capital stock five years into the future, it does lay out how much the Administration intends to add over that period. The outlook is gloomy. As shown in Table 5, federal investment per capita-whether defense capital is included or not-will likely be lower in 1999 than it is today. Short of an unexpected increase in the value of federally owned real estate, the gold reserve, or the oil reserve, such a diminishing flow of investment will result in a continued decline in federal assets and a worsening balance sheet.

Table 4
Federal Debt, 1993-99
(1993 dollars per capita)

	1993	1999	Annual Change 1993-99	Annual Change 1980-93
Gross federal debt	-16,850	- 19,270	2.2%	6.9%
Intra-governmental debt	-5,536	-7,128	4.2%	6.3%
Debt held by public	-11,314	-15141	1.2%	7.1%

Note: Gross federal debt reflects the Administration's estimate of health care savings. Intra-governmental debt assumes the Federal Reserve **holding the same share of debt as in 1990-93. Population for 1999 assumes continuation of growth rates for 1990-93.**

Source: EPI calculations using OMB and CEA data, 1994.

Table 5
Federal Investment Outlays, 1993 and 1999
(1993 dollars per capita)

	1993	1999
Physical capital (total)	***490***	***393***
Defense	295	214
Nondefense	194	179
Human capital (total)	***162***	***157***
Defense	0	0
Nondefense	162	157
Research & development (total)	***265***	***234***
Defense	156	113
Nondefense	108	121
Total	915	***784***
Defense	451	327
Nondefense	464	457

Note: Physical capital projections represent presidential policy from the FY95 budget. Human capital projections are extrapolated from broader projections for budget function **500 (Education, Training, Employment, and Social Services); defense R&D projections are extrapolated from broader projections for budget function 05 1 (Department** of Defense-Military); and civilian R&D projections are extrapolated from broader projections for budget subfunctions 250 (General Science, Space, and Technology) and 552 **(Health Research). All numbers are deflated using the composite deflator from the FY95 budget. Population for 1999 assumes continuation of growth rates for 1990-93.**

Source: EPI calculations using OMB and CEA data, 1994.

National Wealth

As informative as the above exercise may be, it is misleading because it implies that the economic goal of the federal government is to improve ***its own*** financial position. Yet the primary economic goal of the federal government should be to improve the financial position of its citizens--even if its

own balance sheet is burdened in the process. When the federal government gave away vast holdings of land to encourage homesteaders to settle the West, for example, the federal balance sheet suffered, and the nation was enriched. As a result, it was good policy.

The best measure of the financial position of "every baby born in this country," therefore, is national wealth-both public and private. This measure would aggregate the nation's assets and subtract that portion owned by foreigners, thus allowing a true accounting of the national balance sheet.

In 1993, according to OMB, total national assets--comprising physical assets, education capital, and R&D capital-stood at over $51 trillion, or about $198,000 in assets for every man, woman, and child. This level represents a real increase of about 17% over 1980 and is due largely to a rapid increase in the value of the nation's stock of education capital. Growth in that area more than made up for a decline in the value of the nation's physical capital stock.

National liabilities moved in the opposite direction. Prior to about 1990, the claims of Americans on foreign assets exceeded the claims of foreigners on American assets. In 1980, for example,American claims abroad surpassed those of foreigners here by about $2,000 per capita. By 1993, however, the pattern had reversed: the claims of foreigners exceeded those of Americans by about $2,200 per capita.

Netting liabilities from national assets, then, we find that "every baby born in this country" in 1993 started out with nearly $196,000, a gain of $25,000 over 1980 and $100,000 over 1960 in real terms (Table 6).

Table 6
National Wealth
(1993 dollars per capita)

	1960	1980	1993
National liabilities			
Net claims of foreigners	863	2,007	-2,246
National assets			
Physical	57,452	99,001	90,124
Education	35,119	65,526	101,676
R&D	1,622	4,330	6,316
Total	94,193	168,857	198,116
Total national wealth			
(Assets net of liabilities)	95,056	170,864	195,870

Note: Education asset numbers represent a conservative estimate of the nation's human capital stock. They reflect replacement cost of the assets only-i.e., not including opportunity costs. In addition, they omit investments in training.

Source: EPI calculations using OMB data. 1994.

Conclusion

America's economic inheritance is clearly more than just debt. When put into context, a narrowly defmed federal legacy to each newborn totals about 41,000, a substantially smaller burden than the -$17,000 touted by so many in Washington. In terms of overall inheritance, moreover, each child's financial position is a hefty $196,000 (Table 7).

Table 7
Summary Balance Sheet
(1993 dollars per capita)

	1993
Gross federal debt	-16,850
Less intragovernmental debt	-11,314
Plus other contingent liabilities	-18,110
Less federally owned assets	-9,199
Less federally financed assets	-1,001
National wealth	+198,116
Less net claims of foreigners	+195,870

Source: Tables 1-6.

All the numbers expressed above are averages-every child does not share equally in the nation's assets or its liabilities-but they combine to tell a more complete story than is told by focusing merely on the liability side of the ledger. On the upside: the nation's assets far exceed its debts, and its wealth continues to grow; in addition, the federal government has substantial assets that nearly balance its liabilities. On the downside: the pace of national wealth accumulation has slowed, and the federal balance sheet has worsened markedly since 1980.

Thus, while federal liabilities per capita may indeed total $17,000 (in fact, closer to $18,000 by our reckoning), doomsday is not upon us. The growth in the federal debt burden has been reined in, and, by investing in the asset side of the ledger, the federal government can restore a healthy balance sheet to complement each newborn's $196,000 inheritance.

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