

4/8/2011 11:34 AM ET | By Bill Fleckenstein, MSN Money

The nation's \$75 trillion problem

A sobering look at federal spending from bond king Bill Gross suggests there are several creative ways to default on our national debt, and we are working toward all of them.

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Regular readers know where I stand on the subject of the Federal Reserve's monetary policy. Namely, I believe that the consequences of its **quantitative easing** programs (the second of which is scheduled to end in June) will be currency debasement and rather high rates of inflation.

Now it seems Pimco's **Bill Gross** may have joined the same camp, although through different reasoning from mine.

The \$75 trillion puzzle

In his Investment Outlook article published earlier this month, headlined "**Skunked**," he details the staggering size of the financial burden of our unfunded liabilities.

As he points out, these liabilities are not some theoretical estimate of future spending, but rather "the discounted net present value of current spending, should it continue at the projected demographic rate." The sum total is around \$75 trillion.



As Gross illustrates, if you use the **CPI** plus 1% to calculate the interest rate on the debt (which is the rate he used to discount back the government's future liabilities), interest expenses would equal \$2.6 trillion, which is more than 10 times higher than the current level of \$250 billion.

The bottom line: He feels that the size of unfunded liabilities (a consequence mainly of entitlements) means we are headed to an increased use of the printing press. Gross suggests that, when it comes to the size of our real off-balance debt, as opposed to the

size of the \$9.1 trillion on-balance-sheet national debt (\$11 trillion-\$12 trillion counting agency debt), we are "out-Greeking **the Greeks**."

He sums up by saying that "the only way out of the dilemma, absent very large entitlement cuts, is to default in one (or a combination) of four ways: 1) outright via contractual abrogation -- surely unthinkable; 2) surreptitiously via accelerating and unexpectedly higher inflation -- likely but not significant in its impact; 3) deceptively via a declining dollar -- currently taking place right in front of our noses; and 4) stealthily via policy rates and Treasury yields far below historical levels -- paying savers less on their money and hoping they won't complain."

No one's default but our own

And finally, "Unless entitlements are substantially reformed, I am confident that this country will default on its debt; not in conventional ways, but by picking the pocket of savers via a combination of less observable, yet historically verifiable policies -- inflation, currency devaluation and low to negative real interest rates."

In fact, those are exactly the policies we are pursuing now, which is why **Fed Under Fire** we are where we are. Inflation has become the order of the day, and it will only intensify. Exactly when I can't say, but it is worth pointing out that after "QE" began, for about eighteen months, the monetary base did not really percolate. But so far in 2011 it has exploded by 20% or so. I think this is a sign that inflation is likely to begin accelerating.

Of course, inflation is affected by expectations. If people think prices are going to climb, they buy in advance, and that in turn can help push up prices. Thus, psychology plays a large role. However, as I pointed out last February in "**No such thing as good inflation**," the mindset is changing and the genie may be out of the bottle.

Corporations may think they can keep prices the same and shrink the contents of their packages to make people believe nothing has changed. But when the New York Times runs an article **about that practice** on its front page, as occurred a couple of weeks ago, you can be pretty sure people get the joke, and behavior patterns will start to change.

So if inflation were a stock, I would certainly buy it aggressively, and I would buy long-dated calls on it, too.

Hear Bernanke see no inflation

And what do the great stewards of the common good at the Fed have to say? While I make an effort to filter out their blathering (because all that matters is what they're going to do, which we already know), I did note what Fed Chairman **Ben Bernanke** said in his April 4 speech. He reiterated his view that inflation is not going to be a problem: "The increase in inflation will be transitory. . . . Our expectation at this point is that in the medium term, inflation, if anything, will be a bit low. We will monitor inflation and inflation expectations very carefully."

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US | INTERNATIONAL

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Nikkei	9,556.65	-34.87	-0.36
FTSE 100	5,963.12	-32.89	-0.55
DAX	7,120.09	-58.20	-0.81

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NAME	LAST	CHANGE	% CHANGE
Euro/Dollar	1.43349	-0.00868	-0.60
Pound/Dollar	1.62681	-0.00531	-0.33
Dollar/Yen	82.91874	-0.21126	-0.25

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The reason this is important to note is because I think he is telling us what he actually believes, and I can almost guarantee that the Fed will be way behind the curve when it comes to fighting inflation, for three reasons.

First of all, inflation statistics understate inflation. Second, Bernanke has faith in his own ability to stop it virtually at will (as he once stated in a "60 Minutes" interview), though I think he is secretly not even sure inflation can get started. Third, Bernanke has been so certain that he must battle a deflation bogeyman that doesn't exist that he was always bound to be slow in responding to inflationary pressures. What we can expect from the Fed is a whole lot of speeches and chatter about expectations, but action will be tiny, timid and way too late.



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It amazes me that people pay so much attention to what any of these Fed heads have to say. We all know where their biases lie, and the fact that markets flinch every time one of them talks tough is almost comical. Recall that it was a little over a year ago when so many were worried about ending QE1 and the withdrawal of liquidity, and what we got instead was QE2.

In any case, it is what it is, and people will focus on what they will.

You won't feel a thing

It is a shame that people like Malcolm Bryan, a former president of the Atlanta Fed, aren't still around. As quoted from a 1957 speech in the latest issue of [Grant's Interest Rate Observer](#), he described the net effect of "premeditated inflation" (his term for a little bit of Fed-induced inflation) on the average money-saving citizen as follows: "Hold still, little fish. All we intend to do is gut you."

This column is a synopsis of Bill Fleckenstein's daily column on his own website, [FleckensteinCapital.com](#), which he's been writing on the Internet since 1996. [Click here to find Fleckenstein's most recent articles.](#)

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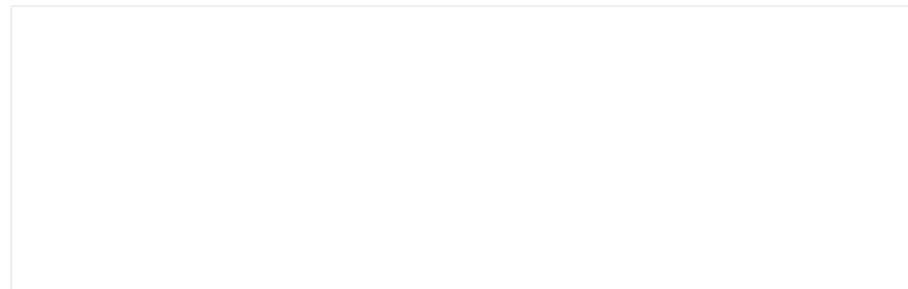
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1 2 3

Sparrows345

Sun 1:40 AM



Here's guessing that few of the clowns reading this have any gold or silver and have sat still during a massive 11 year bull market. Probably the same clowns that actually believe that 1) There really is no inflation, the figures put out are completely honest and 2) One side is guilty on the political aisle, it can't possibly be both. Reality check is just starting.

1 0

reality9999

Fri 9:49 AM



New Realist, YOU DO NOT COMPREHEND ANY OF THIS. Military spending is necessary?? How much and what has it accomplished. We spend a trilliion dollars a year on national security, more than the next five countries combined! This is all deficit spending. Your so called entitlements are not adding one red cent to the deficit. Will they in the future? Yes but right now more money comes in to pay for medicare and social security then goes out. To the tune of over 2 trillion dollars currently. Of course this two trillion has been spent so it is just IOU's. What has it been spent on? Empire building in the middle east and tax cuts for the rich. Your version of comprehension is a joke.

0 0

gandalf456

Tue 3:45 AM



the problem for bill fleck is that he does not live in the real world that most of us have to. when he says that people will anticipate inflation, he is speaking from an idealistic perspective. the truth is that the vast majority of people's input costs are going up faster than their income. they haven't got the available cash to exercise this buy before the inflation occurs. i think that if people see rising costs then they will in fact cut spending out of fear of not being able to get by. Good luck with your hypothesis bill but remember that you are making judgments about other peoples actions from the position where you are most likely very comfortably off.

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Eddie Willers

Mon 11:10 PM



Look at what Caligula and Nero did to Rome and we've got it--inflation and currency depreciation. The Fed even in the best of times aims for 2% inflation, but that means the value of the currency is halved every 36 years (applying the rule of 72). That's terrible. "Hold still little fish," said Malcolm Bryant. "All we intend to do is gut you." Our currency has plummeted since the inflation of the 1970s. A dollar from that period is worth four or five of today's. No wonder bubbles developed in stocks, houses, and now commodities.

9 0

NewRealist

Mon 8:51 PM



What's amazing is that people like cellman and Jim90 can read this article and not comprehend a fragment of it. Jim - military spending is necessary and is a drop in the bucket compared to entitlement programs. No wonder the country is in a mess.

6 10

Gus (cellman)

Mon 7:20 PM



How about this scenario?? WE should end all out of country wars NOW!. retreat all forces from all lands NOW! Close all embassies, PULL them IN NOW! End all , I mean all foreign country giveaways(billions in the wind) In short , although it may hurt our democratic feeling in all the lands, it does mean we have money in the bank! Time to isolate, take care of our own, fix all infrastructure. Make products in this country. Companies making abroad pay tax.Loophoes gone. Train the young folks with good education., Please ask nicely to the wealthy to pay their share OR ELSE.... Do not let any AMERICAN in this country go hungry, homeless, or not have quality health care. Oh, by the way, have the folks we elect have the same entitlements we have, nothing more, so they can vote to keep it safe for them as well. GO TO CHURCH... WE need to embrace countries that have been with us, and MOVE away

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dendl

Mon 6:11 PM



Hey Readers,
It's official now. Gross has not only liquidated his Treasuries: He now is short! Remember! This is client money. That means he and his people must seriously consider their fiduciary responsibility also. Gutsy! Chad in CO

8 2

Jim90

Mon 4:48 PM



Why do all proposed solutions to our spending problems aim at the poor and needy while protecting the assets of the wealthy? Just look at the tea party recommendations - protect the tax cuts for the wealthy and put the knife to food and medical assistance for the underdogs. What bravery! And of course every solution takes a shot at entitlement programs, namely Social Security, Medicare, and the

like.

It's about time for us to open our eyes and see the BIG ELEPHANT in the room, Military Spending. We outspend the total spent by the next 20 highest spending countries! What kind of paranoia are we suffering from? Meanwhile, Bloomberg Business Week's cover story is on how the rich avoid paying taxes.

The primary ways to eliminate the deficit:


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hvasu46

Mon 4:03 PM



 So does it really matter that we pay for the runaway spending by rising inflation, quantitative easing or increased taxation? Or a combination of all three? Either way, we're going to pay. Just like we're paying for the real estate bubble. Everybody pays the price when you live in a country that applauds and fosters bad government and irresponsible management by voting for what you want but not what you can afford. There are no guilty and innocents, only guilty. Capitalistic socialism does not work.

15 2

Klaus Vonterinealis

Mon 2:51 PM



Quickly, we need to get the chinese trade imbalance under control, either with huge tariffs, or limits on imports. We need to quickly work on the huge illegal immigrant problem and all the entitlements they consume. I'm sure most illegals are just trying to feed their families, but we don't have the luxury of allowing this to happen anymore. Over sixty percent of our nations prison population are latino. These are the facts and have no basis in any sort of bigotry or racism in my opinion.

The move for all the political correctness and multiculturalism started by Clinton and his cronies have allowed these government programs and all their waste and abuse ruin it for citizens who really need help. People who've worked and paid in all their lives for it; a crime it is.

10 7

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Mon 1:51 PM



Well my theory of inflation being tied directly to Federal Reserve interest rate is correct I predicted when the Federal Reserve lowered the Fed rate to zero that we would not have any inflation and that has proven true. Also when the Federal Reserve raises interest rates the interest rates raise. Note that Europe and Australia and China all have high interest rates China the highest inflation rate also has logically the highest Fed rate.

We are suffering from a bit of inflation as most of our goods are imported from areas with high inflation read China and the middle east oil. But this is off set by the huge drop in the price of housing which is still dropping. The government can claim inflation is zero however as most of us have not brought a house this year we are stuck with highly inflated house notes from by gone years and as our house

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MirageGuy

Mon 1:48 PM



What happened in Wisconsin is a good thing...

No longer will a Union feed off the public... Unions were nothing more than a scam to funnel money to the democratic party.... The democrats agreed to insane pay hikes, the union in turn forced the teachers to give them money, and they immediately rewarded the politicians with said taxpayer money...

Their GREED did them in. What do public servants need unions for? To protect them from big bad government? Give me a break, the argument is insane on the face of it...

Public unions should be VOLUNTARY. Public unions should be BANNED from making any political

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DTWD

Mon 12:47 PM



"...but by picking the pocket of savers via a combination of less observable, yet historically verifiable policies -- inflation, currency devaluation and low to negative real interest rates."

Exactly! Dont you think the government has their think tank ****s doing the math AS WE SPEAK on

how to manipulate our current economic state to their benefit? All of the money in this country ultimately belongs to the federal government anyway right? Its got their name on it....they just so happen to ALLOW us to keep some of what WE earn so we dont get pissed and revolt.

This country has bastardized the 'American Dream' and is continually discarding everything I grew up thinking was what made this country great. I find myself more and more ashamed for being American.

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26 4

gamerk316

Mon 12:37 PM



For the record, in regards to inflation: Considering inflation is still at historic lows, I fail to see why everyone is jumping off their rockers. Even in normal times, 2-3% inflation is NORMAL, and we're well below that. Secondly, inflation rises as consumers spend more [as per rules of capitalism: demand increases, supply remains the same, so price increases], hence why inflation ALWAYS rises following a recession until hiring improves to strengthen the supply side of the price equation.

I also note: Regan had a 10.8% unemployment rate and over 17% inflation three years into his presidency, so far, I'd say Obama's 10.1% and <2% compares quite favorably.

9 37

gamerk316

Mon 12:33 PM



Looks like Bill is really off his rocker tonight...

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eagz

Mon 12:16 PM



I wonder if anyone can tell me what would be worse having a higher inflation rate, or stop both wars, - not interfere in other countries problems, and pay a higher tax on us individuals and corporations.

I am not sure but a guess in stopping the Afghanistan and iraq wars might save us 300 to 400 billion a year or more. I was thinking of a 5 or 10% surcharge on taxpayers and all corporations. That surtax is to go only in paying our debt down, I would think doing what that group suggested to our president to fix social security and get rid of the health bill.

I would like to see more money for medicaid and raise the low income level on medicaid so more people will be covered. This country is a mess because us the people of this rich nation let our government run ramped. Now we will have to tighten our belts and force the government to bring their

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is a nightmare

Mon 12:09 PM



you're right MirageGuy they said they is not inflation haw could they know if they don pay for anything like everybody does

8 2

MirageGuy

Mon 12:05 PM



Simple souldion...

I remember Jimmy Carter... Buy Gold, Silver, Invest overseas, Buy foreign currency... Canadian/Australian Dollars, Swiis francs.

DUMP DOLLARS. Avoid GOVERNMENT BONDS!!! You will be OK... Let the Donkeys hold their dollars and watch them be inflate dto half value in the next two years.

My Silver Eagles that I bought at \$8 are well north of \$40... But their is no inflation.... LOL

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21 1

is a nightmare

Mon 11:53 AM



why politicians make so much money they don't pay for s__t anyway and they don't do anything but to see who is better republicans or democrats, they should all forget witch party they are from and thing from witch country they are from n start working in something good for their country and make people

believe in the great american dream.

what happened to the USA where everything was possible?

17 1

rdoi

Mon 11:42 AM



If you hate constantly rising prices, tell your congressional representatives. The Fed is merely doing what congress wants it to do.

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