N obody who has even a passing acquaintance with economics could fail to realize that Western governments are highly indebted. On both sides of the Atlantic, budget deficits have increased continually as government expenditures on health care and public pensions spiral. As debt-to-GDP ratios increase further, investor confidence in government commitment to repay debts will erode. The problem, at its root, is that current generations have been consuming at the expense of future generations.

In *The Government Debt Iceberg*, a new research monograph published by the Institute of Economic Affairs, Cato senior fellow Jagadeesh Gokhale argues that in order to deal with fiscally overextended governments, structural changes are needed to bring these public programs into balance. “Europe and the United States will soon begin to encounter fiscal constraints the like of which we have never seen before,” he writes. But the official numbers don’t even begin to scratch the surface of the true magnitude of the problem.

A country’s national debt is, in effect, the accumulation of all the historical budget deficits. “It is therefore almost entirely a backward-looking measure,” Gokhale notes. It doesn’t take into account the future commitments that governments have made. “No private sector firm would be able to present accounts in this way.” Using a combination of micro-data survey information and official budget projections, Gokhale reveals the extent of public indebtedness across both the United States and the European Union (EU).

If both Social Security and healthcare programs are included, the U.S. fiscal imbalance is 9 percent of the estimated present value of future U.S. GDP—meaning that an additional 9 percent of GDP in tax revenues would have to be levied each year. Closing this fiscal gap would involve more than doubling federal payroll taxes. Therefore, if current unfunded spending commitments to future retirees are included, the U.S. fiscal imbalance is about seven times the published figure. In other words, “only about one seventh of the U.S. government debt is visible to the electorate,” Gokhale writes.

“The underlying fiscal situation in the EU is worse,” he continues. The ratio of workers to retirees in EU countries—which currently stands at between three and four—is projected to decline below two workers per retiree by the middle of this century. Combined with future social insurance commitments, this demographic situation will leave the EU with an average fiscal imbalance of 13.5 percent of the present value of GDP. This translates, on average, into a 23.2 percentage point increase in the consumption tax rate if taxes are going to fully finance spending—though this assumes that such a rise is feasible.

What else can be done to address these crises? It is unlikely that countries will be able to grow their way out of their implicit debts. Instead, countries will need to rein in their spending commitments and programs. “Rather than allow financial markets to force such a course of action with unpredictable results for ordinary citizens, it would be better to anticipate these problems and seek a more controlled resolution of national fiscal imbalances by political leaders in both the United States and the EU,” Gokhale writes. He offers a number of clear-headed prescriptions—from adopting forward-oriented metrics of indebtedness to developing a policy environment that encourages savings and investment—that will act as “a sensible compass for navigating a less volatile course.”

Ultimately, each country has its own governance structure fiscal framework. “The one constant, however, is that, in good times and bad, governments throughout the West have adopted policies that impose huge fiscal burdens on future generations,” Philip Booth, editorial and program director at the Institute of Economic Affairs, writes in the book’s foreword. “The electorate is grazing a fiscal commons at the expense of future generations.” As Gokhale shows, the first step in addressing this crisis is understanding it clearly.

**Gokhale’s new monograph takes taxpayers below the surface**

**The Government Debt Iceberg**