



Investment Insights

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When The Safety Net Fails

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Americans were shocked by the images of thousands of people in the Gulf Coast stranded, starving, dying in the wake of Hurricane Katrina. The news organizations referred to these people as “refugees”, but the idea of American citizens being refugees in their own country was too unpalatable, so they were later referred to as “evacuees”. The outcry over the failure of the Federal government to adequately respond to this disaster was swift and overwhelming. Now, Congress has pledged \$60 billion for disaster relief, and the number is expected to grow, possibly ending up north of \$100 billion.

How could the government fail to care for it’s own citizens? Isn’t the job of our government to care for the safety and well-being of its citizens?

In one dramatic natural disaster, America’s internal weakness has been exposed. Simply put, the Federal government’s ability to perform a function as vital as caring for US citizens is not as strong as we expected. Resources are stretched too thinly, and money is very tight. We have little or no “cushion”, and the concept of “money saved for a rainy day” is so far from reality in politics today, it’s laughable. The economy has grown at 3% or greater for eight straight quarters, and over a million new jobs have been this year alone, yet we’re the largest debtor nation in the world, and extending our lead at an alarming pace.

Prior to this catastrophe, the Federal deficit for this year alone was predicted to be over \$300 billion. With the Katrina response, the number is more likely to be near \$400 billion. Speculation about the government’s ability to continue to run huge deficits has many fearing a “melt-down” in the currency markets and US economy. Talk has begun about not extending the capital gains and estate tax reform initiated in 2001, and some have already called for an increase in income tax rates. Increasingly, the government’s ability to write an endless number of checks is running out.

Regardless of your position on how justifiable our government’s use of resources has been in the recent past, everyone should be concerned about what lies ahead. Hurricane Katrina was an unexpected disaster, but there are a number of disasters on the horizon that are very visible and will demand a response far greater than what Katrina required.

The biggest issue looming on the horizon is Social Security reform. By most accounts, the Social Security system will be broke by 2041. The current cost of the bailout

proposed by the Bush Administration is roughly \$1 trillion. This is equivalent to 1,000 Hurricane Katrinas. That number increases every day, rising to an estimated \$11 trillion to keep the system solvent for generations to come.

In the private sector, pension funds are currently “under funded” by an estimated \$350 billion. Just this past month, Northwest Airlines and Delta both proposed to turn over a cumulative \$16 billion in "under funded" liabilities to the Pension Benefit Guarantee Corporation (PBGC). The PBGC is already nearly insolvent, and ultimately many predict the Federal government will have to undertake a massive bailout of that program to cover the forecasted \$70 billion deficit in 10 years.

These are but two of the more visible storms gathering on our horizon. Rebuilding the educational system, repairing the infrastructure of our country, and addressing the economic inequalities exposed by the Katrina disaster are just a few of the many issues the government faces in coming years. On top of this, what will the unknown bring?

Unfortunately, the nature of politics and “feel good” policies are not a good environment to make tough choices and face up to reality. It’s much easier to shrug off these issues and let future leaders deal with them, pacifying the public into believing the government will ultimately take care of everyone and everything. Failure is not a possibility; the government could never let everyone down.

Maybe in the wake of the response to Hurricane Katrina, it’s time to rethink just how strong that safety net is...

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