

ISSUES IN PERSPECTIVE

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PERSPECTIVE NUMBER ONE

THE FINANCIAL CONDITION OF THE UNITED STATES

I believe that God desires for us to be optimists about the future. After all, our confidence and trust is in Him. However, the Bible also talks much about foolish decisions. Further, the Old Testament wisdom literature speaks much of discernment, which among other things is insight into the consequences of our choices. Can we exercise discernment when it comes to analyzing the American economy? Answering that question is the content of this *Perspective*.

- First of all, a word about the US federal deficit. As the *New York Times* recently reported, the US Treasury will soon face a “trifecta” of headaches: a mountain of new debt; a balloon of short-term borrowings that come due in the months ahead; and interest rates that are sure to climb back to normal as soon as the Federal Reserve decides that the financial emergency has passed. With the national debt now topping \$12 trillion, the White House estimates that the US government will need to service its debt at a cost of over \$700 billion per year by 2019, up from \$209 billion this year. Some forecasters argue that the debt service could be much higher. Put another way, an additional \$500 billion a year in interest expense will total more than the combined federal budgets this year for education, energy, homeland security and the wars in Iraq and Afghanistan. There is therefore little doubt that the US long-term budget crisis is becoming too big to postpone, for the US government debt has doubled in the last two years alone! The US will face, as the *Times* puts it, “. . . political battles over the size and role of government, the trade-offs between taxes and spending, the choices between helping older generations versus younger ones, and the bottom-line questions about who should shoulder the burden.” So far, the demand for Treasury securities from investors and other governments around the world has remained strong enough to hold down the interest rates the US must offer to sell them. Indeed, the government paid less interest on its debt in 2009 than it did in 2008. Investors have viewed Treasury securities as the least-dangerous place to invest. In addition, the Federal Reserve has done everything it could to drive interest rates down.

But all of this will change. Investors are already shifting money to riskier investments like stocks and corporate bonds, as well as countries like Brazil and India. And the Federal Reserve is beginning to end its actions, to some extent. All of this means that the United States will need to pay much more to refinance its huge debt, for the upward pressure on government debt interest rates will intensify. (An increase of 1 percentage point will cost an additional \$80 billion.) Estimates are that the US will need to borrow about \$3.5 trillion more over the next three years. On top of that the Treasury will need to refinance or roll over a huge amount of short-term debt that was issued during the financial crisis. Treasury officials estimate that about 36% of the government’s marketable debt—about \$1.9 trillion—

is coming due in the months ahead. The increase of debt-to-GDP will increase to almost unimaginable numbers. For example, the Congressional Budget Office estimates that the Obama administration's planned budgets will increase the debt-to-GDP ratio from 41% in 2008 to 82% in 2019. We are up against a massive wall of debt! What should the US government do? There are really only four possible scenarios:

1. Raise taxes/cut services—the problem here is that so much of the obligations of the government are already committed—Social Security, Medicare and the interest on the debt. Besides, to cut services or raise taxes is politically dangerous and probably will never happen.
2. Inflation—permit inflation to rise, which would erode the value of the debt. Foreign investors would be angry and the buying power and standard of living will fall.
3. Default—this is hardly realistic for it would create a worldwide economic panic.
4. Growth—if the economy grows significantly, then tax revenue would increase significantly as well, allowing the government to pay down debt.

Obviously, none of these solutions is attractive, but one of these will occur. Except for the last one, all are terribly painful. The US will now need to deal with its profligacy and its entitlement programs that are now out of control. Remember as well, that none of these projections factor in realistically the cost of a new health care package.

- Second, consider the effects the various health care proposals will have on the United States. Mortimer Zuckerman, editor-in-chief of *US News and World Report*, argues that the new programs being proposed in Congress will increase our health insurance premiums for the typical family by more than \$1,200 per year and roughly double health-care spending in the next decade from approximately \$2.2 trillion, or 16.2% of GDP in 2009, to over \$4.3 trillion, or 20.3% of GDP by 2019. “And this is based on estimated ‘budget cuts’ that cannot be relied upon.” Furthermore, history tells us that we simply cannot rely upon projections about health care. The House Ways and Means Committee projected that the first-year cost of Medicaid would be \$238 million; instead, it was over \$1 billion. It now costs 37 times more!! Medicare is no better. In 1965, Congress estimated that it would cost \$12 billion in 1990, when its actual cost was \$90 billion. The number of Medicare beneficiaries from 1985 to 2005 rose 37%, but the total Medicare spending jumped by the astounding factor of 372%, from \$71.4 billion to \$336.9 billion. As Zuckerman contends, “The same underestimation of costs undoubtedly applies to the roughly \$900 billion proposal before Congress. The true costs are understated because most of the provisions that expand costs do not take full effect until 2014. . . The ‘reform’ bill’s unfunded liabilities would exceed \$9.2 trillion. That is breathtaking.” We are on the path of fiscal meltdown!! The current administration has put this entire health care debate under the pretense of moral superiority. Medical care is now a right and the US government will ensure that you have a way to pay for this right. In effect, the creation of a new entitlement program is not morally superior; it is incompetency in governing. This legislation, whatever its final form, will most likely produce an unsustainable deficit and the ultimate collapse of this economy. The US simply cannot expect to borrow the costs of the health care proposal. This is not in the national interest.

See Robert Samuelson in *Newsweek* (23 November 2009), p. 21; Mortimer Zuckerman, *US News* (December 2009), pp. 95-96; Edmund Andrews in the *New York Times* (23 November 2009).

PERSPECTIVE NUMBER TWO

COULD THE FINANCIAL CRISIS FOSTER THE DECLINE OF THE US?

The answer to this provocative question is unequivocally yes. Niall Ferguson, Harvard historian, lays out a scenario where this could likely occur. He begins by probing the borrowing binge of the US. Unless entitlements “are cut or taxes are raised, there will never be another balanced budget.” The challenge, of course, is the unfunded liabilities of the US entitlement programs. If one calculates the net present value of the unfunded liabilities of the Social Security and Medicare systems, one recent estimate puts them at about \$104 trillion, 10 times the stated federal debt. Such a number is simply unimaginable! Who will buy the Treasury securities to fund this liability? There are only two real answers: The Federal Reserve, which bought the bulk of Treasuries issued in the second quarter of this year, and foreigners, who bought about \$380 billion. So, let’s focus for a moment on the foreign element. Currently, the People’s Republic of China holds about 13% of US government bonds and notes in public hands. At the peak of this process of reserve accumulation, back in 2007, it was absorbing as much as 75% of monthly Treasury insurance. Will they continue to buy up our debt?

Ferguson notes rather powerfully that history supports the proposition that major financial crises are followed by major fiscal crises. History demonstrates that in the wake of debt explosions, countries have done two things: Default on their debt or allow inflation to make the debt less valuable. He writes that “The history of all the great European empires is replete with such episodes. Indeed, serial default and high inflation have tended to be the surest symptoms of imperial decline.” History demonstrates that as interest payments eat into the budget, something has to give—and that something is nearly always defense expenditures. “According to the CBO, a significant decline in the relative share of national security in the federal budget is already baked into the cake. On the Pentagon’s present plan, defense spending is set to fall from above 4% now to 3.2% of GDP in 2015 and to 2.6% of GDP by 2028.” Ferguson concludes that “This is how empires decline. It begins with a debt explosion. It ends with an inexorable reduction in the resources available for the Army, Navy and Air Force. . . . If the United States doesn’t come up soon with a credible plan to restore the federal budget to balance over the next five to 10 years, the danger is very real that a debt crisis could lead to a major weakening of American power.” The precedents from history are there—Hapsburg Spain defaulted on all or part of its debt 14 times between 1597 and 1696. Prerevolutionary France was spending 62% of real revenue on debt service by 1788. The Ottoman Empire went the same way. Finally, Great Britain by the interwar years was finding that interest payments were consuming 44% of the British budget, making it difficult to rearm in the face of Nazi Germany’s threat. Ferguson concludes that “without radical fiscal reform, it could apply to America next.”

The arrogance of the current administration and the current Congress is that the United States alone will be history’s exception. I am rather confident that the US will not be that exception.

See Ferguson’s essay in *Newsweek* (7 December 2009), pp. 40-44.

PERSPECTIVE NUMBER THREE

WISE COUNSEL FROM ISAIAH

In one of the Bible studies I lead, we are studying the book of Isaiah. In many ways this book is the Bible in miniature. As there are 66 books to the Bible, so there are 66 chapters to Isaiah. Messianic themes are prevalent throughout the book and some of the most important prophecies about Messiah are found here (e.g., the virgin birth of Isaiah 7 and the suffering servant of chapter 53).

But I draw your attention to the penetrating and pithy review of Judah's leadership shortly before the Babylonian conquest of 605 to 586 BC. In Isaiah 5:20-23, we read these convicting words:

“Woe to those who call evil good and good evil, who put darkness for light and light for darkness, who put bitter for sweet and sweet for bitter.

Woe to those who are wise in their own eyes and clever in their own sight.

Woe to those who are heroes at drinking wine and champions at mixing drinks, who acquit the guilty for a bribe but deny justice to the innocent.”

As I study these verses, it seems as if these verses are describing our leaders and our culture. What an indictment of America! As God judged Judah for its sins, it is difficult to believe that God has not already begun judging our nation. But as the book of Isaiah reminds us, our hope and our future rest with God and His redemptive plans. So, at the Christmas season, our minds quickly turn to another chapter in Isaiah—one filled with the hope of the Messiah—Chapter 9:6-7:

“For unto us a child is born, to us a son is given, and the government will be on his shoulders. And he will be called Wonderful Counselor, Mighty God, Everlasting Father, Prince of Peace. Of the increase of his government and peace there will be no end. He will reign on David's throne and over his kingdom, establishing and upholding it with justice and righteousness from that time on and forever. The zeal of the LORD Almighty will accomplish this.”

Amen and Amen!!