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Gleanings

Day of Reckoning



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In my freshman year at the University of Texas, I took a geology class. The class met at 8:00 a.m. on TTS, which stands for Tuesday, Thursday, and Saturday. Needless to say, having a Saturday morning class was not exciting, but it was the price I paid as a first-year university student.

This was a large class consisting of several hundred students who were taking the course as a requirement for their various degree programs. One Saturday the professor walked into a class full of sleepy freshmen and announced, "There is no day of reckoning." I remember perking up from my drowsy state wondering what he was talking about. The mystery was soon revealed—the geology professor had decided to render his opinion on economics.

The professor made this comment at a time when the federal government was incurring budget deficits associated with the Vietnam War. At that time the federal debt was approximately \$300 million. Today the federal debt is approaching \$12 trillion and is currently growing at a rate of approximately 10 percent annually.

According to my research, the federal government has been in debt continuously since the War for Independence more than two hundred years ago. Congress "manages" the debt by imposing a debt limit. This provides a boundary of sorts, but the reality is that Congress can raise the limit any time it chooses.

The purpose of the debt limit is to maintain a manageable debt service level. If the debt service soars, the federal government's ability to pay its obligations is impaired. Currently, approximately 20 percent of the federal budget is allocated to pay interest on the debt.

The philosophy of finance practiced by the federal government is based on the assumption that there will be investor demand for federal debt at a reasonable interest rate so that the interest payments stay within the desired limits. So far, this assumption has been correct, but will it continue to be?

The Chinese and Japanese, owners of a major portion of the US debt, have signaled the desire to reduce their holdings. If they follow through, there may be a significant lack of buyers for the debt, which will put upward pressure on interest rates. This would increase the portion of the federal budget required to service the debt.

If demand for US debt begins to wane, it could produce a domino effect. Such a scenario could occur quickly, placing unexpected financial pressure on the federal government. Such pressure would impair the government's ability to pay its bills. Taxes would increase dramatically, putting a serious damper on the economy. And if the federal government started printing more money, inflation would heat up, creating what economists call *stagflation*—high interest rates (i.e., slowing economy) and high inflation (i.e., rising prices).

The risk for stagflation seems to be increasing and it would be wise to explore the potential implications. There are three scenarios to consider: bankruptcy, banana republic, and dictatorship.

- The idea that the federal government could go bankrupt is almost unthinkable. Bankruptcy is the logical and natural end of any organization that lives beyond its means. We know this is true for individuals and organizations, but surely not government—right? After all, government can always increase taxes if necessary, so how could government go broke?

This common thinking fails to recognize that government cannot increase taxes without consequences. The tax burden on citizens is a major cost factor and dramatically changes the economic environment. Hence, it is not a given that government can tax its way out of financial calamity. Government must learn to live by the rules of finance, which means that, just like everyone else, government can go bankrupt.



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Generally, an organization that declares bankruptcy sells its assets to satisfy its creditors. If the federal government faces bankruptcy, it may sell some of its assets—national parks (such as Yellowstone), federal buildings (such as the White House and the Capitol), and other assets (such as the 600 million ounces of gold in Fort Knox and the 727 million barrel Strategic Petroleum Reserve).

- The second scenario is a banana republic. The term refers to a third world country that is largely disrespected by the global community. According to Wikipedia, “a banana republic is a pejorative term for a country that is politically unstable, dependent on limited agriculture (e.g. bananas), and ruled by a small, self-elected, wealthy, and corrupt clique.” (Source: http://en.wikipedia.org/wiki/Banana_Republic) When you consider the noncompetitive state of US manufacturing and the entitlement mentality of US citizens, it is not difficult to see how a banana republic could form in the United States. The devaluation of the dollar evidences the loss of confidence that other countries have in the US and could be a harbinger of a coming banana republic. In essence, if the US became a banana republic, it would lose its military, political, and economic leadership role in the world.

- Finally, stagflation could produce an economic calamity that might be the end of the US democracy and lead to a dictatorship. Political pundits state that democracies fail when government cannot pay for the entitlement programs demanded by the electorate. This situation opens the door for a dictator who promises to solve the financial crisis.

None of these scenarios is appealing. So is there a solution?

One solution to the impending financial calamity would be fiscal responsibility. Fiscal responsibility is living within the government’s means, including balancing the budget and implementing a credible plan to pay off the debt. To do this would require personal sacrifice on the part of the US population. For example, many government programs would need to be eliminated. Of those not eliminated, many would be greatly reduced. Many government workers would be forced to find employment in the private sector. And the standard of living for the majority would probably be reduced. These measures may sound harsh, but this is the only viable way to balance the budget and begin to pay off our debt.

The reward for fiscal responsibility would be enormous. The United States would continue (or regain its status) as an esteemed world leader. American goods and services would be globally competitive. Our heirs would enjoy the blessings of financial stability and the great American experiment with democracy could continue.

Are these rewards worth the sacrifice? They are to me, how about you?

Sadly, I have not read about any recent discussions in Washington regarding a balanced budget, much less a plan to pay off the debt. Instead, Congress and the Obama administration continue to increase government spending and therefore increase the debt. Soon taxes will be raised even though the US economy is very weak. The illusion appears to continue—there is no day of reckoning, just as my geology professor claimed.

But the reality is that there is a day of reckoning for sin (see Hebrews 4:13). Fiscal irresponsibility is sin; hence, there will be consequences. Solomon warned of the danger of debt when he said:

Do not be a man who strikes hands in pledge or puts up security for debts; if you lack the means to pay, your very bed will be snatched from under you.
Proverbs 22:26-27 NIV

On some level debt is always presumption—the presumption that we can repay the debt. Since no one knows the future, we must be very careful about incurring debt. It is hubris to assume that any organization can build its debt level interminably with no plan to balance the budget and pay off its debt. Any organization (or government) that does this is playing the role of the fool.

No wise individual or business owner would operate this way. Individuals and businesses should understand the basic rules of finance that God put into His universe. Two of these basic rules are:

- A person or organization must live within his [its] means.
- A person or organization must pay his [its] debts.

As simple as these economic principles seem, they are sound. These principles work for everyone and every organization—including the federal government.

I have a suggestion for our government leaders. Instead of increasing the debt with more entitlements and bigger government, make it a priority to balance the budget and develop a plan to pay off the debt. This is the only way that we can return to a stable robust economy. If we don’t do this, the people of the US are facing bankruptcy, a banana republic, and/or a dictator form of government.

Personally, I am willing to sacrifice now to enable my heirs to avoid these scenarios—are you?

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