

Do we have a lack of will?

On March 22, we were blessed with our seventh grandchild – and first grandson. With grandchildren in three different states it is nice to have another one living in town. If you have children or grandchildren you understand that there is a distinct difference in how you feel about “your” baby versus the other babies in the nursery. We have a unique ability to care deeply about “our” newborn, more so than someone else’s newborn. I am truly a proud “papa” (I am told that I am not old enough to be called “grandpa” yet!).

I mention this fact because I wish we would look at the current financial issues facing our nation as a proud grandparent would look at it on behalf of their grandchild. Is the current financial condition of the United States really what we want to leave for our grandchildren? Spending way more than we take in, accumulating massive amounts of debt, arguing over \$60 billion dollars in “spending cuts” when we spend almost \$4 trillion dollars a year (less than 2%), borrowing 43 cents of every dollar we spend. Is this the America I want to leave my new grandson?

I would like to quote a portion of a letter written to Senator Harry Reid by Addison Wiggen, executive publisher, Agora Financial; co-author of *“Financial Reckoning Day and Empire of Debt”* and executive producer, writer of I.O.U.S.A. (1)

“Imagine for a moment that you’ve chosen to smoke cigarettes all your life. You’ve ignored the warnings about them that appear all around you. Then, eventually and unfortunately, you get diagnosed with lung cancer.

Luckily, you’ve caught the disease in its early stages. The doctor presents you with two choices.

First, you can enter chemotherapy. The road to recovery, the doctor tells you, will be harsh. You’ll suffer extreme nausea. You’ll hardly be able to swallow from the ulcers you develop in your mouth. In short, you’ll go through hell in an attempt to beat the disease. But because you caught the disease after the first symptoms appeared, you have a high chance at a full recovery.

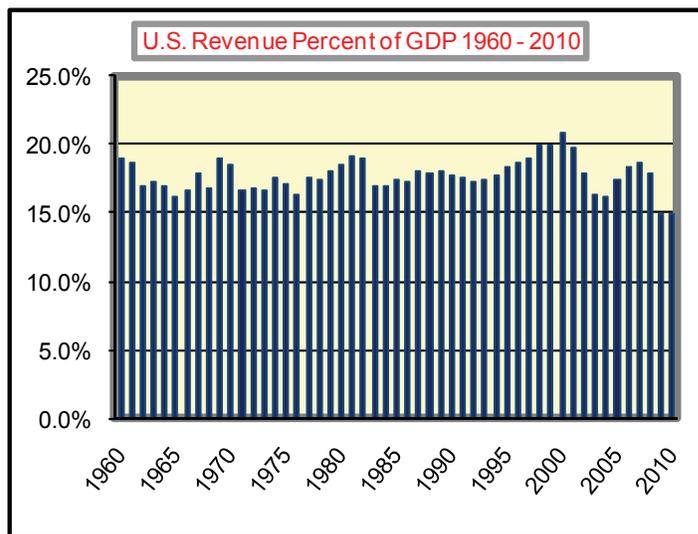
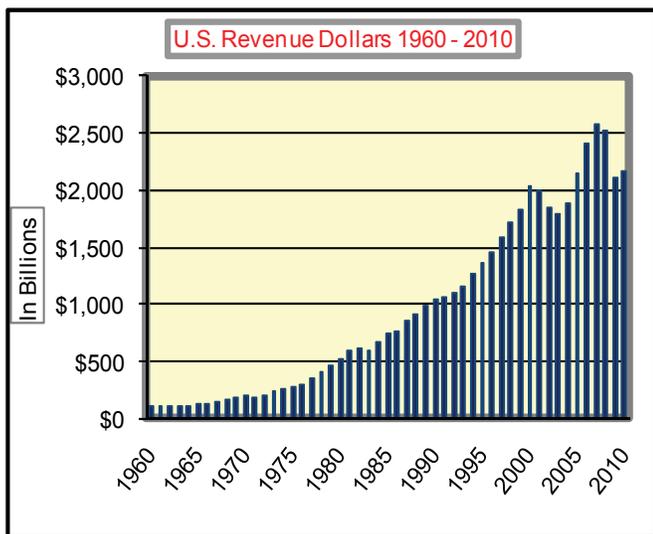
The doctor also offers a second alternative. He’s worked out a deal that allows you to rid yourself of the disease instantly. No pain. No suffering. No hell. All you have to do is agree to give the disease to your 2-year-old grandson.

Would you make that deal...?”

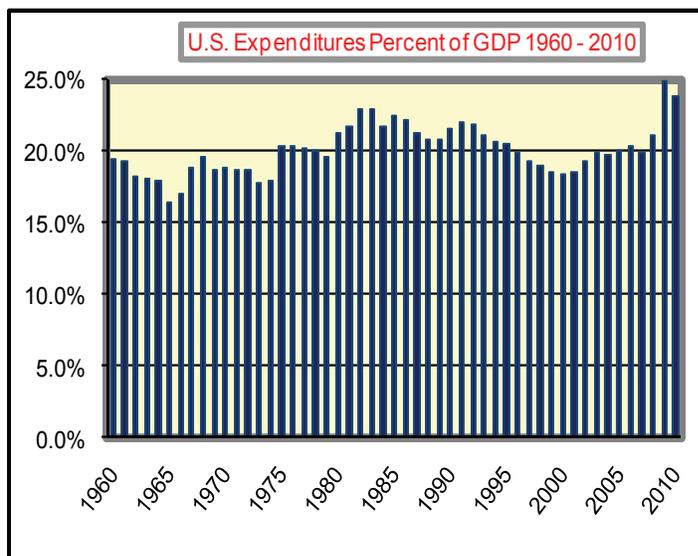
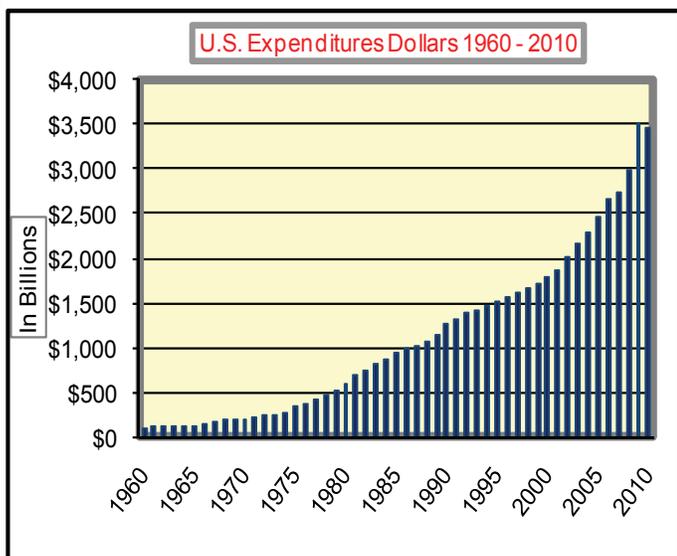
I quote from this letter because it is one of the most explicit pieces I have read on this subject. This is not a problem without solutions – it is a problem of lack of will. A lack of will from our political leaders to do what must be done. A lack of will by voters who will “lose” what they now have and what they believe they are entitled to. And a lack of will from those who will “lose” what they believe has been promised to them in the future when in fact the promise has no financial backing.

Let's turn to some numbers to see what this problem looks like. All data in the following charts is compiled from information obtained from www.usgovernmentrevenue.com (2)

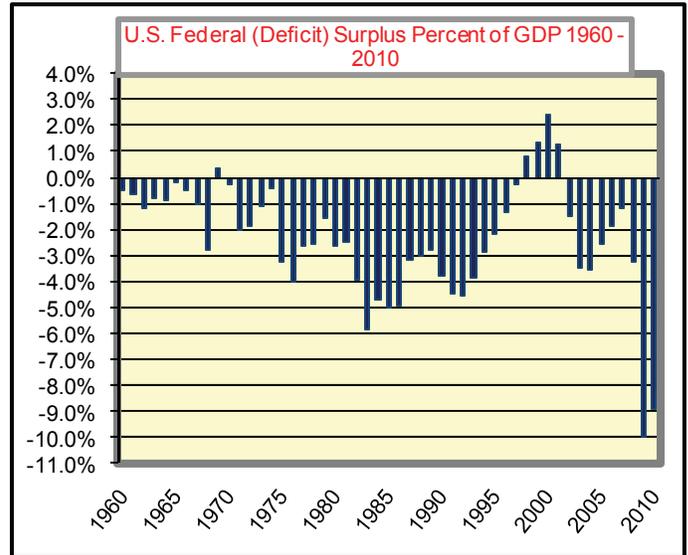
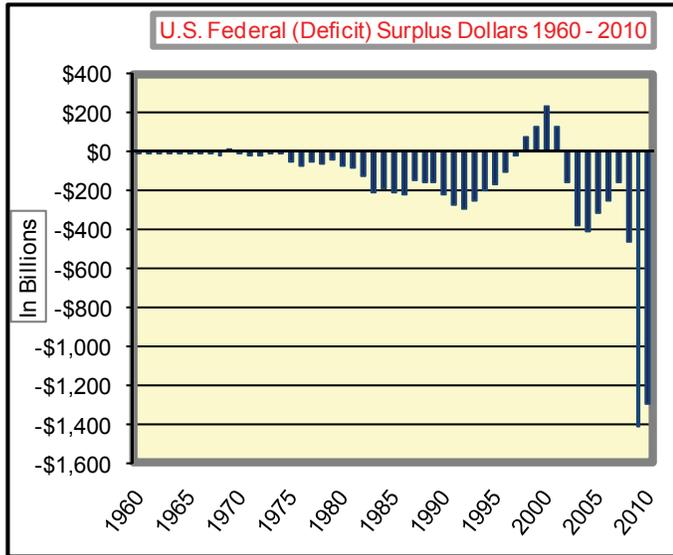
We will begin by looking at the amount of revenue the United States government takes in – both in dollars and as a percent of our Gross Domestic Product (GDP). The GDP is the nation's way of measuring all of the goods and services we produce in a year.



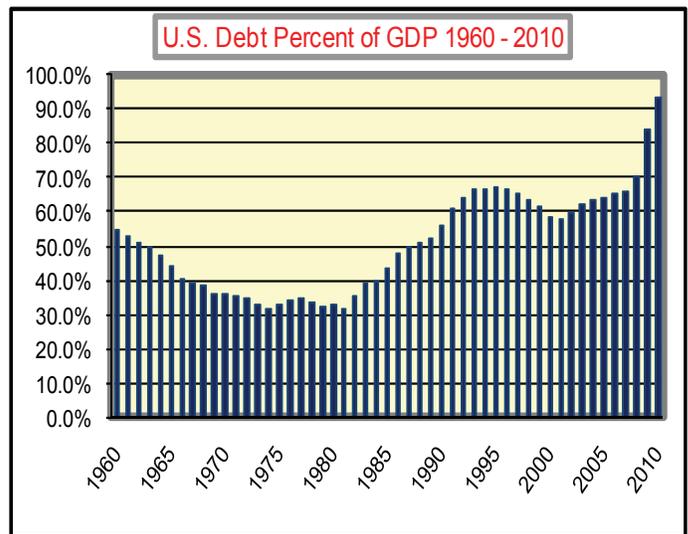
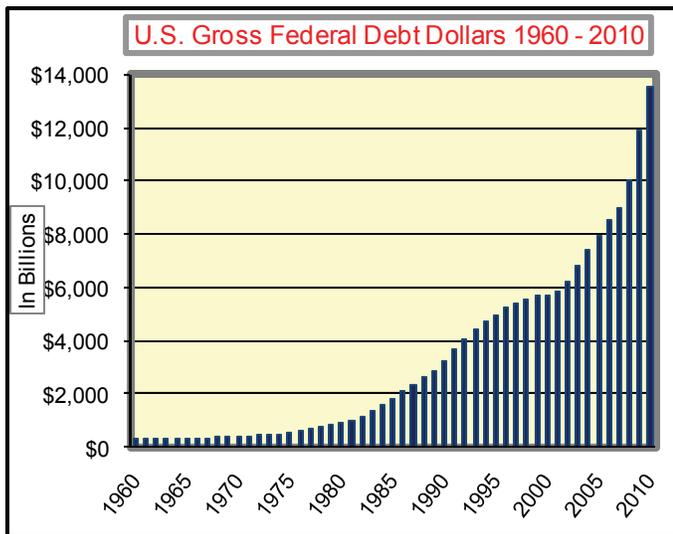
Next we will look at the amount of expenditures the United States government makes. This is the amount of cash actually spent (only cash spent – not promises made). Again, we will look both in dollars and as a percent of our GDP.



Then we will turn to the amount of the United States government's annual deficits, the amount it spends more than it takes in. Again, we will look both in dollars and as a percent of our GDP.



And finally, we will look at the amount of our gross public debt, the amount of money the United States government has borrowed, both in dollars and as a percent of GDP.



So, what do the numbers tell us?

Over the last 50 years, from 1960 – 2010, the United States government's revenue has increased 22 fold while their expenditures have increased 34 fold. Over the same period of time, the United States GDP has increased 28 fold while the gross public debt has increased 47 fold.

Shortening the time period to the last 20 years, from 1990 – 2010, the United States government's revenue has increased 210% while their expenditures have increased 276%. Over the same period of time, the United States GDP has increased 250% while the gross public debt has increased 418%.

Now shorten the period to the last 10 years, from 2000 – 2010, the United States government's revenue has increased 7% while their expenditures have increased 93%. Over the same period of time, the United States GDP has increased 49% while the gross public debt has increased 138%.

Whether we look at the last 50 years, last 20 years or the last 10 years, we see that the government's spending and borrowing has grossly outpaced their revenue and their GDP. Can you imagine what that would do to a business or a family's finances?

During the past few weeks, the Congress and the President passed a bill to complete the 2011 budget. This had not been done, even though the government's fiscal year started in October, 2010. The House wanted to cut \$61 billion from a budget of \$3.82 trillion – a reduction of less than 2%. But the Senate told them that was too much!! They couldn't find where to cut!! So, in a bi-partisan compromise they finally settled on \$39 billion (3) – roughly 1%!!!! Did I hear someone say lack of will??

In addition to the United States government's current debt obligations, it has made promises to pay future benefits in excess of the revenues set aside to fund the promises. A recent study claims that the United States government has promised to pay out an additional \$7.9 trillion for social security, \$22.8 trillion for Medicare and another \$35.3 trillion for Medicaid. (4) That is another \$66 trillion in unfunded promises my grandson will have to pay!

What are the implications of our financial mess? What impact will this have on the ability of the United States to maintain their status as the world's financial super power? Will my grandson's America be the same as my America? Let's look at some recent events that can give us insight.

First, let's start with looking at the current financial crises going on in Europe. So far Ireland (5) and Greece (6) have received bail-out packages from the European Union (EU) and the International Monetary Fund (IMF) to keep them from defaulting on their sovereign debt. In early April, Portugal (7) asked the EU for its own bail-out, as it could no longer raise affordable funds on the open market. And Belgium, (7) has become the fourth country to acknowledge it too is in trouble. The debt to GDP ratio for each of these countries is as follows: Greece 144%, Belgium 99%, Ireland 94% and Portugal 83%. (8) The U.S. debt to GDP ratio is currently over 90% and is expected to rise to 112% within the next two years. (9) How much longer will the United States be able to borrow and expect to make good on its debt obligations?

Second, United States Treasuries are considered the safest investment on earth. Yet, in the last month, two events have sounded a wakeup call to the U.S. government. In their April Investment Outlook, PIMCO, the largest bond fund manager in the world, said that they were getting out of U.S. treasuries because "they have little value". (10) Bill Gross, PIMCO's executive director, cited "Washington's inability to recognize the intractable: 75% of the budget is non-discretionary and entitlement based." He continues "unless entitlements are substantially reformed, I am confident that this country will default on its debt....you must attack entitlements and make "debt" a four letter word". (10) And then, on April 18 "Standard and Poors Rating Service lowered its long-term outlook for the United States sovereign debt to "Negative" from "Stable" due to risks from the country's growing deficit." (11) If the largest bond fund manager in the world won't buy our debt, and the rating agencies view our long term prognosis as negative – how can the United States government continue to finance its debt? How much longer can we spend more than we take in?

And finally, (for length of this letter – not lack of thoughts!), the U.S. dollar is considered the world's currency, accepted by every other nation in the world. For some time, that status has been the envy of the European Union and Japan.

However, now even emerging market countries are asking for, and will soon demand, a more active role in the world's finances. At their April summit, leaders from the BRICS countries (Brazil, Russia, India, China, and South Africa) released a statement that "enhanced economic power of the BRICS countries should entail an increased role for these countries' currencies in the international currency system, both on a global and regional level. In the future, this new basket of currencies should include both the Chinese yuan and the Russian ruble and the currencies of other BRIC countries." (12) As the United States continues to erode its finances, other countries will demand a more active role in the world currency debate. Could the dollar lose its place as the world's currency?

There will be two major financial decisions coming from Washington in the next few months. First, will the United States raise its debt ceiling? The United States will not be allowed to legally borrow funds after the ceiling of \$14.294 trillion (13) is met in early May. And secondly, there will be a battle over the size and makeup of the 2012 budget. As you listen to the talk show hosts, political pundits and our elected officials please keep my new grandson (or your children and grandchildren) in mind. Are they offering real solutions or just adding more "fuel for the fire" in partisan bickering?

I will end with this question - do we, do they - have the will to make tough choices? The problems will not be solved until everyone puts their selfish interests aside and starts looking at the America we are going to leave to our children and grandchildren.

Welcome to the world, grandson – I pray that we get our financial house in order and that the America you grow up in is strong and vibrant. I love you!

By: Jerry Vanderlugt CPA CFP®

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