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Towards a biblical mind

Prodigal stewards:

The looming government debt crisis and what to do about it

by Paul Mills

What has Posterity ever done for me? Robert Heilbroner

Blessed are the young, for they shall inherit the national debt. Herbert Hoover

Summary

During the recent financial crisis, governments borrowed as if they were fighting a world war. They have struggled to reduce deficits ever since and so their debts are at record levels, leaving societies open to the temptations of repression, default, or inflation. This is the poisonous legacy of the 'Prodigal' baby boomer generation that squandered not only their inheritance but that of their children too. Biblical wisdom helps us to understand the state we are in and the possible means of escape. But societies ultimately need a change of heart to understand that debt is financial servitude and we all have obligations before God to future generations.

Introduction

The Global Financial Crisis (GFC) of 2007–09 resulted in a step shift upwards in government debt as states became 'borrowers of last resort' to prevent another Great Depression.[1] With few exceptions, Western countries have struggled to control their borrowing and nearly all are now confronted with high or record levels of peacetime debt. This comes just as aging and shrinking populations and low income growth mean that there is no assurance that coming generations will enjoy the higher incomes needed to service the debt. Without interest rates being kept close to zero by compliant central banks and savers' strong appetite for bonds, governments would struggle even now to service their mountainous debts and would likely be forced to follow the recent examples of Greece and Argentina into default and 'restructuring'.

How have we arrived at this sorry state of affairs, in which the wealthiest countries have borrowed in peacetime as if they were fighting an existential war? And more deeply, how can we revive a sense of stewardship and fiscal responsibility, hoping to leave the government's finances in a healthier state for future generations? This paper will seek to discern God's wisdom revealed through Scripture on the vexed question of debt and stewardship, and apply it to how Christians should think about government borrowing today.[2]

> The abandonment of fiscal continence over recent decades suggests a deeper spiritual malaise.

The hole we have dug

Government deficits and debt in most high-income countries rose sharply from 2007. On the standard measure of gross government debt relative to gross domestic product (GDP), the UK's ratio rose from 44 per cent (2007) to 91 per cent (2013) with the US up from 64 per cent to 104 per cent. (IMF World Economic Outlook database.) However, debt relative to tax receipts is a cleaner measure of government creditworthiness. On this basis, the UK's debt rose from 1.2 years' tax receipts (2007) to 2.4 (2013), and that of the US from 2 years' to 3.4. A major concern is that all these ratios are set to

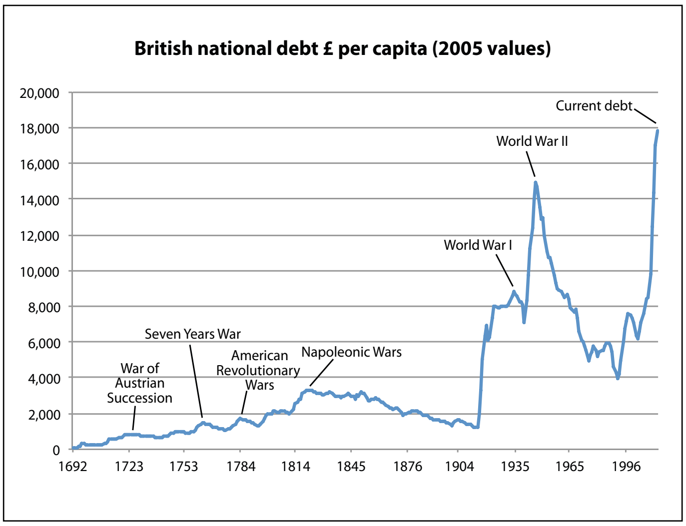
1 For an extended period in 2009, the US government borrowed over 40 per cent of every dollar it spent. The US gross Federal debt in US dollars has more than doubled over the six years of the Obama administration to $18 trillion.

2 This paper does not address the issue of what the appropriate role of government is, including how much it should spend and tax. Rather, the focus is on the persistent gap between the two and the reasons for closing it. It is a separate political choice as to whether taxes should rise, spending should fall or a combination of the two be adopted.

rise substantially further as healthcare and pension spending grows with an aging population, while new international security threats are likely to add to defence budgets.

Conventional justifications for government borrowing

High levels of government debt are nothing new. Indeed, the UK's debt relative to the economy was substantially higher after the Napoleonic Wars and the two World Wars. However, when adjusted for population and inflation, the UK government debt has grown so rapidly that it now exceeds the peak immediately after WWII (see chart). The differences this time are that the debt level has effectively doubled in peacetime to stabilize the economy after the implosion of the private debt system, and that there is no apparent political will to repay it. At best, politicians advocate returning to a balanced budget by 2020 rather than repaying this new debt. Indeed, Margaret Thatcher was the last British politician who stated the ambition to repay the National Debt, in the late 1980s.



Data source: www.ukpublicspending.co.uk

How has this unprecedented increase in peacetime debt come about? There are a number of pragmatic and often plausible justifications for continual borrowing given by politicians, with economists often giving their high-priestly blessing for such prevarication.

First, countries may face acute crises (such as wars or natural disasters) whose costs can be shared with future generations by borrowing, rather than being paid for entirely from current taxes. This allows the burden to be smoothed over generations rather than all being borne by one, in a manner akin to intergenerational insurance.

Second, the detrimental impact of a recession can be smoothed out if the government runs a deficit in economic downturns by not cutting spending along with everyone else. Just as banks become less willing to lend, and households and firms less willing to spend, the state becomes 'borrower of last resort' to maintain demand.

Third, the government may borrow to finance public investment in infrastructure (roads, hospitals, power networks etc.) or education spending, believing their 'returns' in terms of direct revenues or less tangible economic benefits will exceed the interest cost.

None of these justifications necessitate governments running continuous deficits over decades.[3] However, they rationalize the short-termism of elected politicians and are often cited as reasons why it would be damaging in any particular instance to run a budget surplus. Hence, the perpetuation of borrowing because 'now' is rarely the right time for a government to pay for what it spends.[4]

The underlying reasons for sustained government deficits

While there can be economic reasons to justify some temporary borrowing, the abandonment of fiscal continence over recent decades suggests a deeper spiritual malaise. The change in attitude can roughly be dated to the transfer of economic power and political influence from the WWII 'Greatest' Generation to that of those born after the war – the 'Baby-boomer' (or 'Prodigal') Generation during the 1980s and 1990s. To generalise, while the former made great sacrifices for those to come in the future through the post-war period, the latter acted as though it weighed its own gratification well above the interests of future generations.[5] Over a range of areas, from healthcare and generous final salary-linked pensions, to low mortgage costs and state funding for university education, it has enjoyed great privileges at wider society's expense only to then remove them from those following, for fear that the system was getting too costly. Hence, succeeding generations now face a lifetime repaying student loans and mortgage debt (to pay vastly inflated house prices) as well as the inherited public debt, even as their future healthcare and pensions are cut back.

It is no coincidence that the Prodigals' hedonistic sense of entitlement was accompanied by declining birth rates and the break-up of extended and nuclear families through mobility, divorce and cohabitation. Effectively, the spirit of the age asked 'Why should I make sacrifices for the future when I have so little invested in my few immediate progeny or extended family?' The erosion of the veneer of nominal Christianity facilitated the dropping of any pretence of a sense of stewardship towards future generations or an aversion to government (or personal) debt. The progressive acceptance of public deficits – even in times of prosperity – is thus the result of politicians of all persuasions giving the electorate what it 'wants': high levels of government spending without fully paying for it through taxation. Voters are effectively regarded as consumers of state services, wanting benefits now but not having the wherewithal to pay, and so wishing to push responsibility to those in the future.

Two secondary factors have exacerbated this tendency. The first was the near-unquestioned belief from the 1950s onwards that future generations would enjoy higher incomes than the current one through the fruits of technological

3 The French government has not run a budget surplus since 1974 and there is no prospect of one in the foreseeable future. The German government went from 1969 to 2013 without running a budget surplus but should do so in 2014.

4 To paraphrase Augustine, 'Give me prudence, Lord, but not yet' ever seems to be the cry.

5 In the terms of public economics, its social discount rate was very high. That is, when making decisions over investments and future spending commitments, it placed a high weight on income and consumption in the near term as opposed to that to be enjoyed in future decades.

progress and rising productivity. Hence the underlying assumption that future debt burdens would be lightened by rising incomes. In practice, however, this assumption was mistaken. Underlying per capita growth in the US and Europe has slowed noticeably since around 2000 as population aging set in, while growing income inequality means that the bulk of the working population is unable to shoulder the rising debt burden.[6] Rather than recognise the slowdown in underlying growth and cut borrowing accordingly, the Prodigals have borrowed even more to keep the pretence of greater prosperity alive.

The second factor was the volatility in public finances induced by the inherent instability of the debt-based financial system.[7] On the upswing, a relaxation in credit conditions and increasing private indebtedness boosts spending and tax receipts temporarily, fooling governments into believing that their underlying fiscal position is better than it really is. Under electoral pressure, governments often dissipate the windfall through permanent tax cuts or spending increases (as in the UK in the late 1980s and mid-2000s). But when a shock results in the credit cycle turning, the fiscal improvement proves to have been illusory, resulting in a ratcheting up of the underlying deficit. The experience of the UK and US from 2008 onwards has been an extreme version of this cycle, in which governments borrowed heavily not just to try to ameliorate a sharp fall in economic activity as credit conditions froze, but also to bail out the creditors of large banks who would otherwise have suffered substantial insolvency losses.


George Osborne

The threat of 'default'

Since the GFC, Western governments have accumulated ever-mounting debts financed at record low interest rates, thanks to central banks keeping policy rates close to zero and expanding the money supply by buying government bonds and private loans. In this way, the Bank of Japan has managed to keep its government from insolvency and financial system from disintegration for the 20 years since the bursting of its credit bubble, and so it is perilous to assert that the collapse of Western government finances is imminent. Nevertheless, such countries face grave risks as a result of their mounting debts.

First, as with Japan, heavily indebted countries are walking a knife-edge between high inflation on the one hand and deflation or default on the other. On one side, a sharp fall in the exchange rate and rise in inflation would reduce the real value of domestic debt but could quickly spiral out of control. On the other side, a prolonged recession threatens falling prices and a mounting real debt burden that can only be made affordable through outright default. A shock could easily tip a highly-indebted government either way as it risks reneging on its obligations through either inflation or default.[8,9]

Second, even if it avoids formal non-payment on its bonds, a heavily-indebted government is prone to renege on meeting its payment obligations on time and being forced to introduce controls on citizens' freedoms. These can entail more draconian tax powers[10] and means of financial 'repression' (which force savers to buy government bonds) or capital controls (to keep savings in the country). However, high rates of income and wealth taxation to service debt interest payments ultimately become self-defeating as the tax base shifts to lower tax jurisdictions, resulting in fewer and fewer taxpayers bearing an escalating burden.[11,12]

Third, heavily indebted governments often are forced to default on 'soft' commitments by making cuts to welfare, healthcare and pensions which recipients have come to expect. For most countries, substantial unfunded liabilities are mounting up in the form of unfunded future pensions, welfare, and healthcare obligations which will become harder to fulfil given aging and shrinking populations. The United States gross Federal government debt currently amounts to $18 trillion. If the present value of its unfunded pension, welfare, and healthcare promises is added, the 'true' debt has been calculated at approximately $200 trillion.[13]

More fundamentally, younger generations are likely to resent inheriting and servicing a large peacetime national debt in whose accumulation they had little or no voice or choice. This is especially likely when combined with potentially high

6 Median household real income in the US has stagnated in recent years and, in 2013, actually fell back to its level in 1988.
7 See the Cambridge Papers on the Ban on Interest (March 1993) and the Great Financial Crisis (March 2011) for a fuller discussion.
8 There is currently no legal mechanism for a government to enter into 'sovereign bankruptcy procedure' and restructure its debt. Argentina is still entangled in litigation with bondholders after its default in 2001.
9 When forced to choose, policymakers prefer to default via inflation rather than outright non-payment as inflation does not entail the stigma of a legal default or the possible insolvency of domestic banks through losses on their government bond holdings.
10 The Italian and Spanish authorities have recently outlawed all payments in cash above €1,000 and €2,500 respectively to combat tax evasion. In 2014, the UK Treasury proposed giving tax authorities the power to take disputed tax from bank accounts directly, without a court order. The plans were diluted after protests that they would have contravened rights protected for 800 years under Magna Carta.
11 Debt interest payments currently account for 10 per cent of UK government tax receipts, constituting the 4th largest spending programme (ahead of defence) even with interest rates at historic lows.
12 In addition to the secular decline of the US motor industry, the 2013 bankruptcy of the City of Detroit started with the excessive generosity and underfunding of municipal pension promises. As the pension burden mounted, those with higher incomes moved to neighbouring municipal areas to cut their tax bills.
13 G. Callegari and L. J. Kotlikoff, *Estimating the US Fiscal Gap*, TheCanKicksBack.org, 2013. The equivalent figures for the UK are £1.3 trillion (gross) and at least £5.5 trillion including unfunded liabilities (but excluding health spending).

student and mortgage debt, lower state and private pensions, and higher taxes.[14] The surprise is that the scorn for intergenerational equity shown by the Prodigal generation is yet to 'reap the whirlwind' of political or violent revolt by the young. Unless the problem is addressed, a Spartacan revolt of the debt slaves becomes ever more likely.

The unpleasant side effects of high public debt

As well as the risk of default and the potential for intergenerational injustice, high levels of government borrowing and debt induce several other vulnerabilities and temptations. For instance, reliance on deficit financing and the requirement to refinance maturing debt with more borrowing leave a country vulnerable to a loss of confidence by lenders. Government bonds are backed not by collateral but by a government's ability and willingness to tax its populace in the future. If the buyers of bonds begin to doubt the political will to do so, first interest rates rise and then, when a government is unable to borrow at any realistic yield, it either defaults (with consequential reputational damage and losses borne by banks, pension funds etc.), seeks emergency help from outside bodies (such as the IMF), or must immediately run a surplus of tax receipts over spending. In all cases, political freedom of action is lost. When a government's bonds are held disproportionately by official sector foreign buyers, the spectre exists that they may use bond sales as instruments of foreign policy (to influence other nations) or of war (actively to destabilize the debtor country's economy.)[15] Either way, heavily-indebted governments lose their freedom of policy manoeuvre and become subject to the will of their creditors.

In addition, a heavily indebted government will tend to look more favourably upon inflation. Most advanced country government debt is in the form of fixed rate nominal bonds. Hence, if inflation turns out higher than anticipated, the debtor government will benefit. However, if inflation turns out substantially lower than expected, or if prices begin falling, then the burden of a government's debt adjusted for inflation rises sharply. It is no surprise therefore that, since coming off the Gold Standard a century ago, the UK price level has risen roughly one hundred times because government is the main beneficiary of the 'inflation tax' on bondholders. A heavily indebted government will be tempted to allow the price level to rise, just as governments struggling to pay their bills face the temptation literally to print money to do so.[16]

Heavy government debt therefore has numerous malignant consequences. It poses the risk of outright default, results in the loss of political independence, biases governments to accommodate inflation, and facilitates intergenerational injustice.

A biblical response

There is no biblical material that directly refers to the issue of government debt. The very concept was largely unknown until the seventeenth century when first the Netherlands and then the British state borrowed for the first time as a corporate entity. In Britain's case this was in 1693, via the newly-established Bank of England during the reign of William and Mary. Before this, British monarchs borrowed in their own name rather than on behalf of their subjects. At the time, it was even questioned whether it was morally right and even legally possible for the Treasury of a nation's citizens to borrow on their corporate behalf without their direct agreement or authority.[17]


William and Mary

Indeed, this is the root of the problem of government debt from a biblical perspective. Lending and borrowing are relational activities entailing strong moral obligations of love, care, and promise-keeping. Yet government borrowing is as non-relational a financial transaction as it is possible to get. There is no relationship between the lender and an identifiable borrower; usually no information as to what the funding is to be used for; no direct means for the lender to communicate and influence borrower behaviour; and no formal means for negotiation and compromise if the borrowing government finds itself unable to repay on time. A heavy debt burden tempts politicians to break their country's promise to repay through default or an inflation shock. Hence, we shall seek carefully to apply biblical wisdom on lending and borrowing in an area that is singularly alien to its very concepts. These teachings are more fully set out and applied elsewhere.[18] In summary:

1. Debts are promises to be honoured (Psalm 37:21; Romans 13:8). Borrowing entails a solemn promise to repay – hence default is morally worse than theft because the lender is both deprived of their property and a promise is also broken (cf. Psalm 15:4).

2. Borrowing entails financial bondage for the debtor (Proverbs

14 It is estimated that a US 65-year-old retiring in 2013 will receive a net $327,000 from the Federal government over his or her lifetime through pensions, welfare, and healthcare. This is at the expense of as yet unborn future taxpayers who are expected to pay government a net $422,000 in real terms over their lifetime (*Swindled: How the Millennial Generation will Pay the Price of Washington's Paralysis*, TheCanKicksBack.org, 2014, p.9).

15 'The national debt is the single biggest threat to our national security' – Admiral Mike Mullen, Chairman of the United States Joint Chiefs, 10th May, 2012.

16 Even if central banks are given the task of setting interest rates, it is never with the goal of keeping the price level stable, but rather with limiting the rate of price rises to around 2 per cent a year. The resort to 'quantitative easing' has shown that central banks will readily 'print money' in an effort to stop prices actually falling and prevent the real debt burden of government from rising.

17 Indeed, it is not necessarily clear for whom a government is borrowing given that citizens can evade their implied debt obligations by changing their tax domicile or nationality, shifting their assets and income to other jurisdictions, or receiving tax breaks through lobbying or corruption.

18 See the Cambridge Papers on the Ban on Interest (March 1993), Prudence and Saving (March 1995), and the Great Financial Crisis (March 2011).

22:7). Those in debt are under an obligation to keep their promise to repay or face the loss of their collateral (e.g. Deuteronomy 24:7, 13) or freedom (cf. 2 Kings 4:1). Hence, the wisdom in not giving a pledge for the debts of another, thereby losing one's liberty (Proverbs 6:1–5 etc.). Prudence and saving are 'wise' for the financial independence they bring.

3. Debts are periodically to be cancelled, and debt-slaves released (Deuteronomy 15:1–6; 12–18) to ensure periodic intervals of debt freedom within the community. This would have meant that long-term debt would not have existed and that debt could not be inherited from one generation to another. Also, unlike today, government debts could not readily circulate as 'money' as they would periodically lose all their value.

4. Interest could not be charged on debts within the OT Israelite community (e.g. Deuteronomy 23:19; Psalm 15:5) for this would be to profit hard-heartedly from the bondage of a 'neighbour' (cf. Leviticus 19:18; Luke 19:22, 23). Jesus then extends the injunction against lending at interest for his disciples (Luke 6:34, 35). Equity, leasing and rental contracts are the preferred alternatives to interest-bearing debt as ownership responsibility and financial return are not separated.

In addition, other relevant teaching and laws apply to the role of government and intergenerational covenants.

5. The powers and prerogatives of the OT king are to be tightly controlled and placed under God's law with tight restrictions on central spending (Deuteronomy 17:14–20) as a constraint on the abuse of power by sinful rulers. If these are not respected, a powerful central government will likely abuse its tax-raising powers to enslave the populace (1 Samuel 8:11–18).

6. God's covenants with his people span the generations, with both blessings and curses having intergenerational consequences (Genesis 12:3; 15:18; Exodus 20:5, 6; Deuteronomy 28:58–63). Hence the need for the wise to bless succeeding generations (Psalm 71:18; 145:4) and for parents to educate their children (Deuteronomy 6:4–7). A good government that emulates God's intergenerational perspective will therefore be one that does not abuse its current temporal position at the expense of the future, but seeks to balance the needs of the present and future generations. Through God's spanning of the generations, the obligation of neighbour love still applies, even if a direct relationship does not.

Practical policy suggestions can be derived from the Bible's teaching on debt to promote justice for both current and future citizens.

7. Government ultimately is appointed by, and responsible to, God to punish wrongdoing and promote the common good (Romans 13:1–6; 1 Peter 2:13–14). God's purpose for those made in his image is to work in and tend his Creation for the fulfilment of God's purposes and the benefit of future generations (Genesis 2:15). Hence, good government manifests responsible decision-making by passing on to future generations an improved means of existence, rather than obligating the unborn with far larger debts than their parents inherited.

8. When planning for the future, we should take a humble approach, for only God knows the future (Proverbs 27:1; James 4:13–16). It is folly to base current plans on the optimistic extrapolation of current trends (Isaiah 56:12; Luke 12:16–20; 2 Peter 3:3–10).

Application to government finances

The key to applying these principles is to focus on the relational dynamics at work between borrower and lender, and between current and future generations, rather than merely giving priority to the pragmatic maximizing of perceived economic benefits in the present. Taking this approach, we can adopt the following aspirations:

1. Government embodies society's obligation of stewardship towards future generations. This can be achieved through government reducing its debt level, seeking to develop the nation's capital stock and preserving the environment such that succeeding generations can expect to have at least as good life chances as the present one. Practical ways to encourage the achievement of this goal could include:

An Intergenerational Covenant to commit the current generation to care for those in the future. This could be reinforced at a national level by a constitutional commitment to a declining government debt:revenue ratio over the economic cycle until the government achieves a positive asset position.[19]

Transparency over intergenerational government accounts. To combat the persistent desire of politicians to hide government debts 'off-balance sheet' through public–private partnerships and debt guarantees, any such intergenerational covenant needs to be reinforced by clarity over every debt that the government has guaranteed and is incurring. In addition, future welfare, pensions, nuclear clean-up costs and healthcare promises which are not covered through taxation or funded through current saving would need to be valued and published, including an estimate of implied intergenerational transfers. An auditing body fully independent of the Treasury should be charged with these tasks and report directly to Parliament to ensure the Finance Minister acts in accordance with these goals.[20] Indeed, a reformed House of Lords (in the UK) or second chamber elsewhere can be given the explicit role of defending the interests of future generations against the ever-present pressure of short-termism faced by elected politicians.

2. Whenever possible, governments should operate as investors or savers, rather than borrowers. This applies most obviously where a country enjoys a one-off windfall as a result of resource extraction and invests abroad for the benefit of

19 In 2009, Germany passed a constitutional amendment whereby the Federal government needs to operate a budget deficit below 0.35 per cent of GDP from 2016 onwards, barring exceptional circumstances.

20 The UK's Office of Budget Responsibility goes some way towards this goal but does not have this wider intergenerational mandate or full independence.

future generations.[21] But even without such windfalls, a nation will benefit through eschewing indebtedness and not being beholden to creditors. Governments could still operate to stabilize the economy in a crisis or recession by running down their assets, rather than adding to their debts.

3. Government can finance capital spending by non-debt means. When general taxation is not deemed appropriate to finance specific infrastructure projects, financing can come from selling franchises to levy user fees if appropriate (such as toll roads), or leasing capital goods directly. Similarly, government should seek to develop non-debt replacements for student loans to address the looming problem of heavy indebtedness of younger generations. This could be through a graduate tax, university endowments, or future employer grants, but whatever vehicle is chosen it is needed to address this modern form of debt slavery.

*4. If government debt is to be issued, it should be short-term and interest-free***.** Modern payment systems and current accounts are difficult to operate without some form of secure and liquid asset being available from a central bank or Treasury. Keeping any such borrowing short-term minimizes both the temptation for government to accommodate inflation and any potential loss of political independence to placate long-term creditors.

How can we revive a sense of stewardship?

While we can devise any number of clever policies and rules to encourage a greater sense of government stewardship towards future generations, they will fail unless there is a change of societal 'heart'. Responsibility may be imposed temporarily by 'rules' but unless a society's aspirations change from self-absorption to self-giving any new-found prudence will be short-lived. In addition to seeking the discipleship to Christ of all nations (Matthew 28:16–20), Christians can act as examples of intergenerational stewardship to others in how they conduct their personal, family and community affairs. On a personal level, this can take the form of seeking to minimise the use of debt within one's own finances and using our savings to assist those within our extended or church families to live freely with as little student, consumer or mortgage debt as practicable. It could also entail voting, campaigning, or seeking political office for parties that espouse a far greater concern for intergenerational justice and notions of stewardship than is currently on display.

Conclusion

The global financial crisis showed the power private debt has to threaten immediate financial collapse. The public debt crisis now faced by most Western nations is a 'slow-burn' problem that, unless tackled, will not likely be resolved until governments are forced to resort to draconian spending cuts, wealth confiscation, default or inflation. Without rapid transformation, aging democracies will be ill-equipped to take mitigating action as electorates increasingly reflect the desires of those in or approaching retirement. Christians have a unique message to address the underlying 'heart' issue of intergenerational selfishness through the Gospel, while practical policy suggestions can be derived from the Bible's teaching on debt to promote justice for both current and future citizens.

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21 Currently Norway, some of the Gulf States, Russia, and Canada operate substantial sovereign wealth funds to invest oil and other resource revenues in a modern emulation of the wisdom of Joseph (Gen. 41:41–57; cf. Pr. 27:23–24).

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