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Light From Darkness

By DAVID ROCKER

The task ahead is to create a new normal for American financial behavior

The debt-limit debate, as painful as it has been, could prove to be a very positive event for America. It has revealed much about who we are and how we are governed. It has focused us on how we must change. Our nation, like every household within it, must live within its means. In the past, we have operated on the premise that we could do whatever we wished, and to the extent that we couldn't pay the tab ourselves, others would be willing to lend us the balance.

We have not been alone in this irresponsible behavior, as the crisis in Greece and the financial difficulties in other European nations have shown. But the game has changed, and we must all adapt to new norms of behavior. There is no easy fix, and the damage done in past decades will not be undone in a year or two.

America's Best Days

America became a great nation because it offered its citizens and immigrants the freedom to pursue their own happiness. It was a land of opportunity, and those who worked hard could rise above modest beginnings.

Seeing that opportunity, Americans were willing to sacrifice and forgo present consumption to save and invest for their families' futures. America became a magnet for risk-takers from around the world. The country was regarded as a land of boundless optimism.

Despite our reflexive national pride, most Americans fear that our best days are past. Our manufacturing base has shrunk dramatically, and jobs are more difficult to find.

Confidence in our institutions, especially in our government in Washington, is at an all-time low. Our leaders have been followers—of polls, of lobbyists, of campaign donors. They have been unwilling to risk their careers in politics by compromising to bring about the change they know is needed, but talk about in the abstract.

With austerity now being forced on numerous ill-disciplined economies, including our own, growth will likely be slower, and fewer jobs will be created than we had anticipated. Indeed, much of the job creation of the past two decades has been illusory, artificially stimulated by steadily increasing debt.

Household dynamics may help clarify this. A family with a \$100,000 annual income may spend \$120,000 a year if its members are confident about the future and borrow the balance. If loans become unavailable, the family can spend only \$100,000. If the family members become worried about their future, they may spend even less to save for a more difficult period ahead. A nation with many such worried families will require years of savings and base-building to recover from years of consumer-driven growth and borrowing.

As citizens and voters, Americans have refused to adopt credible plans to return to a more responsible path, choosing instead to vote for candidates who would provide them with short-term benefits, regardless of the long-term costs, a form of intergenerational larceny.

The markets have shown us that we have reached our limits. The Standard & Poor's lowered ratings and the Tea Party are not responsible for the recent market meltdown. Years of irresponsible fiscal policy, in both Republican and Democratic administrations, are the cause. We have brought this on ourselves, and we must fix it ourselves with hard work and sacrifice. Austerity is no longer an option. We must get used to limits and focus to a greater degree on what we need rather than what we want. The establishment of priorities when resources are limited is what budgeting is all about.

Address Entitlements First

One of the biggest battles of this recent debate has been about what to do about "entitlements." Social Security, Medicare, Medicaid, veterans' benefits and pension liabilities are growing faster than our economy. They are coming to dominate our spending. Painful as it may be, they must be addressed first, not last, in the current congressional discussions. Failure to do so is like seeking to diet without being willing to modify lunch and dinner menus.

The very word entitlement speaks loudly about why we are where we are. When rewards for work and risk-taking are replaced by entitlements, why work? Why take risk?

The stimulus programs created for this economic crisis haven't been particularly effective because they were more focused on preventing further job losses than creating new jobs. Much of the spending was politically motivated and aimed to maintain existing programs and spending through grants to states. A big chunk went to extended unemployment benefits, which might relieve discomfort, but didn't create many jobs.

The Fed's low interest-rate policy and "quantitative easing" punished seniors and savers, who actually cut their spending as their income declined. This policy also gave a gift to big borrowers, especially the very bankers whose imprudence led to the crisis. The banks had to be saved, not the bankers.

Banks and corporations are loaded with cash, but aren't spending or lending because our political climate is unstable. They don't feel confident about economic policies, especially the threat of higher taxes and more business regulation. Political dithering and presidential bashing of corporations and the rich further undermine the chances for the very job growth that the government ostensibly seeks to encourage.

A Time to Focus

We have much work to do. But the American people have the resources and the resourcefulness to do it if we recognize the new reality. It is time to focus on what is best for the common good, not special interests.

Simplifying and flattening the tax code would be a good place to start. Tax deductions, tax credits and special rates have become entitlements as troublesome as entitlement spending. The moderate elements of the two parties need to work together on tax reform, but to do so they must withstand their inflexible fringes. The time has come for term limits in Congress and new rules to put less emphasis on seniority.

The debt-ceiling debate and the S&P downgrade sent us a message that we are still digesting and debating. That's healthy, if we come to understand that we cannot go back to the old ways.

Can we rise to the challenge and build a better and stronger America?

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