Fiscal Debt: Charging Ahead

What's a liberal to do? At the very time that President Obama and his Democratic allies in Congress are moving aggressively to fulfill two of the most cherished leftist conceits — confiscation of firearms and general amnesty for millions of illegal immigrants — economic woes continue to rear their ugly heads. Already reeling from massive tax hikes that few Americans were even expecting, the country now awaits the outcome of the other half of the fiscal cliff debate — the seemingly impossible decision to actually cut government spending.

In May, something will need to be done about the debt ceiling, although congressional Republicans have managed to kick that particular fiscal can just a little further down the road. And to top it all, the economy has begun contracting once more, with figures from the fourth quarter of 2012 pointing to a stagnant 0.1 percent decline, according to the Commerce Department. These bad tidings came a day after the government announced a steep decline in consumer confidence at year's end, effectively erasing all the putative gains for 2012. The downturn that started with the Great Recession grinds on and on, with no end in sight, prompting many Americans to wonder where our government's seemingly incurable addiction to debt, excessive spending, tax hikes, and expansion of its own powers will ultimately lead.

The Obama administration and its courtier-economists were quick to dismiss the dismal fourth-quarter economic figures as consequences of one-time aberrations, such as a more than 20-percent decline in end-of-the-year defense spending, in anticipation of a fizzled fiscal cliff. But as we go to press budget cuts are coming — automatically, under the "sequestration" deal reached during the last debt ceiling set-to, on March 1, unless Congress comes up with an alternative.

Meanwhile, the latest job figures, released on the first day of February, will prove harder for the Obama administration to dismiss. While the economy created 157,000 new jobs in January and 127,000 more jobs in November and December than had previously been acknowledged, the official unemployment rate crept up once again to 7.9 percent, stoking fears that it would once again breach eight percent. Unemployment, while not as acute as a few years ago in the depths of the recession, is still more than twice what America enjoyed during headier times (and, as has often been pointed out, the real unemployment numbers are well into the double digits, but newer, looser standards of reporting conceal the true extent of the problem).

Though it is true that ballooning government spending and debt create a drag on the economy, unemployment rates are likely to rise in the if looming mandated cuts in government spending kick in. The general sentiment in Washington is that the automatic across-the-board seven-percent cuts for the Pentagon and five-percent cuts for domestic programs will take place, not only because there is no partisan common ground on what programs can be cut, but also because such automatic cuts, mandated by a bipartisan "supercommittee," will protect Republicans and Democrats from blame.

Much of the discussion in the mainstream media is focused on the alleged need to prevent spending cuts — even if new taxes must be levied — because cutting government spending will supposedly cause the fragile economy to contract at a time when more stimulus is plainly in order. According to White House Press Secretary Jay Carney, allowing the dreaded automatic cuts to occur in March is "political brinksmanship of the kind that results in one primary victim, and that's American taxpayers, the American middle class." Cutting the size and cost of government would hurt American taxpayers by trimming the services government can provide, reducing or eliminating government contracts with private industry, and costing large numbers of government employees their jobs — so the argument runs.

Such thinking assumes that it is government that is the linchpin of a strong economy, and that government jobs, contracts, and benefits contribute crucially to economic growth. Nothing could be further from the truth, as economists from Frederic Bastiat onward have demonstrated time and time again. Government does not produce wealth or accumulate capital; it consumes and often destroys it. Every penny confiscated by government from the private sector and used to fund projects deemed important by politicians (including, of course, the salaries of legions of government bureaucrats who oversee such wealth transferral) is a penny not spent by the private sector for things that the free market prefers. Every tax dollar spent by government is one dollar withheld from private-sector savings and investment. And every salaried government bureaucrat is one less potentially productive worker or entrepreneur for the private sector. Government, as Bastiat pointed out long ago, traffics in that which is seen — a new bridge, a repaired highway, a new block of low-income housing, another public school, a state-of-the-art battleship, or an "entitlement" program are all things for which money is taken and spent, and their results are visible. Because of this, the public is tempted to regard such expenditures (and numerous other government projects like them) as "investments."

But the public (and most politicians) often forgets what is not seen — those things that the private sector will never be able to produce as a result of wealth extracted by the public sector. It is impossible to say what might have been built with funds used to repair a highway or a government building, for example, but the money would have been used somehow — to build a hotel, endow a private college, start a furniture company, or develop a better automobile engine, for example — but because the opportunity has been denied the private sector, the benefit will remain unseen.

Low-hanging Fruit

While few dispute the need to spend money on legitimate government activities that will protect freedoms and safeguard the rule of law, to assert — as the Obama administration is now doing — that increased government spending, financed by tax hikes, is more beneficial to the economy than private-sector capital formation is the height of economic ignorance. The results of unchecked government spending are already drearily apparent to Europeans, whose governments, drowning in debt, are now seeing fit to impose "austerities" — mostly in the form of higher taxes and reductions in promised benefits — rather than make meaningful cuts in the size and cost of government itself. In country after country across the foundering EU, so-called public servants, when the economic chips are down, have been willing to raise taxes and otherwise fleece the productive private sector, while imposing no comparable hardships on themselves. This is the reason that violent demonstrations are becoming almost a daily event in Greece, and Spain is on the verge of disintegrating. Most Europeans, unfortunately, cling to their illusions of benign socialism, but for the economically discerning, the fruits of a half-century of rampant Big Government in Europe are painfully clear.

President Obama, along with many of his congressional co-partisans, appears to be congenitally incapable of contemplating cuts in government spending, which is why, now that he has gotten the Republicans to cave on tax increases, he and his fellow Democrats are scrambling to find more ways to hike taxes in order to avoid actually having to cut spending when sequestration kicks in. According to a January 29 piece in Bloomberg, Senate Democrats, led by Harry Reid, are working to come up with "revenue-generating alternatives" in order to "offset automatic spending cuts set to take effect March 1." One target popular with Democrats is oil companies; under discussion is a proposal by President Obama to generate an estimated $27 billion in additional revenue by going after oil and gas companies, which would include "repealing companies' ability to deduct certain drilling costs immediately rather than over several years." Senator Reid confirmed Congressional intent to "deal with oil companies," referring to them as "low-hanging fruit."

In other words, aware that no more tax hikes on the American public are feasible in the near term, President Obama and Senate Democrats are going to seek further tax hikes on corporations, those reliably villainous caricatures of cutthroat capitalism that the American Left loves to scapegoat. It is telling that Democrats would single out oil and gas companies as potential sources of new revenue, given that the extraordinary growth in natural gas production, thanks to "fracking," has been the one real bright spot in an otherwise moribund economy over the last several years. Hydraulic fracturing technology has permitted the extraction of natural gas trapped in deep shale formations like the Marcellus Formation of northern Appalachia, and has driven natural gas prices down steeply while creating tens of thousands of new jobs in Pennsylvania, West Virginia, and elsewhere. Meanwhile, boom conditions have transformed the once-lethargic economy of North Dakota, where drilling for petroleum in the Bakken Formation has rendered that remote prairie state all but immune to the economic downturn.

But all that President Obama and his congressional allies see in the energy sector is "low-hanging fruit" ripe for the picking, an easy source of new revenue for politicians to spend.

And spend it they will, mostly to fund America's galactic debt, which has surpassed 100 percent of the GDP and continues to rise. Against such a backdrop, the token cuts mandated by sequestration are insignificant; they are, after all, not merely reckoned in single-digit percentages, they are also slated to be phased in over the next six years. In other words, they will be a barely registered blip on federal accounts, all but invisible atop the runaway debt and the towering interest payments already required to service it. And in all likelihood, Washington politicians, having secured their tax hikes, will find some way to avoid making even these token cuts, so hopelessly addicted to deficit spending have they become. (It is worth pointing out that the best that establishment Republicans — so-called "deficit hawks" like Rep. Paul Ryan — have been willing to propose is a reduction in the rate of spending increase, in the hopes that somehow, some way, we will eventually be able to grow our economy to the point where a multi-trillion dollar debt becomes trivial by comparison. This is, of course, a quixotic fancy typical of career politicians who have never had to meet a payroll and have little idea how the economy actually works.)

As for the impending debt-ceiling kerfuffle, expect the usual sound and fury, signifying nothing. If America has learned anything from the last several debt-ceiling donnybrooks, it is that, in the end, the Republicans will acquiesce to Democratic demands for more debt, and yet another Faustian bargain will be struck.

Greece's Instructive Example

What happens to nations when their political leadership becomes so morally bankrupt that even the notion of slowing the rate at which the debt is rising fills the establishment with horror? The nations of Europe, and especially southern Europe, furnish instructive examples. Greece, whose name has become synonymous with political corruption and fiscal ineptitude, is Exhibit A. Following the destruction of the Second World War, Greece, like many others of Europe's ruined economies, eventually rose from the ashes in an extraordinary run of economic growth that has been dubbed the "Greek economic miracle." From the end of World War II until 1949, Greece was embroiled in a bitter civil war that pitted communists against the Greek military. With help from the West, the military eventually vanquished the Soviet-backed communists, saving Greece from ending up behind the Iron Curtain with the rest of Eastern Europe.

From about 1950 through the mid-1970s, Greek economic activity exploded, thanks not only to generous infusions from the Marshall Plan but also to a comparative reduction in government controls over the Greek economy. Throughout the '50s, the Greek economy grew at an annual average in excess of 10 percent, and industrial growth surpassed 10 percent per annum well into the '60s. Greece became a mecca for tourism, but also underwent significant industrial expansion, particularly in the manufacture of chemicals, and her cities boomed with new construction projects. During these years, Greece was governed by an anti-communist military junta which — like so-called "benign" military dictatorships in South Korea and (later) in Chile — refrained from excessive interference in the economy and were motivated by a strong antipathy for socialism that characterized all juntas that came to power by fending off Marxist insurgencies.

With the overthrow of the Greek junta in 1974 and the establishment of a modern European-style populist socialist government, Greece's economic miracle came to an abrupt end, although there was at first little reason to suspect that Greece had embarked on a long road to ruin. With the election of socialist Andreas Papandreou in 1981, Greece's long descent into mammoth government spending and eventual insolvency began in earnest. Papandreou instituted many reforms in Greece that will have a familiar ring to Americans: He nationalized healthcare, established a comprehensive welfare state, and instituted a system of graduated taxation, among many other socialist-inspired reforms. Under Papandreou and his successors (which included, in 2009, his son Georges, who has also served as president of the Socialist International since 2006), the size and cost of the Greek public sector exploded, and Greece was obliged to borrow massive amounts of money to keep the welfare-state Ponzi scheme going. Despite suspicions over the extent of Greek indebtedness, Greece successfully petitioned to join the eurozone in 2000, and, for a few years, her economy managed to continue a decade and a half-long growth spurt, thanks to unfettered access to other European markets.

The salad days came to a definitive end with the onset of the global recession in 2008. Unemployment that had been low by Greek standards (7.2 percent) at the beginning of 2008 exploded to 26 percent by 2012 (with youth unemployment near 60 percent). Construction plummeted by more than 70 percent between 2010 and 2012. And, more ominously, civil unrest began in earnest. This, in a country that had enjoyed 14 straight years of economic growth and had been touted as a great European success story.

Greece's troubles had begun decades before, with the introduction of socialism and welfarism on a massive scale. For nearly three decades, Greece had managed to paper over her massive debts by borrowing and printing more drachmas. Entry into the eurozone allowed her to jettison the drachma for the euro, and thereby to dilute her balance-book woes for a few more years. Unbeknownst to the world at large, Greece had retained the services of Goldman Sachs prior to entering the eurozone, and had received help to creatively restructure her finances to conceal her unsustainable indebtedness from would-be creditors.

But Greece's financial dry rot was finally laid bare when the pitiless laws of economics had their say in 2008. Greece's debt was found to be in excess of 100 percent of the GDP (roughly where ours is now, in fact), and the financial rout began. From apparent success story to international financial pariah, Greece's descent into receivership has led to her near-total submission to international authorities in exchange for a succession of bailouts that have done little to mitigate her debts. With sporadic social unrest, political turmoil, and economic malaise continuing, Greece's story is not finished, and her outlook is bleak.

And Greece is not the only "sick man of Europe" these days. At the other end of the Mediterranean, both Spain and Portugal have followed very similar trajectories, and are not too far behind the Greeks on the path to utter economic and social collapse.

The Other Sick Men of Europe

Depression-era Portugal, ravaged by old debts and hampered by a comparatively backward, rural society, saw its fortunes change in 1933 with the rise of Antonio Salazar, who instituted the authoritarian but rigidly anti-Marxist regime known as the Estado Novo ("New State"). Criticized for his relentless persecution of Marxists, Salazar nevertheless instituted policies that allowed Portugal to begin paying down debts and embark on a gradual path toward modernization and real economic growth. Labor unions, for example, were illegal and there was no minimum wage, in striking contrast to other Western countries of the day, including the United States. Portugal escaped the ravages of the Second World War by remaining neutral, and from 1950 onward her economy grew at a brisk clip. By the end of Salazar's tenure in office in 1968, Portugal was catching up to the rest of Western Europe on many fronts.

The Portuguese economy continued to grow apace until the so-called "Carnation Revolution" in 1974, a peaceful leftist military coup that threw the Portuguese economy into turmoil. Finally triumphant over the anti-Marxists of the Estado Novo, Portugal's new leftist leaders promptly instituted a series of socialist economic reforms that sent the economy into a tailspin. Industries were nationalized and enormous tracts of land were confiscated from wealthy landowners for redistribution to "the people." Collective farms were set up, which virtually destroyed Portuguese agriculture. Almost overnight, Portugal went from being the fastest-growing economy in Western Europe to the slowest, even reversing course altogether for several dark years.

Eventually, Portugal settled into a more gradualist socialist program similar to those adopted elsewhere in Western Europe. In 1986, Portugal joined the European Union, and in 1999, became one of the founding members of the eurozone. Like most of the rest of Europe, Portugal benefitted from the global financial bubble, posting annual growth rates of around three percent from the early '90s onward — rates that were an improvement over almost two decades of stagnation, but which did not approach the growth achieved under the Estado Novo of Salazar and his successors. The great bubble, in Portugal as elsewhere, nourished the illusion that welfarism and the deficit spending required to sustain it were, after all, the stuff of economic miracles. Even as the Portuguese economy grew, so too did her politicians continue to borrow and spend without restraint.

Portugal's socialist Cloud Cuckoo Land came to an end as jarring as Greece's, and while Portugal has shown somewhat greater resolve in self-imposing reforms, most of these have consisted of massive tax hikes that have driven the desperate Portuguese, like the Greeks, into the streets. Portugal's unemployment rate is somewhere north of 15 percent and — rosy assurances notwithstanding — there is little indication that Portugal will have any more success at paying down her gargantuan debts than Greece.

The situation is severer still in Portugal's larger peninsular neighbor, Spain. The first four decades of the 20th century witnessed a struggle for Spain's political soul that culminated in the Spanish Civil War. The anti-communist General Francisco Franco emerged the victor, and like Portugal's Salazar, instituted an authoritarian, anti-Marxist regime that lasted until 1975. Franco, despite his opposition to communism, had a strong socialistic bent of his own, and flailed ineffectually to reform the Spanish economy via various economic centralization schemes before finally attempting free-market reforms (including opening Spain's doors to foreign capital) in 1959. The result was the "Spanish miracle" that saw the economy grow by leaps and bounds into the mid-'70s.

With the death of Franco, Spain joined the rest of Western Europe in the rush into "social democracy." Spain's economy faltered in sync with the rest of the world's in the late 1970s, but recovered in the 1980s under the leadership of Felipe Gonzalez. Despite his socialist pedigree and strong collectivist impulses (he was general secretary of the Spanish Socialist Worker's Party from 1974 to 1997), Gonzalez was enough of a pragmatist to disencumber Spain of a number of inefficient and costly bureaucracies and government agencies, privatizing more than 200 state-owned corporations. At the same time, Gonzalez initiated the welfare state in Spain on a massive scale, instituting a social security system and greatly expanding pensions, unemployment benefits, and a range of other "entitlements." The Gonzalez government spent heavily on infrastructure as well, constructing highways and railroads, and also creating a high-speed rail system. Along the way, Spain was the beneficiary of a tourism boom, as millions of visitors drawn to her beach resorts, mountains, and picturesque medieval cities flooded Spanish coffers. During the great bubble years, the Spanish economy soared to almost unprecedented heights, with her enormous stretches of desirable beachfront property inspiring a spasm of real estate speculation second only to the American real estate bubble.

Government spending soared too, of course, as people in Spain drew the same conclusion as people almost everywhere else: Government and debt could expand without limit, and perpetual economic growth would forever immunize government and society from any consequences for fiscal imprudence.

Today, unemployment in a humbled Spain is over 25 percent, her real estate market is in shambles, her level of indebtedness is soaring, and her enraged populace is in the streets almost daily. Catalonia, Spain's wealthiest and most productive region (and home to Spain's second-largest and most cosmopolitan city, Barcelona), is threatening to secede outright, since the Catalans (who have their own language and culture) have been forced to pay disproportionately for Madrid's profligacy. As with Greece and Portugal, the full story of Spain's decline has not yet been written.

The Bloom Is Off the Rose

Greece, Spain, and Portugal all experienced strong economic growth coincident with periods of free-market reform and strong anti-Marxist policies. After succumbing to the siren song of "soft" Western-style socialism, these three countries continued to prosper — for a time — even as debts mounted and economic controls multiplied. But now that the bloom is off the economic rose, the folly of Big Government and the unsustainable indebtedness it occasions is starkly evident.

The very same consequences (if not worse) await the United States if her political leadership continues to refuse to change course. In possessing the world's default currency, though, the United States has at once more leverage to stay in the game longer than the Greeces and the Portugals — and more rope to hang herself. Put otherwise, America can postpone the evil day by force-feeding more dollars (and more debt) to ever-more reluctant creditors who remain unwilling to kill the golden goose, but if she waits until the laws of economics force a brutal reckoning, the fall will be much farther.

There are those who claim that the point of no return has already been surpassed, and that America's debts and other economic woes are too great for repair. But our level of public debt to GDP is roughly the same now as it was at the conclusion of World War II, and our country managed to walk away from that financial abyss more than a half century ago. Postwar Washington, however, was able to muster the political will to cut the size and cost of the federal government by as much as 50 percent. That scaling-back of Big Government produced an "American miracle" that surpassed anything in Greece, Portugal, Spain, Germany, Japan, or any of a host of other countries whose economies grew vertiginously after the war. However, many of those postwar spending cuts, tied to national demobilization, were politically easy to carry out. Any meaningful cuts nowadays would of necessity gut peacetime expansions of government power that millions of Americans have come to view as indispensable programs. And historically, it is a rare governing body indeed that will voluntarily surrender power by defunding itself.

We have every reason to believe that the second Obama administration and a lickspittle Congress will preside over the greatest expansion of federal government power and cost yet seen, and will add untold trillions to the national debt while hiking taxes — without making any cuts whatsoever. Only if the American people make their views felt as vociferously and forcefully as possible will our leaders reverse course and keep America from following the nations of Western Europe into financial bondage and social disintegration.