OP-ED

Forbes

9/13/2012 | JIM POWELL

Is President Obama's Depression Coming Our Way?

Barack Obama began his presidency talking about a "New New Deal," referring of course to his hero Franklin Delano Roosevelt's policies during the Great Depression. Those policies had the unintended effect of prolonging double-digit unemployment, principally by making it more expensive and difficult for employers to hire people. Whenever something becomes more expensive and difficult, there's likely to be less of it. In this case, private sector jobs.

Now Obama is presiding over the worst economic recovery since the Great Depression, and if he's elected for another term, this official "recovery" – with incomes falling faster than during the 2008-2009 recession – could turn into a crushing depression.

In all likelihood, we have already seen what a second Obama term would be like. He wouldn't need to be concerned about the unpopularity of his policies, since – if the Constitution is upheld – this would be his last term. He could pursue his hardcore progressive agenda without electoral consequences.

Obama seemed to be free from electoral consequences following the 2008 election, because Democrats controlled both houses of Congress. He reportedly told Republicans: "I won. I don't have to take your ideas." As we know, he rapidly increased spending. He increased taxes and approved tax refunds for people who didn't pay taxes. Debt soared, and costly regulations proliferated. He promoted crony capitalism, compulsory unionism and government-run health care. He got almost everything he wanted.

Obama became accustomed to exercising arbitrary power. After Republicans gained a majority of the House in 2010, he evaded congressional approval of some controversial appointments, intimidated Chief Justice John Roberts into upholding Obamacare and gutted the 1996 welfare reform bill by eliminating the work requirement. He also nixed the

Keystone pipeline that would have created thousands of American private sector jobs.

There was even some thuggish behavior. Perhaps frustrated by Republican opposition, Obama reportedly invited House Budget Committee Chairman Paul Ryan to attend an April 2011 speech to be delivered at George Washington. Ryan sat in the front row. Obama denounced Ryan's approach to the federal budget, and Ryan didn't have an opportunity to respond. Obama later denied this was a setup to embarrass Ryan, but during his 2010 State of the Union Address, Obama had similarly denounced Supreme Court justices who were in the audience.

In his acceptance speech at the Democratic National Convention, Obama made fun of pro-growth policies like tax cuts and deregulation. "Feel a cold coming on?" he sneered. "Take two tax cuts, roll back some regulations, and call us in the morning."

Yet these pro-growth policies have been associated with the most successful American economic recoveries of the past century, during the 1920s, the 1960s and the 1980s. Ronald Reagan faced a worse economy than Obama did, because there was double-digit unemployment, double-digit inflation, double-digit mortgage rates and chronic shortages that disrupted businesses and consumers alike. After Reagan cut taxes and streamlined regulations, the result was annual economic growth rates up to 8 percent, quadruple Obama's record now.

Obama has relentlessly promoted runaway spending and denounced those who want to bring it under control. In particular, Obama has avoided efforts to reform the giant entitlements that account for more than half of all federal spending and, if they aren't reformed, could eventually squeeze everything else out of the budget.

It's no secret that Medicare and Social Security, for instance, face insolvency. There are two principal reasons.

(1) These are pay-as-you-go programs where current payroll tax revenue is spent immediately on current beneficiaries, and the government, unlike private insurance companies, hasn't built up an income-generating portfolio to help provide for its future beneficiaries. The so-called "trust fund" consists of government bonds that can be redeemed only with more tax revenue and/or more borrowed money.

Also, (2) both Medicare and Social Security amounted to huge, unhedged bets on future demographic trends. The politicians who made the bets – especially Obama's heroes Franklin Delano Roosevelt (Social Security) and Lyndon Baines Johnson (Medicare) – made bigger, more reckless bets than the wildest Wall Street plungers. These entitlements might have had a rosy future if the number of people paying Social Security/Medicare taxes always grew faster than the number of people qualifying for benefits. But the number of beneficiaries has grown faster than the number of taxpayers – and beneficiaries are living longer which means collecting more total benefits than beneficiaries had paid for. Unfunded Medicare and Social Security liabilities are in the tens of trillions of dollars.

Considering Obama's deep commitment to runaway spending, during a second term he could be counted on to make more people dependent on government money. For instance, we could see the number of people on food stamps soar to 50 million, 60 million, 70 million or even more. Unemployment benefits might be extended for two or three years until these benefits become more like permanent welfare programs. Since Obama has eliminated the work requirement from welfare, we could again see generation after generation on the dole. The administration is promoting home loans to more people who will have trouble making the payments, so it could be déjà vu all over again in the housing market. Altogether, the percentage of households receiving more in government benefits than they're paying in taxes could soar past 60 percent. There will be a solid majority of takers rather than makers.

This could probably make it politically impossible to ever cut government spending peacefully. Private individuals as well as government employees would become so dependent on entitlements of one sort or another that efforts to cut back – even just reduce the rate of spending increases – could provoke violence, as has happened in France, Greece, Italy, Spain and many other places.

In addition, a second term for Obama probably would enable him to appoint more Supreme Court justices and establish a solid progressive majority indefinitely. The American Dream could be forgotten as Egyptians forgot the meaning of hieroglyphics and Romans forgot how to speak Latin.

All this makes steep tax hikes inevitable. Obama likes to talk about higher taxes on the "millionaires and billionaires" who make more than $250,000. But such taxes harm ordinary people. The less capital that's available, the less growth and fewer private sector jobs there will be. Since a substantial number of rich people are investors and entrepreneurs, higher taxes on these people reduce the amount of capital available for the private sector – and throttle private sector job creation. In addition, higher U.S. business taxes encourage investors and entrepreneurs to look for opportunities overseas where business taxes are lower. As long as there's a 35 percent tax on funds repatriated to the U.S., the money will stay overseas.

Moreover, there aren't enough "millionaires and billionaires" to pay for a second-term spending spree, even if Obama expropriated all their assets. So inevitably Obama will have to raise taxes on middle class people. That's where the money is. There are far more middle class people than rich people. In a desperate effort to fund runaway spending, Obama might end up demonizing "millionaires and billionaires" making more than $50,000.

The higher taxes go, the stronger the incentives people have to change their behavior in ways that reduce their tax liabilities. For example, more people would do business in cash to avoid leaving a paper trail, more people would incorporate themselves to claim more tax deductions, shelter income in trusts, shift assets to lower-tax jurisdictions, and so on. After various states imposed soak-the-rich taxes, the number of high-income tax filers declined as such people vanished — moving to lower-tax jurisdictions. There's an undeniable point of diminishing returns when higher tax rates yield lower revenue.

During his first term, Obama became increasingly dependent on borrowed money. It's no secret that the national debt went up by more than $5 trillion during his watch. Since Obama is so deeply committed to runaway spending, it seems likely that the federal government will continue borrowing at least 40 cents of every dollar it spends, unless of course the Treasury bond market collapses amidst accumulating credit-rating downgrades. In that case, though, the Fed would end up buying all the bonds, monetizing the debt and bringing us closer to a ruinous inflation.

In an Obama second term, there will be much more hammering on investors and private sector job creators. Obamacare taxes and mandates will take effect, making it more expensive and difficult for employers to hire people. Unemployment will almost certainly go up. Spending will skyrocket since Obamacare did much to subsidize demand for health care services and did nothing to reduce major factors driving up healthcare costs, like the prohibition of inter-state health insurance competition. By cutting reimbursements to health care providers, Obamacare creates more incentives for these people to find other ways they could earn a good living, which means long queues and health care rationing for the healthcare providers who remain. Bureaucrats, not patients, will make more decisions about treatment. Altogether Obamacare will be highly disruptive for people's lives and for the economy.

The Dodd-Frank law, with its hundreds of regulations and additional bureaucracies, will have a greater impact in an Obama second term. It impairs the functioning of the nation's financial system, promotes government allocation of credit and sanctions too-big-to-fail financial institutions – which means more and bigger bailouts.

That's not all. Expect more restrictions on coal-fired power plants. The administration is already tightening regulations on fracking that has been a key factor responsible for the natural gas boom. Like India, we could find that unexpected stresses on the power grid lead to brownouts and blackouts, making it harder for businesses to function and encouraging more businesses to locate operations offshore — contributing to higher U.S. unemployment.

As the government is already financially-stressed, it's vulnerable to unforeseen events that could trigger a crisis. While there has been much talk about state bankruptcies that would lead to huge federal bailouts, a Mideast war that would mean a surge of military spending, a cyber attack on critical U.S. assets like the power grid and communications networks — nobody knows when such things might happen. The government doesn't have a crystal ball. That's why U.S. intelligence officials were surprised by the 9/11 attacks, and Federal Reserve officials were surprised by successive financial bubbles. Moreover, when there are multiple crises simultaneously, which happens from time to time, the consequences could be overwhelming.

Americans could rediscover inflation during a second Obama term. Three decades have passed since the last serious American inflation was vanquished by Ronald Reagan and Paul Volcker. Probably millions of Americans have no idea how destructive and dangerous inflation can be.

Inflation is an expansion of money and credit. Politicians resort to this when government spending exceeds what they can raise from taxation and borrowing. The most familiar effect of inflation is a general rise in prices, as opposed to a rise of particular commodities prices because of factors in those markets. A shortage of one commodity, for instance, would lead to higher prices for that commodity, but if government didn't expand money and credit, the only way of paying those higher prices would be to spend less money on other things, so those prices would remain steady or decline.

Inflation depreciates the purchasing power of savings that people built up over many years. Inflation benefits some people – like government employees and contractors – who receive new money and credit soon after it's issued and spend it before prices are bid up. By the time new money and credit has passed through many hands, it has lost substantial value as prices are bid up, people find that their purchasing power lags behind consumer price increases, and their living standards fall. There's more and more anxiety. People on fixed incomes are virtually helpless.

There's widespread resentment about the unfairness of inflation. Politicians blame everybody but themselves. They demonize oil companies, retailers, middlemen and others who deliver inflation. Politicians never point their fingers at the government where inflation is produced.

By causing economic chaos, runaway inflation provides a breeding ground for demagogues who promise to "restore order" and avenge people's suffering. During the German runaway inflation that climaxed in 1923 and wiped out the middle class, Adolf Hitler emerged as a public figure by appealing to "starving billionaires" who had big bundles of paper money but couldn't afford a loaf of bread.

Soaring prices, however, are only part of the devastation caused by inflation.

When inflation becomes front-page news, there's usually a clamor for the government to "do something." Invariably, this means price controls. But to the extent that price controls maintain below-market prices, they simultaneously encourage consumers to buy more and encourage producers to supply less. Everywhere, the result is chronic shortages. The next step is government-enforced rationing that disrupts businesses and consumers. Wage controls, profit controls, exchange controls and other inflation-related restrictions similarly make it harder for businesses to function. All this contributes to economic collapse, relieved mainly by a burgeoning underground economy based on barter or transactions involving precious metals, stable foreign currency or whatever else might be commonly accepted.

Although many politicians have promoted inflation as a cure for recession or depression, the end result is often a witches' brew of both inflation and depression.

Nobody is immune from a ruinous inflation. Advanced as well as developing economies have had it, including Argentina, Bolivia, Brazil, Britain, Chile, China, France, Germany, Greece, Hungary, Indonesia, Israel, Italy, Poland, Russia, Turkey, Uruguay, Zimbabwe, and, yes, the United States (during the Revolution, the Civil War and the 1970s).

So suddenly, Americans could find that we have become like a banana republic where the economy is a mess, and government employees go on strike and even riot in the streets, because the government is broke.

Something like this could be brewing in Chicago where the teachers' union went on strike after rejecting a 16 percent pay hike over four years, demanding exceptional benefits and guaranteed job security despite the wretched performance of the public schools, while taxpayers are suffering through the worst recovery since the Great Depression.

Economic crises are bad, but as some of these comments suggest, the political consequences can be much worse.

Consider the case of Argentina. From about 1880 until World War I, Argentina pursued policies that encouraged individuals to make the most of their opportunities. The country was at peace. Taxes were low, and the peso was convertible into gold. There weren't any major restrictions on the movement of people, goods or capital.

Back then, Argentina ranked among the world's wealthiest nations — chiefly by exporting beef, wheat and wool. During the early 20th century, it was estimated that Argentina accounted for about half the railroad mileage in all South America. The most lavish buildings in Buenos Aires date from this era. Writing about Buenos Aires in 1914, the American author G. I. Morrill gushed about Argentine prosperity and sophistication: "An afternoon walk shows the city very much like Paris in its architecture and fashionable stores. At night it is a big white way with electric lights blazing a trail to the light-hearted cafes and theaters." The British author James Bryce was every bit as enthusiastic in 1916: "All is modern and new; all belongs to the prosperous present and betokens a still more prosperous future."

Unfortunately, by then Hipólito Yrigoyen, known as "el polido" (the hairy armadillo), became president. He served for eight years, promoted government intervention in the economy, and Argentina began to decline. Amidst disorder in 1943, the military overthrew the civilian government, and the socialist-fascist colonel Juan Perón became the labor minister. He did favors for powerful unions and gained control of them, emerging as

Argentina's president three years later. He promoted runaway government spending, printed plenty of paper money, expropriated private property, introduced pervasive economic controls, overturned a constitutional one-term limit and declared a "state of siege" that enabled him to gain even more power.

Perón and his wife Evita encouraged a personality cult not altogether unlike the cults that have arisen about other presidential couples. In 1948, journalist Philip Hamburger wrote in *The New Yorker* that "Everywhere I heard the same stories — how Señor Perón is at his desk each morning by 6:30 and does not leave until 7 or 8 at night; how Señora Perón arrives early at her office in the Under Secretariat of Welfare and Labor; how she receives from 10 to 20 delegations of farmers, laborers and sheepherders a day; how she attentively listens to their problems and comforts them with advice or a promise that their demands will be granted; how she has worn herself to the point of anemia by her untiring social work; how, when she travels around the countryside, she is greeted as though she were a saint; how the people blow kisses at her and call her 'Blessed One' and 'Little Madonna,' and how she, in return, often leans from the train window and tosses sweet cakes and bottles of cider at the crowd; how she speaks in such an inexpressibly low, sad, haunting voice that people feel themselves slipping under her spell."

The Peróns' personality cult, however, couldn't avoid economic crises that were a consequence of the government's policies. His oppressive regulation and expropriation discouraged private sector investment. Unemployment went up. Perón spent more money, but the result was a double whammy of both higher inflation and higher unemployment. Government-run enterprises lost money, adding to budget deficits and inflation. Economic controls caused chronic scarcity. Proud Argentines felt humiliated to endure coarse black bread and beef shortages.

Perón was overthrown, but subsequent Argentine rulers pursued similar policies with similar consequences, and they, too, were overthrown. Perón served another term as president of what could be called gangster government. Since then, there has been a discouraging succession of scoundrels, civilian and military. Three times in recent decades, the Argentine currency became worthless and had to be replaced by another currency. Private pensions were seized in the name of balanced budget that – naturally – never seemed to balance.

What, if anything, could be done to protect Americans from gangster government, runaway spending, taxes, debt, inflation and economic collapse?

A short answer is that it's urgent to re-establish limits on government power while that's still possible.

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