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Spending can be cut our way, or Europe's

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Better-than-expected job growth in recent months is increasing confidence that the economy may become more robust this year. However, serious challenges remain, especially on the federal budget, that are likely to constrain the recovery. To encourage investors to take more risks, businesses to hire more workers, and consumers to spend more money, lawmakers must resolve the budget deadlock soon, and in the right way. That should include privatization of social insurance programs such as Medicare and Social Security.

Recent sharp increases in interest rates on European government debt have forced Greece, Spain, Italy, and other nations to adopt austerity policies involving deep cuts to their social insurance programs. This should serve as much-needed notice to U.S. lawmakers, especially liberal-leaning ones: If they continue to make outlandish demands for more revenue, and the policy deadlock continues until U.S. debt valuations begin to slide, it will be too late to avoid a fate similar to that of the fiscally strapped Europeans facing forced austerity policies.

Why shouldn't America just raise taxes to cover deficits that stem primarily from social insurance programs? For one thing, even the Europeans are emphasizing spending cuts. Moreover, it would be counterproductive to finance U.S. spending commitments by increasing taxes, which would require roughly doubling payroll taxes immediately and permanently.

A recent International Monetary Fund analysis shows that closing deficits by raising more revenue tends to lead to deeper recessions and slower growth. It's far better to follow the example of Canada's mid-1990s reforms, which involved just $1 in tax increases for every $7 in cuts, and which resulted in strong economic performance over the next decade.

Emphasizing tax hikes would also reinforce high levels of social insurance benefits, diminishing individual incentives to acquire skills, work, save, and invest. In a key 1937 Supreme Court ruling establishing Social Security's constitutionality, Justice Benjamin Cardozo paraphrased those opposed to the program as arguing "that aid from a paternal government may sap those sturdy virtues and breed a race of weaklings."

U.S. productivity growth weakened during the early 1970s, soon after health entitlements were established and Social Security benefits were protected from inflation. More recently, the brief productivity spurt of the 1990s information-technology shock has dwindled. America is suffering from poor skill acquisition, with education performance sliding for the past two decades; a reduced work ethic, with average weekly work hours having declined from 39 during the mid-'60s to 34 today; and saving and investment rates that have been dropping since the late '70s. The fear about our "sturdy virtues" is proving true.

Reinforcing social spending through taxes would increase the chances that, like the Europeans, we will discover such spending can't be financed by an economy of "weaklings." That would eventually force austerity measures that would amount to a backdoor privatization of social programs. That is, Americans would have no choice but to increase savings, work longer, or scale back their living standards in retirement.

Unfortunately, a long-term agreement to reduce the deficit seems unlikely this year. The failure of Congress and President Obama to achieve a deal thus far is a double-edged sword. On the one hand, it signals Republicans' willingness to steadfastly reject destructive tax increases. On the other, it brings us closer to an undesirable, European-style privatization through forced austerity.

Isn't it time to think about actively privatizing our social programs to make them sustainable while we can still decide who will bear the cost?

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